

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

New York Independent System Operator, Inc.)
)
) Docket No. ER20-1718

**MOTION TO INTERVENE AND COMMENTS
OF THE
NEW YORK ISO’S MARKET MONITORING UNIT**

Pursuant to Rules 212 and 214 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission, 18 C.F.R. §§ 385.212 and 214 (2019), Potomac Economics respectfully moves to intervene in the above-captioned proceedings.

The New York Independent System Operator (“NYISO”) filed proposed tariff revisions to the buyer-side mitigation (“BSM”) provisions known as the Part A test. Potomac Economics is the Market Monitoring Unit (“MMU”) for NYISO and is responsible for monitoring the electricity markets and evaluating potential rule changes that impact these markets.

I. NOTICE AND COMMUNICATIONS

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

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II. BACKGROUND AND PURPOSE

From December 2019 through April 2020, the NYISO conducted discussions with stakeholders about BSM rule changes that are needed to ensure that there is an appropriate balance between (a) allowing New York state to move forward with legitimate policies to promote the use of cleaner fuels in the generation of electricity and (b) protecting the wholesale market from the price-suppressive effects of policies that subsidize new investment in generating supply. This process culminated in a Management Committee vote on tariff revisions that were opposed by just two stakeholders. As the broad stakeholder support demonstrates, the proposed changes are reasonable and improve the balance between the two objectives stated above.

On April 30, 2020, the NYISO filed the proposed changes to the BSM provisions in Attachment H to the NYISO's Market Administration and Control Area Services Tariff ("NYISO Tariff").¹ Specifically, the NYISO is proposing to change the ordering of the Part A and Part B tests as well as the ranking of individual projects within the Part A test to ensure that public policy resources have the opportunity to enter when it would not lead to an excessive capacity surplus. In addition, the NYISO is proposing to establish two separate mitigation study periods that better reflect the timing of new entry in the assessment of whether the new entry will lead to an excessive surplus in the corresponding timeframe. Taken together, these provisions ensure that when there is an emerging need for new resources, that public policy resources will have the opportunity to satisfy the need. At the same time, they eliminate inefficient incentives to invest in conventional resources that are not needed in the face of the entry of public policy resources.

¹ *New York Independent System Operator, Inc.*, 170 FERC ¶61,121 (2020) (the "February 20 Order").

As the MMU for the NYISO, we consulted with the NYISO as it developed these provisions and support them as filed. We find that they will facilitate the new entry of resources that will contribute towards New York State’s achievement of various policies such as the Climate Leadership and Community Protection Act (“CLCPA”) while ensuring that such entry does not suppress capacity prices below competitive levels. This balance is achieved in the Part A exemption test, which will allow new resources to enter to the extent that it does not increase the capacity surplus above the existing Part A test threshold. The purpose of this filing is to discuss our assessment of the proposed revisions and encourage the Commission to approve them.

III. ACCOMMODATING SUBSIDIZED RESOURCES IN THE ICAP MARKET

To provide context for our assessment of the proposed revisions, we first discuss the importance of BSM measures, the role of capacity markets, and their interaction with state policies in this section. This discussion provides the principles and background necessary to assess the provisions proposed by the NYISO.

A. Importance of BSM Measures

The BSM measures are designed to prevent entities from suppressing capacity prices below competitive levels by subsidizing investment in uneconomic new generation. The BSM measures deter uneconomic new entry by imposing an Offer Floor that prevents the new generator from selling capacity at prices below its costs. Hence, the BSM measures largely prevent the new generator from suppressing capacity prices, so a large entity will be deterred from subsidizing new entry when its primary purpose would be to suppress prices.

The BSM measures are not intended to deter states from promoting clean energy and other legitimate public policy objectives. However, the BSM measures are an important tool for ensuring a workable balance between state policy objectives and ensuring that prices are just and

reasonable for both merchant and subsidized resources. This balance is critical because if market participants lose confidence in the market and the competitiveness of future prices, the market will fail to fulfill one of its primary purposes – to efficiently facilitate private investment and retirement decisions. Although the primary objective of subsidies for clean energy is to promote environmental policy, ambitious policies to add large amounts of supply without removing less-clean existing generation will tend to suppress prices in the short-term.

Just and reasonable capacity prices are particularly important in the NYISO because it operates a spot market where the capacity price is set based on the level of supply and a “demand curve” based on the annualized cost of new entry of a conventional generator assuming a 20-year investment horizon. When supply increases significantly above the resource adequacy requirement, prices fall below the annualized Net CONE. Conversely, when the surplus falls near the requirement, prices rise above Net CONE. Hence, investors build generation based on the assumption that the NYISO will remain committed to competitive markets over the 20+ year investment horizon. Merchant generators risk capital without a guarantee to future revenue. To ensure just and reasonable capacity prices, the BSM measures should prevent out-of-market subsidies from upsetting the balance between supply and demand over an extended period.

To accomplish these purposes, the BSM measures provide several types of exemptions to allow generators to sell capacity:

- *Competitive Entry Exemption* – Generators receive a CEE if they are willing to enter the market without subsidies or other support. Competitive new entry benefits consumers by reducing prices and encourages older high-cost existing generation to retire.
- *Part B Test Exemption* – Generators receive this exemption if they can demonstrate their annualized net cost of new entry is lower than expected capacity

prices over the first three years of operation. Like the CEE, this allows consumers to benefit from low-cost new entry.

- Renewable Entry Exemption and Self Supply Exemption – The Commission recently accepted provisions for these exemptions, although the specific MW-level of the REE is being determined in another proceeding.²
- *Part A Test Exemption* – Designed to give resources an exemption if their entry does not lead to an abnormally large capacity surplus. In the New York City, the Part A exemption surplus level is approximately 600 MW above the capacity requirement. In the lower Hudson Valley, this level is approximately 710 MW above the requirement. Although the REE provides for certain types of renewable generation to receive an exemption, the Part A test could allow for a broader set of subsidized resources to sell capacity provided that the volume of new entry from subsidized resources is reasonably balanced by policies that lead to retirements of older generation.

B. Role of Capacity Markets and Interaction with State Policies

Capacity markets supplement energy and ancillary services markets by providing the “missing money” to resources that are required for satisfying the planning reliability requirements.³ Economic signals from the capacity market play a key role in motivating efficient entry and exit decisions. These signals complement New York state policy initiatives by: (a) ensuring that while some entry and exit from the market is policy-driven, market signals

² See Docket ER16-1404.

³ The “missing money” refers to the revenues over and above those earned from selling energy and ancillary services that are needed to provide market incentives for maintaining sufficient capacity margins to satisfy planning reliability criteria such as the “one-day-in-ten-year” reliability standard.

will still encourage investment needed to maintain reliability; and (b) rewarding those subsidized resources that provide greater value to the wholesale market, thereby reducing the cost of developing them.

New York state has used its regulatory authority to bring about the retirement of 3 GW of coal and nuclear capacity in 2020 and 2021. Another wave of retirements (up to 3 GW) is expected from 2023 to 2025 when the NYDEC tightens air emissions requirements for older peaking units in ozone non-attainment areas. Approximately 1.8 GW of new merchant generation has become operational from 2018 to 2020, and this private investment has been partly motivated by these expected policy retirements. On the other hand, state subsidies for new entry of policy resources will tend to reduce the amount of merchant generation that enters the market. Hence, the capacity market complements public policies by ensuring that these policy retirements will not lead to high prices or violations of planning reliability criteria.

The NYISO markets also complement state policies by providing market incentives for resources that provide greater value. Generators that locate in areas that cause less congestion or help relieve congestion receive significantly more revenue. Resources that provide greater resource adequacy benefits also receive more compensation in the capacity market. The NYISO markets provide key incentives that influence the selection of specific projects to build renewable generation and energy storage resources. For example, many of the peaking units that will retire between 2023 and 2025 because of tightening air emission requirements are located in import-constrained load pockets, so the NYISO markets will provide incentives that attract some subsidized resources to these load pockets where they can be rewarded for providing significant reliability benefits. These market incentives ultimately lead to selection of more efficient public policy projects, which reduces the cost of these policies for consumers.

Subsidized new entry can disrupt these long-term economic price signals that facilitate merchant entry and exit. However, capacity markets in New York (through market response and/or application of BSM rules) have performed reasonably well in regulating entry and exit decisions even as the state has sought to effect a number of resource mix changes.⁴ The capacity market would not be able to attract investment without the NYISO's strong commitment to competitive market principles and BSM measures that ensure subsidized entry does not drive prices below competitive levels.

The Commission has recognized there are legitimate public policy objectives that affect the wholesale markets, and it has allowed for narrowly tailored exemptions for public policy resources when it can be done a way that does not upset the supply-demand balance in the capacity market and result in substantial artificial capacity surpluses that may not be absorbed for several years.

IV. COMMENTS ON THE PROPOSED REVISIONS TO THE PART A TEST

For subsidized resources that do not receive a renewable exemption from mitigation, the Part A Test Exemption is designed to provide a mechanism for selling capacity as long as there is a reasonable balance between supply and demand. The Part A Test generally allows any resource to receive an exemption if its entry would not raise the capacity surplus to more than 5 to 6 percent of the capacity requirement. New York State policies will lead to the retirement of up to 6 GW of generation from 2020 to 2025, and this should allow many subsidized resources to receive Part A Test Exemptions. However, these retirements may also encourage investment in new conventional resources that would increase the capacity surplus beyond the level that would allow subsidized resources to pass the Part A Test.

⁴ For instance, in the last year over 1 GW of fuel-efficient merchant entry has occurred in the Mitigated Capacity Zones in NYISO.

Therefore, we are concerned that the current BSM rules might allow new conventional resources to enter and preempt capacity sales from new resources that are subsidized for legitimate state policy reasons. If this is not addressed, the current BSM rules would impede state policy goals even where the subsidized resources would not suppress capacity prices. Importantly, this would also contribute to a larger supply surplus and associated distortions in the NYISO's energy and ancillary services markets.

We find that the NYISO's proposed revisions to the Part A test will address these issues and improve the balance between two objectives: (i) allowing New York state to influence the environmental impacts of its generation fleet, and (ii) ensuring the state subsidies for certain resources do not lead to capacity price suppression. This is accomplished by ensuring that when capacity margins tighten and new investment may be needed, that subsidized resources entering the market for policy reasons have an opportunity to satisfy this need before the markets incentivize investment in other resources that are ultimately not needed. How the NYISO's proposal accomplishes this objective is discussed in the subsections below.

Subsection A discusses the NYISO's proposed changes to the ordering of the Part A and Part B tests as well as the ranking of individual projects within the Part A test to ensure that public policy resources have the opportunity to enter when it would not lead to an excessive capacity surplus. Subsection B discusses the NYISO's proposal to establish two separate mitigation study periods that better reflect the timing of new entry in the assessment of whether the new entry will lead to an excessive surplus in the corresponding time frame.

A. Changes to the Ordering of Tests and Individual Projects

Existing conventional generators are expected to retire in the coming years because they will become less economic and/or because of tightening environmental standards in New York state. This will create natural opportunities for new state policy resources to enter the market at a

pace that will not lead to excessive surpluses, provided that the BSM rules can be modified as discussed in this subsection. The problem with the current rules is that new conventional generation may be encouraged to enter the market and effectively preempt the state policy resources from receiving exemptions from the BSM rules. The NYISO has proposed changes to the Part A test to address this concern.

The NYISO proposes to perform the Part A test before the Part B test and, within each time period of the Part A test, to evaluate Public Policy Resources before other resources. The current BSM process tests each project in the NYISO's interconnection Class Year in order, ranking each project from lowest to highest based its Unit Net CONE (which is an estimate of its annual net cost of new entry). Thus, lower-cost conventional generators are tested before most subsidized resources. Consequently, when a subsidized resource is evaluated for a Part A Test exemption, the capacity surplus will have been increased by any lower-cost conventional generators already receiving exemptions. The ranking of projects solely based on cost criteria puts state policy resources at a disadvantage, and it fails to recognize that they will enter even if mitigated.

For example, suppose 400 MW of BSM exemptions are opened up by the retirement of an existing generator. If a new conventional 500-MW generator is tested first and receives a Competitive Entry Exemption from the BSM rules, it will preclude capacity sales from higher-cost battery storage resources that are receiving subsidies. Thus, even when retirements would create opportunities for the entry of new public policy resources, the current BSM process will tend to allow conventional generators to jump ahead and effectively preempt capacity sales from the public policy resources. The proposed Part A Test changes would correct this by allowing PPRs to be tested before other projects. This would ensure that when retirements of existing resources reduce the capacity surplus to reasonable levels, PPRs would have the opportunity to

enter the market. Conventional resources could still receive Competitive Entry Exemptions and/or Part B test exemptions, but the incentive for new entry by conventional resources would be reduced because the entry of PPRs would reduce investment signals for new entry.

B. Creation of Two Mitigation Study Periods and Timing of Entry

The NYISO proposes to modify the BSM test assumptions regarding the timing of new entry to be more consistent with the specific circumstances of the project. The current BSM process was designed assuming every new entrant would be a gas-fired generator that would take three years to develop. However, this current class year includes projects with a wide range of development timeframes, including battery storage resources capable of entering in just a few months as well as HVDC transmission lines and offshore wind projects with much longer development timeframes. In the case of a battery storage project, the actual timing of entry is likely to be based on a combination of factors such as the permitting lead time, contractual incentives, when wholesale prices are likely to be most attractive, and forecasted reductions in battery purchase costs. Consequently, battery storage projects in the current class year might have a range of different plans with the potential for entering in 2020, 2021, 2022, or 2023, depending on individual circumstances.

However, the current BSM rules require the NYISO to assume that battery storage projects would not enter until May 2022. If the BSM rules were modified as NYISO proposes, it would be possible for the NYISO to grant exemptions to individual projects that would commence in a particular year. Modifying the BSM test to correct this issue would reward first-movers that are capable of bringing resources online quickly while ensuring that the pace of new subsidized entry does not lead to large capacity surpluses.

This change would also facilitate entry of large subsidized resources with long (i.e., four to six year) lead times. For example, suppose a large project in the current class year sought to

enter the market in 2025. Considering the anticipated timing of entry of the project would allow it to obtain exemptions that would be made available by generators expecting to retire because of the DEC's Peaker Rule. The current test assumes every unit in Class Year 2019 would enter in May 2022, so the retirements resulting from the Peaker Rule would not be considered in the current BSM test because they would not happen before May 2022. Hence, a large subsidized project could receive a partial or total exemption in this class year that would be made available by peaking resources planning to retire in 2025, and the project would then be first in line to receive any exemptions made available by additional retirements. Together, these changes would evolve the BSM rules to facilitate entry of subsidized resources while maintaining a commitment to investors to support a competitive wholesale market. It would also ensure that the BSM rules do not inadvertently provide incentives in new conventional resources that are not needed.

V. CONCLUSIONS

Based on our assessment of the NYISO's proposed tariff revisions, we find the proposal to be a well-reasoned and balanced approach for allowing the State to support the entry of resources with certain desirable characteristics, while minimizing the potential price impacts and associated harm to the market. Therefore, we respectfully recommend that the Commission accept the NYISO's proposed tariff changes.

Additionally, we believe that uncertainty regarding the status of these provisions could adversely affect the current Class Year process. Therefore, we support the NYISO's request that the Commission issue an order accepting the filing with an effective date of June 30, 2020. This will allow the Class Year process to proceed on schedule with certainty regarding the application of the BSM provisions.

Respectfully submitted,

/s/ David B. Patton

David Patton
President
Potomac Economics, Ltd.

May 21, 2020

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 21st day of May 2020 in Fairfax, VA.

/s/ David B. Patton
