

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION  
90 FERC ¶ 61,319

Before Commissioners: James J. Hoecker, Chairman;  
William L. Massey, Linda Breathitt,  
and Curt Hébert, Jr.

New York Independent System  
Operator, Inc.

Docket No. ER00-1483-000

ORDER ACCEPTING TRANSITIONAL INSTALLED CAPACITY MARKET  
DESIGN  
PROPOSAL SUBJECT TO CONDITIONS

(Issued March 29, 2000)

On February 1, 2000, the New York Independent System Operator (NYISO), pursuant to section 205 of the Federal Power Act, submitted a transitional installed capacity (ICAP) market design. The NYISO requests an effective date of March 15, 2000. For the reasons set forth below, the Commission accepts the NYISO's transitional ICAP market design filing, subject to conditions, to be effective March 15, 2000, as requested.

Background

On October 28, 1999, the Commission directed the NYISO to modify its previous ICAP auction proposal in regard to the market clearing price and participation eligibility.<sup>1</sup> On January 28, 2000, the NYISO submitted a filing to comply with the October 28 Order. On February 1, 2000, the NYISO filed its transitional ICAP market design. The NYISO states that it intends to file a permanent ICAP market design in time for the winter 2000-2001 capability period, but believes that the proposed transitional ICAP market design is a substantial improvement over the existing ICAP provisions. The ICAP market design filing is intended as a replacement for the ICAP compliance filing. The NYISO requests that if the Commission is unable to approve the market design filing in time for the 2000 summer capacity period, the Commission should approve the ICAP compliance filing so

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<sup>1</sup>New York Independent System Operator, Inc., 89 FERC ¶ 61,109 (1999) (October 28 Order).

that the NYISO can conduct an ICAP auction for this summer.<sup>2</sup> The NYISO requests waiver of notice to allow an effective date of March 15, 2000, and further requests that the Commission expedite action on the proposed transitional ICAP market design, and accept the proposal no later than March 15, 2000.

In October 1999, the NYISO began a process to improve New York's ICAP market design. It expects that the proposed transitional ICAP market design will be superseded by a permanent ICAP market design in time for the winter 2000-2001 capability period. It anticipates that the permanent ICAP market design will incorporate only two substantial additions to the proposed transitional ICAP market design (adoption of an unforced capacity methodology, and adoption of a one month obligation procurement period).

The NYISO states that the transitional ICAP market design has been endorsed by an overwhelming majority of the stakeholders and requests Commission deference to the proposed design. The transitional ICAP market design has been approved by the NYISO's independent governance institutions, the NYISO Board of Governors, and 94% of the voting interests.

A special ICAP working group was formed to improve New York's ICAP market design. A sizable majority of working group participants favored making more substantial revisions to NYISO's ICAP market design than the October 28 Order required. After many meetings and much negotiation, the working group came to favor seven major revisions:

- (i) Making load serving entity (LSE) obligations known and requiring that they be satisfied prior to the beginning of each "Obligation Procurement Period" rather than permitting them to be satisfied during a post-capability "back-buying" period, as under the existing system;
- (ii) developing new procedures to accommodate load-shifting associated with the implementation of retail competition in New York State;
- (iii) establishing regular monthly ICAP auctions to facilitate ICAP transactions;
- (iv) clarifying energy recall protocols;

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<sup>2</sup>The NYISO's January 28, 2000 compliance filing was approved under delegated authority by order issued March 15, 2000.

- (v) accommodating participation in the installed capacity market by additional resources, such as distributed generation and interruptible load resources;
- (vi) eliminating unnecessary obstacles to resources becoming ICAP suppliers, thereby increasing the amount of ICAP available in New York State; and
- (vii) adopting market-based, proportionate sanctions to ensure that both LSEs and ICAP suppliers satisfy their ICAP obligations.

These features, among others, have all been included in the NYISO's transitional ICAP market design proposal.

The NYISO states that the October 28 Order guidance has been incorporated into the transitional ICAP market design. In the October 28 Order, the Commission found that the NYISO's ICAP proposal was acceptable in all but two areas: (1) the determination of market clearing prices; and (2) eligible participants. In that order, the Commission also directed the NYISO to clarify how the market-clearing prices are determined and to explain and support its definition of market-clearing price in its filing to implement the permanent auction. The Commission also directed the NYISO to revise its filing to permit any entity to participate in the ICAP auction.

#### NYISO's Proposal

In the instant proposal the ISO has proposed to expand the number of auctions, each with its own intended purpose. First, the ISO plans to conduct an Obligation Procurement Period auction in which LSEs can bid for, and suppliers may offer, capacity to satisfy the installed capacity requirements established by the ISO. Second, the ISO will conduct monthly auctions so that LSEs may buy or sell, as needed, installed capacity to reflect load shifting that may occur due to retail access. Finally, the ISO will conduct Deficiency Procurement auctions in which the ISO will purchase installed capacity on behalf of LSEs that are deficient in meeting their ICAP requirements after the Obligation Procurement Period auction and the monthly auction.

Each auction will be conducted in two phases. In the first phase, the auction will be limited to LSEs that serve load within New York City seeking to make purchases to fulfill their locational ICAP requirements, other entities wishing to secure ICAP within New York City, and installed capacity resources within New York City. LSEs awarded installed capacity in the first phase will pay the market clearing price established in the auction. In the second phase of the auction, there are no restrictions on participation except for In-City generators subject to mitigation. If all In-City LSEs have satisfied their

locational requirements, then any In-City generators not yet committed to providing installed capacity may participate in the second phase of the auction.

The deficiency procurement auction will be conducted much like the other two auctions, except it shall be limited to LSEs that are deficient in installed capacity. Moreover, the ISO will submit bids on behalf of capacity deficient LSEs equal to the deficiency penalty that would apply to an LSE. The ISO will not reveal the amount of capacity that LSEs are deficient prior to the auction. LSEs will then pay either the lower of the equilibrium price for capacity in this auction or the deficiency penalty.

In addition to the installed capacity auction itself, the NYISO has revised some of the procedures governing the supply requirements for generators and the requirements for load serving entities while keeping many procedures governing installed capacity the same.

The installed capacity requirement, determined by the ISO, for the New York Control Area (NYCA) will simply be one plus the installed reserve margin multiplied by the forecasted peak load for the upcoming Capability Year.<sup>3</sup> The installed reserve margin is to be determined by the NYSRC for each year. The forecasted peak load is determined by the peak load from the previous year adjusted for forecasted load growth. Each LSE's ICAP requirement is then equal to its forecasted peak load multiplied by the installed capacity requirement. LSEs may satisfy their ICAP requirement either through the ISO facilitated auctions described above, or through bilateral transactions. Unlike the previous installed capacity rules, LSEs must have acquired enough ICAP to satisfy its requirement no later than ten days prior to the start of capability period.<sup>4</sup> If an LSE fails to acquire the necessary installed capacity, the ISO will procure installed capacity for that LSE through the ICAP deficiency auction. Moreover, the ISO will determine any locational installed capacity requirements that may be applicable to LSEs in a given locality.<sup>5</sup>

In order to accommodate load shifting that may occur under retail access, the ISO will update each LSE's ICAP requirement to reflect the changes in the load that it serves. LSEs gaining load must procure additional installed capacity to meet their new ICAP

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<sup>3</sup>The capability year runs from May 1 to April 30.

<sup>4</sup>The capability period and the obligation procurement period coincide.

<sup>5</sup>Locational requirements have been established for New York City and Long Island and approved by the Commission in Central Hudson Gas & Electric Corporation, 88 FERC ¶ 61,138 at 61,390-92 (1999).

requirements, while LSEs losing load may sell any excess installed capacity that they no longer need.

An installed capacity supplier must furnish the ISO with information such as its name and location, dependable maximum net capability, maintenance and outage schedules, and verification that it is not providing ICAP to more than one LSE. Additionally, ICAP resources must commit to either bid into the Day-Ahead market, or supply load within the NYCA through Day-Ahead bilateral transactions. If the supplier is located in an external control area, then the NYISO must be assured that the external control area will not recall or curtail generation from the external ICAP provider.

If an ICAP provider is not scheduled in the Day-Ahead market, it may engage in export transactions subject to recall by the NYISO. At the time an ICAP provider submits a schedule for an external transaction, it must also submit a recall bid to the ISO indicating the price at which the ICAP provider's transaction can be recalled into the NYCA. In the event of a recall, the ICAP provider will be paid the higher of either the location based marginal pricing (LBMP) price at the relevant bus, or its recall bid. The tariff states that the recall bid will be treated as any other bid by the ISO for the purposes of scheduling.

The NYISO has expanded its potential pool of ICAP suppliers by including special case resources, municipally owned generation, and energy limited resources.<sup>6</sup> Special case resources and municipally owned generators are exempt from the provisions that dictate ICAP providers bid into or schedule in the Day-Ahead markets. Energy limited resources must continue to bid into the Day-Ahead market for all hours, but must only provide energy for four hours each day due to the nature of the resource.

The NYISO also proposes to impose sanctions on suppliers of ICAP for violations of ICAP obligations. First, if an ICAP supplier fails to provide the ISO with the required information in a timely manner, the ISO may impose the following sanctions: On the first day the information is late, the ISO informs the ICAP supplier that the information is past due, and that the ISO reserves the right to impose financial penalties. Beginning the third day the information is past due, the ISO may impose penalties of the higher of \$500/day

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<sup>6</sup>Special case resources include interruptible loads and distributed generators rated at 100 kW or higher, and not visible to the ISO's market information system. Energy limited resources are resources that cannot operate continuously on a daily basis due to design considerations, environmental restrictions, cyclical requirements, or other non-economic reasons.

or \$5/MW of installed capacity supplied per day. Starting on the 10th day past due, the ISO may levy penalties of the higher of \$1000/day or \$10/MW of ICAP supplied per day.

On any day an ICAP supplier fails to follow the bidding and scheduling requirements, the ISO may impose financial penalties of up to the deficiency payment charged to LSEs multiplied by the number of MW the supplier failed to bid or schedule. Moreover, if an ICAP supplier fails to meet the bidding and scheduling requirements during an hour in which energy is recalled, the supplier may also incur a financial sanction, the real-time LBMP multiplied by the number of MW the supplier failed to bid or schedule. If, in addition, the ICAP supplier subject to sanctions is involved in an external transaction, the ICAP supplier will not be paid its recall bid if the ISO recalls that supplier's energy.

In regard to locational installed capacity requirements for New York City, the ISO proposes a rebate plan for New York City LSEs. In the first phase of the ICAP auctions described above, it may be the case that the market clearing price for installed capacity is greater than the price cap for installed capacity from mitigated units. If this is the case, the ISO will have excess revenues from the auction since the mitigated units can only receive prices up to their price cap. The ISO will rebate this revenue to New York City LSEs in proportion to their share of the total New York City installed capacity requirement regardless of whether they took part in the first phase of the auction.

The NYISO has requested waiver of the prior notice requirement to allow an effective date of March 15, 2000, and a waiver of any requirement to file a redlined copy of the tariff. Additionally, the NYISO requests that the Commission expedite action on the proposed transitional ICAP market design and accept the proposal no later than March 15, 2000. The NYISO states that the transitional ICAP market design must be accepted no later than March 15, 2000, if the NYISO is to conduct the first obligation procurement period auction as scheduled on March 31, 2000, and further states that if this auction is not held on this date it will be impossible to implement the transitional market design in time for the summer 2000 capability period which begins May 1, 2000. The ISO requests that if the Commission is unable to approve the transitional ICAP market design in time for the summer 2000 capability period, then the Commission instead approve the NYISO's January 28, 2000 ICAP auction compliance filing (ER97-1523-024, et al.).

#### Notice of Filing, Interventions, and Protests

Notice of the filing was published in the Federal Register, 65 Fed. Reg. 7541 (2000), with protests and motions to intervene due on or before February 22, 2000.

Timely motions to intervene were filed by Sithe/Independence Power Partners, L.P. and Sithe Power Marketing, L.P.; Southern Energy Bowline, L.L.C., Southern Energy Lovett, L.L.C., and Southern Energy NY-Gen, L.L.C.; Duke Energy Trading And Marketing, L.L.C.; Dynegy Power Marketing, Inc.; Member Systems; Enron Power Marketing, Inc. (Enron); and New York Electric & Gas Corporation (NYSEG), Niagara Mohawk Power Corporation, Rochester Gas & Electric Corporation, and Central Hudson Gas & Electric Corporation (Four Utilities). In addition, the New York Public Service Commission (the New York Commission) filed a notice of intervention.

In their motion to intervene, the Member Systems state that they support the Transitional Installed Capacity market design. However, stating that two sentences of section 5.12 of the services tariff were inadvertently dropped from the text of the renumbered Section 5.12.2 in the NYISO's filing, they request that the Commission accept the filing with a correction. In a motion to respond to Member Systems' filing, the NYISO confirms Member Systems' statement that the two sentences were inadvertently omitted from proposed section 5.12.2. The NYISO urges the Commission to approve the instant filing, with the correction identified by the Member Systems.

Enron and the New York Commission filed comments in support of the proposed Transitional Installed Capacity Market Design.

The Four Utilities generally support the filing and request that the Commission accept the filing, suspend it for a nominal period and make it effective subject to refund, and establish hearing procedures and/or appoint a settlement judge. They claim that recall energy is a new product requiring market power analysis before market-based rates can be granted for it.

Moreover, the Four Utilities argue that the filing does not establish a reasonable method for determining the price for energy that ICAP suppliers will be paid if the NYISO orders the energy associated with ICAP supplies sold through external transactions to be recalled to serve the New York Control Area, nor does the filing explain how recall bids will be used to set LBMP. They assert that by stating that the bids will be used in the balancing market evaluation, the filing implies that the NYISO will select bids based on least-cost dispatch protocol and that recall bids may be used to set the real time LBMP. According to Four Utilities, this would dramatically increase the price of energy through the entire market. As a consequence, ICAP suppliers may bid any amount and the NYISO and LSEs would have to pay the price however high it may be. Consequently, they request that the filing be clarified to state that the recall bids do not set the LBMP to be applied in the NYISO's real time market.

The Four Utilities claim that this proposed pricing scheme provides gaming opportunities to ICAP suppliers by allowing them to set the market price for recall energy or avoid their obligation to provide energy during emergencies. The Four Utilities also assert that LSEs who are responsible for purchasing recall energy will not be able to adequately assess the cost and manage the risk that accompanies price fluctuations and that there is no mechanism in place to enable loads to curtail in response to high prices set by these recall bids. The Four Utilities contend that this unfairly discriminates against demand side resources and further exacerbates the gaming opportunities for generators.

The Four Utilities argue that the filing appears to imply that only internal generators are subject to recall energy requirements. If the filing does not apply to external generators supplying recall energy, it treats internal generators supplying ICAP in an unduly discriminatory manner. If the NYISO intended that the filing also apply to external ICAP suppliers, these intervenors insist the filing should be clarified.

Finally, the Four Utilities assert that the filing also fails to explain important aspects of the recall proposal. For example, the filing does not list or describe the circumstances under which the NYISO may recall energy; it does not discuss what changes will be required to the current NYISO software to accept recall bids or whether the software will have to be modified; the filing does not explain whether recall bids will be implemented to optimize the recall energy needed to reestablish system reliability while minimizing costs; and it does not explain how the NYISO will apply and implement recall bids, other than to say that such bids are submitted with external transaction schedules.

NYSEG proposes an alternative pricing plan. Rather than paying an ICAP supplier a recall bid price, an ICAP supplier engaged in an external transaction should receive the market price applicable to the control area in which the supplier was selling its energy at the time the supplier's energy was recalled. NYSEG also proposes a non-bid based solution using firm liquidated damages clauses. NYSEG states that a firm liquidated damages provision requires that the seller who is unable to deliver the energy pay the buyer of the energy the difference between the price paid to the seller under the contract and the market price that the buyer will have to pay to replace the undelivered energy.

On March 8, 2000, the NYISO filed an answer to the protest of the Four Utilities.

## Discussion

### Procedural Matters

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (1999), the timely, unopposed motions to intervene listed above serve to make the filing entities parties to this proceeding. While Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (1999) prohibits the filing of an answer to a protest, we will allow the NYISO's March 8, 2000 answer since it has helped us in our consideration of the NYISO's revised ICAP market design proposal.

### The Transitional ICAP Market Design Filing

Subject to the conditions discussed below, the Commission accepts the NYISO's transitional ICAP market design, to become effective March 15, 2000, as requested. We find the design of the auction market provides detailed procedures for determining the market-clearing price in the installed capacity auction, and allows entities other than LSEs to bid for ICAP in the auctions, issues that the Commission found lacking in the ISO's previous ICAP market filing.<sup>7</sup> We note that the NYISO states that it is concurrently seeking a broader CFTC waiver that would allow unfettered participation in its auctions, and if future CFTC action permits the NYISO to further broaden the scope of participation in its auctions, the NYISO will seek the Commission's permission to make appropriate changes to the ISO Services Tariff and to the Revised Installed Capacity Auction Description. The Commission anticipates that the NYISO will pursue these efforts.

The Commission also finds that the proposed revisions will increase the supply of resources available to provide ICAP, and will foster increased competition and system reliability.

The Commission finds that the ISO's proposal for "market-based" sanctions for violations of ICAP obligations is reasonable. ICAP generators are compensated at market rates for meeting their ICAP responsibilities, including the obligation to bid into the New York markets. The NYISO is proposing to impose a penalty for failure to schedule or bid into the market during capacity-tight periods; the penalty being equal to the applicable LBMP energy price. The LBMP reflects the cost of acquiring energy during such periods. A penalty that varies with market conditions (as the ISO's proposal does) helps to ensure that the ICAP generators meet their responsibilities. By contrast, if the penalty were constant during all periods, an ICAP generator may find it profitable to sell outside New York during periods of tight capacity and high prices, because the high price would

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<sup>7</sup>89 FERC at 61,300-01.

more than offset the penalty for failing to bid into the New York market. However, the Commission finds the sanctions provision regarding ICAP suppliers engaged in external transactions ambiguous. It is not clear from reading the proposed provision whether ICAP suppliers exporting power and subject to sanctions will be paid the real-time LBMP as opposed to their recall bid if their energy is recalled, or if they will not receive any payment for recalled energy. Therefore, we require the NYISO to clarify in its compliance filing how generators subject to sanctions and involved in export transactions will be compensated for their recall energy.

Moreover, the Commission finds to be reasonable the financial sanctions proposed by the NYISO for installed capacity providers that do not submit the information required of installed capacity providers in a timely manner. Without such penalties, installed capacity providers would have no incentive to submit the required information to the ISO, information that is necessary for the ISO to conduct operations in a safe, reliable fashion.

The Commission agrees that the NYISO's filing should be amended to reflect the two sentences of section 5.12 of the services tariff that were inadvertently dropped from the text of the renumbered Section 5.12.2, as noted by the Member Systems and confirmed by the NYISO. Accordingly, the NYISO shall file revised tariff sheets to incorporate the omitted sentences.

The Commission disagrees with intervenors that the filing should be suspended and set for hearing regarding the new energy recall provisions for ICAP suppliers. The Commission rejects the intervenors' arguments that recall energy is a new product, and hence subject to review by the Commission for market-based rates. Energy, whether it is recalled from an external transaction or bid into any of the ISO markets, is still simply energy. Since the Commission has already granted market-based rate authority for sales of energy, the intervenors' argument has already been addressed. Moreover, we reject NYSEG's alternative pricing plan. NYSEG's proposal is dependent upon there being a readily available market clearing price in an external control area. Such a price may not exist if the external control area does not have a centralized, bid-based market. Even if the external control area does have a market clearing price, it may be that the ICAP supplier involved in the export is conducting the export via a bilateral transaction, a transaction for which the price is only known to the transacting parties. Hence, it is not reasonable to expect that the agreed-upon price in the bilateral transaction is reflected by the market clearing price in the external control area. Furthermore, in this proceeding, there was no other protest against the ISO's recall energy proposal, and NYSEG's alternative proposal did not garner the support that the ISO's current proposal did in the stakeholder process. Hence, we shall defer to the stakeholder process in this instance.

While the Commission recognizes there may be some possibility for gaming by ICAP generators, we believe the potential is relatively small. ICAP suppliers could bid extremely high prices into the day-ahead market to reduce their chances of being accepted, then schedule an external transaction and submit a high recall bid. ICAP suppliers that attempt to employ this strategy would draw the attention of the market monitor, however. Bidding extremely high prices could be considered economic withholding and may subject the ICAP suppliers to potential mitigation measures. Although the extent of such strategic behavior, if any, cannot be known precisely without operational experience, the potential to draw the attention of market monitors should keep this kind of strategic bidding behavior to a minimum. We would expect the NYISO to discuss in its annual report<sup>8</sup> the extent to which gaming may have occurred under this recall provision, and any instances in which ICAP suppliers might have strategically manipulated recall energy bids. If the oversight of the market monitor proves to be insufficient to deter strategic bidding behavior by ICAP suppliers, the NYISO may file revised recall energy provisions if it believes that such a filing would be an appropriate response to strategic bidding behavior by ICAP suppliers.

The Commission also concurs with intervenors' arguments that the new recall provision is ambiguous in places, and we acknowledge the NYISO's commitment to make such matters clear in a compliance filing. Hence, we direct the NYISO to clarify and explicitly state in its compliance filing the following items: (1) that energy will be recalled on a least bid-cost basis; (2) that recall energy bids will not set the LBMP; (3) that recall provisions apply to both internal and external suppliers of ICAP; and (4) the circumstances under which energy recalls will likely take place.

The Commission orders:

(A) The NYISO's February 1, 2000 transitional ICAP market design filing is hereby accepted for filing, to become effective on March 15, 2000, subject to the condition set forth in Ordering Paragraph (B) below.

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<sup>8</sup>New York Independent System Operator, Inc., et al., 89 FERC ¶ 61,196 at 61,603 (1999).

(B) Within 30 days of the date of issuance of this order, the NYISO shall file revised tariff sheets which address the concerns discussed in the body of this order and incorporate the section 5.12.2 omitted sentences, as discussed in the body of this order.

(C) The NYISO will be informed of rate schedule designations at a later date.

By the Commission.

( S E A L )

David P. Boergers,  
Secretary.