

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

New York Public Service Commission,)
New York Power Authority, and)
New York State Energy Research)
and Development Authority)
)
v.)
)
)
New York Independent System Operator, Inc.)

Docket No. EL13-62-002

**COMMENTS OF THE
NEW YORK ISO'S MARKET MONITORING UNIT**

Potomac Economics moves to file comments concerning the recent response by the New York Independent System Operator (“NYISO”) to the Commission’s letter of November 16, 2015 pursuant to the above-captioned proceedings. The Commission’s November 2016 letter, as well as the NYISO’s December 17 response to the letter, involve issues relating to market power in the NYISO capacity markets. Potomac Economics is the Market Monitoring Unit (“MMU”) for the NYISO and is responsible for monitoring the electricity markets and evaluating potential changes that impact these markets. Potomac Economics previously filed a motion to intervene and comment in this proceeding on July 17, 2015.

I. NOTICE AND COMMUNICATIONS

All correspondence and communications in this matter should be addressed to:

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II. BACKGROUND AND PURPOSE

This proceeding involves the buyer-side mitigation (“BSM”) rules that address the concern that resources can be subsidized by entities that have an incentive to artificially suppress capacity prices. This proceeding resulted from a complaint by the Independent Power Producers of New York who sought to expand the BSM rules outside Southeast New York to limit capacity sales from generators that would retire if they did not enter into out-of-market contracts.¹

In response to the complaint, the Commission ordered the NYISO to evaluate two issues: (1) whether there are circumstances that warrant the adoption of BSM rules in the rest-of-state (the portion of New York outside the local capacity zones, “ROS”); and (2) whether BSM rules should be applied to the retention of existing units and, if so, how should such rules should be designed.² The NYISO addressed the first question on June 17, 2015 (“NYISO’s June 2015 Compliance Filing”) stating that the BSM rules should not be applied to *new* resources in ROS, but the NYISO deferred responding to the second question.³

¹ 150 FERC ¶ 61,214, (2015) (“March 19, 2015 Order”) at PP. 2-21.

² March 19, 2015 Order at P. 71.

³ *New York Independent System Operator, Inc., Compliance Report*, Docket No. EL13-62 (filed June 17, 2015) at page 5.

In response to the Commission’s November 16, 2015 letter asking for further information, the NYISO filed on December 16, 2015 (“NYISO’s December 2015 Response”) stating that there is a need to address the incentive to suppress capacity prices in ROS through the use of subsidies to *existing* generators that would otherwise retire. The NYISO proposed a process to screen for existing generators that may be uneconomic, to investigate whether they may be receiving subsidies to remain in service, and to refer to the Commission instances that may constitute uneconomic retention of existing resources to suppress capacity prices.⁴

We agree with the NYISO’s conclusion that there is an incentive to suppress capacity prices in ROS by subsidizing existing resources that would otherwise retire, and we agree that a process is necessary to identify such arrangements. However, the NYISO’s proposal to simply refer such instances to the Commission’s Office of Enforcement may not be an adequate remedy to address buyer-side market power concerns. If the Commission determines that enforcement is not an appropriate remedy, we recommend that the Commission require the NYISO to implement BSM rules that could be imposed prospectively in a timeframe that would protect the market from attempts to exercise buyer-side market power.

III. SCREENING FOR UNECONOMIC RETENTION OF EXISTING RESOURCES

In the NYISO December 2015 Response, the NYISO proposed to screen for “suspicious behavior” that may be part of a strategy of uneconomic retention. The NYISO discussed several different approaches to formalize a process for identifying such behavior, including one where it would systematically screen for uneconomic generation that remains in service.⁵ This process would identify generators that appear uneconomic based on (a) generic technology-specific

⁴ *Response to Information Request*, Docket No. EL13-62-002, (filed December 16, 2015) at page 3 and at Attachment II – pages 13-19.

⁵ *Id* at Attachment II – pages 13-15. The NYISO discussed several potential approaches to screening with stakeholders. Here we refer to the first of two “Supplier Side Approaches”.

going forward cost (“GFC”) estimates, (b) estimated energy and ancillary services net revenues, and (c) forecasted revenues from spot capacity prices. The NYISO would identify generators whose estimated GFCs exceed revenues from capacity, energy, and ancillary services markets. After identifying an individual generator that might be uneconomic, the NYISO could consult with the generator to: (a) refine the GFC estimate and (b) identify any above-market contracts that might enable the generator to remain in service.

We find this screening process to be reasonable and note that it is designed to detect the potential existence of contracts that may otherwise not be known to the NYISO or the MMU. We would recommend that this process also include units that are known to have received contracts to remain in operation even if the technology-specific GFCs would indicate that the units are likely not economic to retire. With this addition, we support this proposed approach to monitoring for uneconomic retention.

IV. COMMENTS ON THE NYISO’S PROPOSED REMEDY

If it finds a generator that appears to remain in service because of an uneconomic contract, the NYISO proposes to refer this to the Commission’s Office of Enforcement. This proposed remedy assumes that the decision to contract with an uneconomic unit to keep it in service would qualify as a Market Violation and, therefore, be subject to a sanction by the Commission. If this assumption is not valid and such conduct would not be deemed market manipulation by the Commission, then the remedy will be ineffective. As a market monitor that has made many referrals to the Commission’s Office of Enforcement for conduct in a number of RTO markets, we are not confident that uneconomic retention would qualify as a Market Violation that would be subject to the Commission’s enforcement authority. If this is the case, the most reasonable remedy would be for the NYISO to expand its buyer-side mitigation

measures to apply to uneconomic retention of existing resources. Therefore, we recommend that the Commission evaluate this question before approving the NYISO's proposal.

1. Potential Disadvantages of Enforcement as a Remedy for Uneconomic Retention

However, even if the uneconomic retention could be construed to be a Market Violation, there may be advantages to addressing uneconomic retention through mitigation measure that would be specified in the NYISO tariff:

- It would be difficult to ensure that the market will perform competitively and that market power will be deterred effectively without clear rules to mitigate buyer-side market power, which includes uneconomic retention.
- Tariff-based mitigation measures *prevent* the exercise of market power, which is valuable because it is generally not possible to go back after the fact and repair the effects of an exercise of market power.
- The Commission's Office of Enforcement does not operate under a transparent or predictable schedule. Enforcement actions frequently occur years after the conduct occurred. Hence, addressing uneconomic retention via after-the-fact enforcement authority would create significant uncertainty for the generator in question and for market participants on the whole.

2. Advantages of a Tariff-Based Mitigation Measure for Uneconomic Retention

If the NYISO identifies a generator that would likely have retired but for a contract that appears to have been entered into at a price exceeding competitive levels, the NYISO could impose an offer floor at the level of the generator's GFC. This approach would prevent such a contract from suppressing capacity prices. Additionally, the existence of the BSM rule would likely deter such exercises of market power.

One concern that the NYISO indicated in its filing related to identifying and mitigating uneconomic retention is the difficulty of distinguishing between market power and legitimate hedging behavior. However, we believe that this difficulty can be addressed by utilizing futures prices. For example, the NYISO could determine whether the contract is above-market based on whether the contract terms exceed the futures prices at the time the contract terms were finalized. Thus, if prices fall after an arms-length contract was negotiated in good faith, the NYISO would still identify the contract as competitive even if the generator was receiving an above-market rate.

V. CONCLUSIONS AND RECOMMENDATIONS

In recent communications with stakeholders and the Commission, the NYISO has identified incentives to exercise buyer-side market power in “Rest of State” capacity market by subsidizing an existing generator that would otherwise retire. The NYISO has outlined a process to monitor the market and make referrals of such behavior to the Commission’s Office of Enforcement.

While we agree with the NYISO’s concerns regarding the incentives to exercise buyer-side market power, the NYISO’s proposed remedy may be inadequate to ensure the market performs competitively. The preferred method for ensuring that ISO markets perform competitively is to develop appropriate tariff-based market power mitigation measures.

Therefore, we respectfully recommend the Commission require the NYISO to propose market power mitigation measures that would impose an offer floor on a generator (at its GFC level) if the NYISO determines that the generator would likely have retired but for an above-market contract.

Respectfully submitted,

/s/ David B. Patton

David B. Patton
President
Potomac Economics, Ltd.

CERTIFICATE OF SERVICE

I hereby certify that I have this day e-served a copy of this document upon all parties listed on the official service list compiled by the Secretary in the above-captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated this 11th day of January 2016 in Fairfax, VA.

/s/ David B. Patton
