

105 FERC ¶ 61, 108
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

New York Independent System Operator, Inc. Docket Nos. ER03-647-001
ER03-647-002
ER03-1296-000

ORDER DENYING REHEARING, ACCEPTING COMPLIANCE FILING
AND ACCEPTING FOR FILING TARIFF REVISIONS

(Issued October 23, 2003)

1. On May 20, 2003, the Commission issued an order accepting for filing, with modifications, revisions incorporating into the New York Independent System Operator, Inc.'s (NYISO's) Market Administration and Control Services Tariff (Services Tariff) an Installed Capacity (ICAP) Demand Curve in the ICAP market.¹ The Commission found that the ICAP Demand Curve will benefit customers because it will provide better price signals to investors for the construction of new generation, encourage the formation of long-term bilateral transactions, and, as modified, reduce incentives to withhold capacity from the ICAP market. In this order, we deny requests for rehearing of the May 20 Order and reject a motion for clarification of that order. We also accept for filing a compliance filing submitted in Docket No. ER03-647-002 and accept for filing the proposed tariff revisions implementing a revised Supplemental Supply Fee that satisfies the concerns noted in the May 20 Order filed in Docket No. ER03-1296-000.

BACKGROUND

2. NYISO filed a proposal to modify the rules governing the requirement for load serving entities (LSEs) in New York to procure installed capacity (ICAP).² For reliability purposes, each LSE has had to procure resources equal to 118 percent of its peak load.

¹ New York Independent System Operator, Inc., 103 FERC ¶ 61,201 (2003) (May 20 Order).

² The ICAP market is designed to ensure that there is sufficient generating capacity available to supply energy needs while providing adequate operating reserves. The product bought and sold in the ICAP market is actually called unforced capacity or UCAP. UCAP represents the amount of ICAP that is actually available at a particular time; it is the amount of ICAP available adjusted for periods that generating units are not available to supply ICAP due to forced outages.

Previously, each LSE was assessed a fixed deficiency charge of three times the annualized cost of a new peaking unit per MW for each MW that it was deficient. NYISO contended that those rules yielded a market value of ICAP above the minimum 118 percent requirement at near zero, and a market value below that requirement at the deficiency price; thus, according to NYISO, market participants experienced a vertical demand curve at 118 percent of capacity. As a result, NYISO believed that the energy markets experienced increased volatility, leading to less investment in new generation, so that the rate of capacity additions had not kept up with needs.

3. NYISO proposed to replace the vertical demand curve with a sloped demand curve, which is used to determine both the amount of the ICAP requirement as well as the market price for ICAP. This ICAP demand curve was designed to promote greater stability in the ICAP market, resulting in more effective price signals for new investment and a reduction in the frequency of price spikes in the energy and ancillary services markets. The curve was set so that the demand price at 118 percent is equal to the annualized cost of a new peaking unit for each of three areas,³ and the demand price gradually falls for amounts of capacity beyond 118 percent of peak load until, at 132 percent, it is \$0. The demand price gradually rises above the annualized cost of a new peaking unit for levels of capacity below 118 percent to a maximum of about two times the annualized cost of the new peaking unit. NYISO proposed to use the ICAP demand curve in monthly ICAP spot market auctions, which would replace LSE bids in deficiency procurement auctions. The point where the supply curve of bids crosses the ICAP demand curve establishes the aggregate ICAP requirement and the associated ICAP price.

4. NYISO proposed an additional feature for instances where the monthly auction cleared at less than 118 percent of peak load. At these times, each LSE would be assessed an additional charge, called the Supplemental Supply Fee, for its deficiency in ICAP resources below 118 percent. The revenue from the Supplemental Supply Fee, set at 1.5 times the cost of a new peaking unit, would be used by the NYISO to purchase (outside of the auction market) additional ICAP resources so as to meet the 118 percent target.

5. The Commission agreed with the NYISO that the proposal would encourage greater investment in generation capacity and thus improve reliability by reducing the volatility of ICAP revenues, and in the May 20 Order, the Commission accepted the proposal with modifications. The Commission also agreed that the proposal, as modified, would reduce the incentive for suppliers to withhold ICAP capacity from the market and would provide “net benefits especially compared with the existing vertical demand

³ The three areas are Long Island, New York City, and the rest of New York state.

curve.”⁴ Important factors in the ruling were the role of the New York Public Service Commission (NYPSC) in developing the proposal, and NYPSC’s and NYISO’s determination that the proposal “will adequately and reliably serve customers’ needs over the short and long term.”⁵ However, the Commission noted that this is a novel idea requiring a measure of judgment, and thus directed the NYISO to file detailed evaluations of the demand curve and its implementation annually for three years.

6. The primary modification that the Commission required was elimination of the Supplemental Supply Fee.⁶ The Commission found that the Supplemental Supply Fee presented an incentive for suppliers to withhold capacity from the ICAP spot market auction, leaving that market deficient, and then to re-offer capacity at the much higher Supplemental Supply Fee rate. The order noted that rejecting the Supplemental Supply Fee would increase the chance that LSEs can make up any capacity deficiencies through the spot market and increase the likelihood that capacity of 118 percent will be available at a reasonable price.

7. Two groups of parties timely sought rehearing of the May 20 Order: Industrial Consumers⁷ and NY Municipals.⁸ These rehearing requests are discussed in detail later in this order. On June 23, 2003, KeySpan Ravenswood, LLC (KeySpan) filed a motion for clarification regarding elimination of the Supplemental Supply Fee. Subsequently, NYISO, NYPSC, and a Coalition of market participants⁹ (the Coalition) filed answers to the request for clarification.

⁴ May 20 Order at P 13.

⁵ Id. at P 15.

⁶ The other modification was to clarify that Installed Capacity procured by an LSE prior to the ICAP spot market auction is counted toward an LSE’s Minimum Installed Capacity Required as determined in the ICAP spot market auction.

⁷ Industrial Consumers include the Electricity Consumers Council (ELCON), the NEPOOL Industrial Customer Coalition, and the PJM Industrial Consumer Coalition.

⁸ NY Municipals comprise the municipal electric utilities of the Village of Bergen, Village of Freeport, Jamestown Board of Public Utilities, Village of Rockville Centre and Salamanca Board of Public Utilities. The pleading notes that several other municipal utilities in New York support the request for rehearing.

⁹ The Coalition consists of Consolidated Edison Company of New York, Inc. (Con Edison), New York State Electric & Gas Corporation (NYSEG), Orange & Rockland Utilities, Inc. (Orange & Rockland), Rochester Gas and Electric Corp. (Rochester), Consumer Power Advocates, Strategic Energy, and Strategic Power Management, Inc.

8. On June 19, 2003, NYISO filed in Docket No. ER03-647-002 revisions to the Services Tariff to address the Commission's directions from the May 20 Order. NYISO proposes to add language to describe the ISO spot market auction process and to delete references to the Supplemental Supply Fee and related concepts in various sections of the Services Tariff. NYISO also indicates that a revised version of the Supplemental Supply Fee was under consideration. In the June 19 compliance filing, NYISO states that its Business Issues and Management Committees had approved revisions to the Services Tariff. NYISO further stated that it would file that revision, under Section 205 of the Federal Power Act (FPA), in the event that it is approved by the NYISO Board. In addition, NYISO proposes certain ministerial changes to the Services Tariff in order to correct minor typographical and pagination errors.

9. On September 3, 2003, NYISO filed in Docket No. ER03-1296-000 additional revisions to its Services Tariff pursuant to Section 205 of the FPA. This filing is essentially an extension of the June 19 compliance filing made in Docket No. ER03-647-002; it proposes to modify the Supplemental Supply Fee provision in order to set the price of that fee equal to the ICAP spot market auction market-clearing price. Following approval from the Business Issues Committee and the Management Committee, the NYISO Board approved the revised Supplemental Supply Fee on August 19, 2003. The Board also rejected an appeal by KeySpan of the revisions approved by the Business Issues Committee. The NYISO also proposes in this filing to correct several typographical errors.

NOTICES OF FILING, INTERVENTIONS AND PROTESTS

10. Notice of the NYISO's compliance filing submitted in Docket No. ER03-647-002 was published in the Federal Register, 68 Fed. Reg. 39,536 (2003), with motions to intervene and protests due on or before July 10, 2003. The Coalition filed a conditional protest, asserting that the filing was not in compliance with the May 20 Order because it did not limit the NYISO's payments to the price under the Demand Curve, but stating that if NYISO files tariff revisions approved by its Management Committee on June 18, 2003 and they are approved by the Commission, then its concerns would be satisfied. KeySpan submitted comments in support of the filing, contending that no further revisions to the tariff are necessary to comply with the May 20 Order.

11. Notice of the NYISO's filing in Docket No. ER03-1296-000 was published in the Federal Register, 68 Fed. Reg. 54,440 (2003), with motions to intervene and protests due on or before September 23, 2003. Indicated New York Transmission Owners¹⁰ filed a

¹⁰ The Indicated New York Transmission Owners are: Central Hudson Gas & Electric Corp., LIPA, New York Power Authority, and Niagara Mohawk Power Corp.

motion to intervene raising no substantive issues. A group of transmission owners consisting of Con Edison, NYSEG, Orange & Rockland, and Rochester (Transmission Owners), moved to intervene and commented in support of the filing. KeySpan moved to intervene and protested the tariff revisions. On October 15, 2003, NYPSC filed a motion for late intervention and a motion to consolidate Docket Nos. ER03-647-000 and ER03-1296-000. NYISO and the Coalition filed answers to KeySpan's protest, and the Coalition also requests that the Commission consolidate Docket Nos. ER03-647-000 and ER03-1296-000.

DISCUSSION

Procedural Matters

12. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. ' 385.214 (2003), the timely, unopposed motions to intervene in Docket No. ER03-1296-000 of the entities that filed them serve to make them parties in that proceeding. We will grant NYPSC's motion to intervene out-of-time in Docket No. ER03-1296-000 given its interest in the proceeding, the early stage of the proceeding, and the absence of any undue prejudice or delay. Although answers to protests generally are prohibited under 18 C.F.R. § 385.213(a)(2), we nevertheless will allow NYISO's and the Coalition's answers in Docket No. ER03-1296-000 because they provide additional information that assists us in the decision-making process.

13. The Commission rejects KeySpan's June 23 motion for clarification of the May 20 Order. Section 313(a) of the FPA requires an aggrieved party to file a request for rehearing within thirty days after the issuance of the Commission's order. KeySpan's pleading, however styled, is essentially an untimely request for rehearing. The Commission routinely rejects such requests,¹¹ and we do so here. Consequently, we will also dismiss the answers to KeySpan's pleading filed by NYPSC, the Coalition, and the NYISO.

14. The Commission typically consolidates proceedings only for purposes of hearing and decision.¹² As we are not setting either of these proceedings for hearing, there is no

¹¹ See, e.g., Revised Public Utility Filing Requirements, 100 FERC ¶ 61,342 at P 11 (2002); Niagara Mohawk Power Corp., 100 FERC ¶ 61,247 at P19 (2002); Avista Corp., et al., 96 FERC ¶ 61,058 at 61,173 (2001). In any event, we address the objections that KeySpan raises in its motion for clarification in our discussion of Docket No. ER03-1296-000.

¹² See, e.g., Arizona Public Service Company, 90 FERC ¶ 61,197 (2000).

need to formally consolidate the dockets. Accordingly, we will deny the motions to consolidate.

Rehearing of May 20 Order

Standard of Review

15. In the May 20 Order, the Commission rejected protesters' arguments that the ICAP demand curve is subject to case law governing incentive rates. Protesters had asserted that these cases require a higher level of scrutiny for "incentive rates." The Commission noted that the relied upon precedent was not controlling because it was applied in different circumstances to different types of rates. The Commission also disagreed with arguments that several cases regarding NEPOOL's ICAP market require a different standard of review because those cases never referred to the incentive rate cases nor to ICAP as an incentive rate.¹³ The Commission found the appropriate standard of review to be whether the ICAP demand curve was just and reasonable, and held that the proposal met that standard.

16. On rehearing, Industrial Consumers assert that, because the purpose of the ICAP Demand Curve is to incent new supplies, the incentive rate cases must apply. Industrial Consumers also contend that the First Circuit Court of Appeals held in Sithe that ICAP is appropriately treated as an incentive rate and that excessive ICAP charges will not be sustained. They further fault the Commission for failing to give meaningful consideration to alternatives and for a "conclusory" finding that the proposal is just and reasonable. Industrial Consumers assert that the Commission must scrutinize proposals that increase costs for consumers even if they are "undertaken for purposes of improving reliability."¹⁴

17. NY Municipals assert that the Commission failed to address arguments that NYISO did not justify its ICAP Demand Curve as either a cost-based rate or as a market-based rate. These arguments reasoned that the ICAP Demand Curve would permit suppliers to recover charges that are neither cost-based nor market-based but rather based on a hypothetical proxy, a result that conflicts with the just and reasonable standard in FPA Section 205. NY Municipals regard Central Maine and Sithe as further support for its position that the Commission is required to provide a reasoned explanation for its

¹³ See Central Maine Power Company v. FERC, 252 F.3d 34 (1st Cir. 2001) (Central Maine); Sithe New England Holdings, LLC v. FERC, 308 F.3d 71 (1st Cir. 2002) (Sithe).

¹⁴ Industrial Consumers rehearing at 14.

acceptance of charges. “[T]he mere assertion that Section 205 of the FPA requires that charges must be set high enough to give sellers comfort that they are recovering their costs, does not mean that the Commission is relieved of its obligations to ensure that those rates are not exorbitant.”¹⁵

18. NY Municipals further assert that the Commission failed to address the argument that the ICAP Demand Curve mixes cost-based and market-based rates in contravention of Commission precedent. According to NY Municipals, Indiana & Michigan Elec. Co., 10 FERC ¶ 61,295 (1980), requires that energy and demand charges be assessed on a consistent basis, so that they reflect the same resources.¹⁶ Thus, they believe that the ICAP Demand Curve will permit the mismatching barred by this precedent by permitting some generators to receive excessive capacity prices based on administrative intrusion and market-based energy prices above costs.

19. Industrial Consumers and NY Municipals do not persuade us that incentive rate cases apply to ICAP markets. Although the incentive rate cases mentioned involved proposals to encourage new supplies, as does New York’s ICAP Demand Curve, they were implemented as different types of rates than the instant one and with a different potential impact on ratepayers. As we discussed in the May 20 Order, the incentive rate cases involved incremental rate increases levied upon all customers for the basic commodity; here, the ICAP charges will be incurred by an LSE only if the LSE needs to procure additional ICAP in the spot market over that amount that it already has procured through bilateral purchases or through self-supply. The LSEs may be able to hedge against the charges by acquiring greater amounts of capacity. Thus, customers will not necessarily be exposed to the charges. The part of the Sithe order that Industrial Consumers quote as purportedly concluding that ICAP is appropriately treated as an incentive rate actually deals with the issue of whether the Commission may impose a higher charge retroactively.¹⁷ The court was not discussing the scrutiny that the Commission must use when analyzing the ICAP proposal. Indeed, the court indicated that the level of ICAP charges “is a perfect example of a choice with reasonable policy arguments on both sides, so that the agency’s choice easily controls so long as it

¹⁵ NY Municipals rehearing at 12-13.

¹⁶ The rehearing also cites the following cases for the same principle: Florida Power & Light Co., 66 FERC ¶ 61,227 (1994), Southern Company Services, Inc., 62 FERC ¶ 61,072 (1993), and Illinois Power Co., 57 FERC ¶ 61,213 (1991). See also Industrial Consumers rehearing at 13, n.4, discussing the same cases.

¹⁷ See Sithe, 308 F.3d at 76-77.

adequately explains its position.”¹⁸ Thus, the court clearly did not utilize the analytical approach used in the earlier incentive rate cases.

20. But even if we were to evaluate the proposal under incentive ratemaking standards, it would not change our conclusion. As we explained in our May 20 Order, the ICAP demand curve is clearly necessary in our judgment (as well as that of the NYPSC and the NYISO) to reduce volatility in the ICAP and energy markets, provide better price signals for investment in new generation, and reduce incentives to withhold capacity. The requests for rehearing do not question that the NYISO needed to change its existing ICAP rules. NYISO’s ICAP demand curve proposal is an innovative way to address the deficiencies in the existing ICAP market, and should lead to enhanced reliability in New York. Whether this mechanism will produce an appropriate level of revenues to achieve its objectives cannot be known at this time. Because this is a novel idea requiring a measure of judgment, we directed the NYISO to file detailed evaluations of the demand curve and its implementation annually for three years. These assessments will provide us with the information necessary to ascertain whether the ICAP demand curve is working as intended. Based on this information, the NYISO may propose, or the Commission may require, adjustments to the ICAP demand curve mechanism to ensure that the appropriate level of revenues are being provided.

21. Regarding NY Municipals’ argument that the ICAP Demand Curve was not justified as either a cost-based or market-based rate, it is not the case that a rate must be either one or the other. Courts have held that the key to whether a rate is just and reasonable is the end result, not the particular formula used to reach that result.¹⁹ Thus, the Commission need not find that the ICAP Demand Curve satisfies one of those two methods of analysis. In the May 20 Order, the Commission determined that the ICAP Demand Curve is an appropriate and reasonable approach to resolving the problems encountered under the former ICAP methodology and would ensure adequate capacity and just and reasonable wholesale power prices. The Commission considered the rate impact and the promise of new generation leading to enhanced reliability. Taking into account that the ICAP Demand Curve had originally been proposed by the NYPSC - the entity with responsibility for ensuring that New York residents have access to reliable utility service – that it was adopted after extensive stakeholder input, and that its implementation will be evaluated and monitored, the Commission found that the proposal is just and reasonable.

¹⁸ Id. at 77, quoting M/V Cape Ann v. United States, 199 F.3d 61, 63-64 (1st Cir. 1999).

¹⁹ See, e.g., Federal Power Commission, et al., v. Hope Natural Gas Co., 320 U.S. 591 (1944).

22. In response to Industrial Consumers' assertion that the Commission failed to give meaningful consideration to alternative proposals, we note that the parties for the most part referred to alternatives brought before the NYISO, and they did not present these alternatives to the Commission. As to the two specific proposals that were made, bilateral contracts and demand response, the Commission considered these and explained that adopting the ICAP Demand Curve would not preclude parties from implementing those measures and could foster the formation of long-term bilateral contracts.

23. Finally, we reject the parties' assertion that the principle precluding sales of capacity at cost-based rates and sales of energy at market-based rates applies here. Unlike the situations in the cited cases, ICAP is not a charge for electricity assessed against sales customers of an LSE. Instead, ICAP is a cost of ensuring resource adequacy. To the extent that an LSE has not met its resource adequacy obligation through self-supply or bilateral contracts, it must fulfill its obligation through the ICAP spot market. Because ICAP is a different product than the energy and demand components of electricity, and is one that is purchased by the utility rather than sold to the utility's power sales customers, it is not necessary for the NYISO to use the same basis to price ICAP as the LSEs use to price electricity. We conclude therefore, that the cited cases have no relevance to the pricing mechanism used in NYISO's ICAP spot market auction.

Impact on New Generation

24. Industrial Consumers take issue with the Commission's response to arguments that (1) the ICAP Demand Curve will not incent new generation because increased revenues will be paid to existing suppliers and (2) there is no requirement that the revenues would be used to site generation in New York. The Commission had reasoned that "all capacity suppliers, regardless of the age of their resources, are entitled to the same treatment in the ICAP market."²⁰ Industrial Consumers assert that the Commission's response ignored the key point that if the greatest need was for generation available in New York City for peak loads, then the NYISO should have sought to encourage the addition of peak generation rather than "indiscriminately subsidize all generation."²¹

25. The Commission's acceptance of the ICAP Demand Curve was based on its readjustment of the incentives for building new generation and retaining existing generation. However, as we stated in the May 20 Order, the development was based on "some measure of judgment, since there has been no experience with this new

²⁰ May 20 Order at P 81.

²¹ Industrial Consumers rehearing at 16.

mechanism.”²² Due to its novelty and concerns that the parameters chosen may not be sending the right incentives for new generation, we required the NYISO to file an evaluation of the ICAP Curve by December 1, 2003. Hence, no new action is required here. The Commission did not ignore in the May 20 Order the point that capacity needs of New York City requires a specific solution different from the remainder of New York State. The ICAP Demand Curve does use an ICAP for New York City that is different from the rest of the state. The use of the resultant ICAP prices in conjunction with New York City’s locational ICAP requirement provides specific New York City price signals.

Market Uncertainty and Volatility

26. In the May 20 Order, the Commission found that the prior ICAP mechanism in New York promoted price volatility in the market. Industrial Consumers argue on rehearing that the Commission did not adequately respond to parties’ objections related to market uncertainty and volatility. These objections include: (1) that the ICAP Demand Curve will only substitute quantity volatility for price volatility; (2) that LSEs will have no idea of their obligations until after the monthly ICAP auction and that there will be no way to hedge against the monthly required quantity; and (3) that, because of the volatility, LSE’s lowest risk strategy will be to purchase all of the requirements in the spot market auction, avoiding the strip auctions and bilateral contracts. Further, Industrial Consumers state that the Commission did not give reasoned consideration to concerns that aspects the ICAP Demand Curve are unlikely to compel investors to commit funds in new generation, such as NYISO’s ability to revise the ICAP Demand Curve at any time, subject to governing procedures, and the process of adjusting the ICAP Demand Curve every 3 years.

27. NY Municipals also raise the concern that LSEs will at times be forced to purchase ICAP in the spot market and argue that this imposes an excessive burden on LSEs. Further, NY Municipals cite to record evidence that since LSEs will be unable to hedge against the quantity that must be purchased, they have a disincentive to contract for capacity in advance. NY Municipals conclude that the Commission has merely replaced the form of volatility in the current system with a more complicated and expensive system without resolving questions of volatility.

28. We are not persuaded that the modest quantity uncertainty associated with the ICAP Demand Curve is grounds to reject the mechanism. Industrial Customers and NY Municipals note that, under the ICAP Demand Curve, LSEs would not know precisely their quantity of ICAP obligation in advance of the auction. However, the uncertainty would be bounded; it would effectively lie between 118 percent and 132 percent of peak

²² May 20 Order at P 17.

load, since the ICAP obligation would lie between these two percentages.²³ By contrast, as we noted in our May 20 Order, under the prior ICAP mechanism, the ICAP market price could fluctuate widely – between \$0 and over \$200 per kW-year, depending on whether the market was in surplus or deficit. While LSEs may not be able to fully hedge their obligation under the ICAP Demand Curve, they would be able to hedge most of their obligations by purchasing an estimate of their ICAP obligation through bilateral contracts (which would lie between 118 percent and 132 percent of their peak load). Moreover, to the extent that an LSE were to purchase more capacity through contract than its obligation, it would be able to sell the excess back into the spot market. And as we noted in the May 20 Order, the potential for the quantity requirement to fluctuate from month to month is likely to decrease over time, as parties gain more experience with the ICAP Demand Curve.

29. As NYISO and NYPSC indicated previously in this proceeding, there are substantial benefits from reducing price volatility in the ICAP market. We noted in the May 20 Order that a more stable and predictable ICAP revenue stream would reduce the risk to generation investors, and thus reduce the cost of financing new investment, and we expect that customers would share in this cost reduction. Industrial Consumers and NY Municipals have not shown this expectation to be unwarranted.

30. NY Municipals and others state that, under the ICAP Demand Curve, the cost of purchasing ICAP quantities in excess of 118 percent of peak load is guaranteed to be less than the cost of purchasing 118 percent – but only if an LSE purchases all of its ICAP requirements in the spot market auction. As a result, they argue, the ICAP Demand Curve would discourage LSEs from procuring their obligations through long-term bilateral contracts. We disagree. LSEs could benefit from purchasing obligations through contract when (1) the contract purchase would reduce the uncertainty of its total ICAP costs, and/or (2) the contract would reduce the expected total ICAP costs. Purchasing through contract can reduce the uncertainty of total ICAP costs by locking in a price for quantity under contract. And purchasing through contract will reduce total ICAP costs when the price specified in the contract is below the spot market price. ICAP contract prices could be lower than average spot prices over the long run because

²³ In theory, the spot market auction could clear at a quantity either below 118 percent or above 132 percent. However, if the auction were to clear below 118 percent, NYISO would attempt to purchase sufficient additional capacity outside of the auction to bring the total ICAP capacity up to the 118 percent level. The costs of these additional purchases would be assigned to LSEs that had not previously acquired 118 percent, so acquiring capacity in advance equal to 118 percent of peak load would hedge against this possibility. Conversely, if the auction were to clear at a quantity above 132 percent, the market price for capacity would be \$0, so there would be no financial risk to procuring only 132 percent in advance of the auction.

contracts provide an assured revenue stream for generators that tend to lower their risks and finance costs.

31. We do not agree with NY Municipals that it is unreasonable to require LSEs to purchase ICAP in the spot market to the extent that they have procured less than their obligations. Such a requirement merely ensures that all LSEs share equally in the requirement to procure ICAP, and that LSEs that initially procure less than the ICAP requirement make up their deficiency through the auction process.

Mandatory Participation

32. NY Municipals argue that the Commission erred in requiring mandatory participation by LSEs in the ICAP market. They contend that the May 20 Order failed to acknowledge that the ICAP Demand Curve mandates participation in the spot markets and failed to acknowledge that mandatory participation is a flawed policy. In support, NY Municipals note that by requiring LSEs to purchase ICAP resources based on a market-determined ICAP price, the Commission essentially requires LSEs to participate in a spot market, which they contend is inconsistent with the Commission's policy encouraging voluntary spot market participation.²⁴

33. The Commission rejects NY Municipals' rehearing request regarding mandatory participation in spot markets. The Commission disagrees with their assertion that the ICAP Demand Curve mandates participation in the spot market. First, as we stated in the previous section, participation in the spot market to procure ICAP resources is by choice, and there are benefits to LSEs in procuring ICAP through contracts or bilateral agreements. Second, regarding the reference to the Commission's proposed Standard Market Design, the Municipals have misinterpreted "proposed" Commission policy. The Commission's discussion of reduced reliance on spot markets was directed towards markets for energy and ancillary services, and did not relate to resource adequacy requirements.

Justification for Cost Impact

34. Industrial Consumers argue on rehearing that it was arbitrary and capricious to implement ICAP Demand Curve without evidence that the proposal could produce substantial benefits and accomplish the stated purpose of encouraging new generation in areas where it is needed. They assert that the Commission erred by justifying the cost of

²⁴ Citing Remediating Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design, FERC Stats. & Regs. ¶ 32,563 at 34,327 (2002).

the proposal by comparing it to the preexisting deficiency penalty, which exceeds the deficiency penalty in neighboring ISOs and should have been reduced in any event.

35. The arguments raised by Industrial Consumers either are not new or are a misinterpretation of the Commission's justification for approval of the ICAP Demand Curve proposal. In the May 20 Order, we concluded that NYISO adequately supported the benefits of the ICAP Demand Curve in its original filing. The Commission remains convinced that the ICAP Demand Curve sends the right incentives to providers of ICAP resources, encouraging the construction of new generation, and should result in substantial benefits. Absent actual experience, there is no way of definitively determining that there will be the claimed benefits. However, our requirement that NYISO file detailed evaluations of the demand curve and its implementation annually for three years will provide further evidence of actual benefits. Industrial Consumers' request for a demonstration of substantial benefits would unnecessarily delay the implementation of the proposal. The Commission's support for the proposal is multifaceted and is not based solely on a comparison to the preexisting deficiency penalty.²⁵

Administrative Determination of Level and Pitch of Curve

36. In the May 20 Order, the Commission reasoned: "Although this proposal includes administrative setting of the demand for ICAP, both the current proposal and the existing ICAP proposals use ICAP demand levels and deficiency prices that are administratively determined. Hence, there is no reason to reject the proposal based strictly on whether it is set administratively. The issue is whether the proposed administrative approach (like the existing administrative approach) is 'just and reasonable.'"²⁶ Industrial Consumers assert that this response gave insufficient attention to protests claiming that the administrative determination relied on erroneous estimates and failed to reflect realistic market conditions. Thus, Industrial Consumers conclude that a proposal dependent on such highly speculative, administrative guesses is unworkable and must be rejected.

37. NY Municipals similarly contend that the level of the ICAP Demand Curve is set far in excess of the costs that reflect the market. They cite protests asserting that the assumptions relied on in setting the level of the demand curve are inaccurate and

²⁵ Additional reasons for support of the proposal included: "that the proposal will benefit customers because it will encourage the construction of new generation, will encourage the formation of long-term bilateral transactions, and, as modified below, will reduce incentives to withhold capacity," May 20 Order at P 36, and "the Commission considers the NYPSC's role in developing the ICAP proposal to be an important factor in our ruling," id. at P 15.

²⁶ May 20 Order at P 49.

erroneous. Specifically, NY Municipals assert that NYISO relied on an oversupply of turbines in the market, too short a useful life for turbines, and other than the most cost-effective technology, and fails to account for energy and ancillary service market net revenues.

38. NY Municipals also assert that the Commission erred in failing to justify the pitch of the ICAP Demand Curve in the face of evidence that allegedly indicated that the demand curve slopes too gradually. NY Municipals argue that only a more gradual slope would yield rates commensurate with the added increase in reliability.

39. The Commission will deny rehearing on this issue. Both rehearing requests assert that the ICAP Demand Curve's parameters are based on flawed estimates. As stated in the May 20 Order, the Commission believes that the parameters of the ICAP Demand Curve, as proposed, are appropriate and reasonable, but determining specific parameters, including slope and level of the curve, requires some measure of experience. We still do. The Commission considers the ICAP Demand Curve to be an appropriate new tool in providing reliable service to consumers. The Commission believes that it demands close monitoring and thus directed NYISO "to file a detailed evaluation of the Demand Curve and its implementation by December 1, 2003, and annually for two years thereafter."²⁷ In its proposal, NYISO provided for a review of the ICAP Demand Curve every three years. Such a review will include stakeholder input and may result in adjustments to the ICAP Demand Curve, subject to Commission approval. The Commission found this review process to be just and reasonable. The Commission believes that periodic reviews will allow participants to advocate for adjusting certain parameters of the curve based on their experience with it.

40. That the ICAP Demand Curve was initially proposed by NYPSC – as well as reflected input from participants – was an important factor in the Commission's decision-making process. The NYPSC argued that the implementation of a gradually sloped demand curve would, among other things, enhance reliability over the long term.

NYISO Authority

41. In response to allegations that NYISO lacks the authority to require LSEs to purchase capacity beyond the 118 percent minimum required for reliability purposes, the Commission noted in the May 20 Order that neither the Reliability Council nor the NYPSC raised this issue. The Commission declined to question the NYISO's authority absent any objection by the Reliability Council. On rehearing, NY Municipals state that the Commission failed to address the argument that the NYISO does not have the contractual authority under the Agreement between the NYISO and the Reliability Council, which defines separate and distinct duties for the two entities. NY Municipals

²⁷ Id. at P 17.

contend that the ICAP Demand Curve effectively usurps the Reliability Council's authority to establish reliability requirements by directing LSEs to purchase more capacity than needed to meet the 118 percent minimum reserve requirement, and that the violation of the NYISO/Reliability Council Agreement is another reason why the Commission should reject the proposal.

42. We disagree that NYISO's proposal effectively usurps the Reliability Council's authority to establish reliability requirements. The ICAP Demand Curve sets terms and conditions consistent with the Reliability Council's requirements. Although over the short-term, the precise quantity of ICAP required in a particular month may be higher than 118 percent, the intent of the proposal is to maintain adequate capacity (at the level determined necessary by the Reliability Council) over the long term. Previously, the ICAP market experienced extreme price differentials around the 118 percent reserve requirement; the ICAP Demand Curve is a rational way to implement the Reliability Council's requirements over the long term.

Multi-ISO Capacity Adequacy Efforts

43. Commenters raised concerns that accepting NYISO's ICAP Demand Curve would interfere with ongoing regional efforts to address reliability issues. Specifically, parties asserted that the proposal would be a departure from the broader regional approach being developed in the multi-ISO Resource Adequacy Markets Working Group (RAM WG). They also believed that approval of the ICAP Demand Curve would raise seams issues and encourage sales of ICAP from neighboring regions into New York.

44. The Commission responded that adoption of the ICAP Demand Curve would not prevent implementation of any future actions recommended by the RAM WG and stated that it was encouraged by NYISO statement that it would be as flexible as necessary to accommodate the results of the working group process. The Commission also noted that if the sale of ICAP into New York caused a capacity deficiency in PJM or ISO-NE, then the ISOs should explore and file market solutions to retain capacity.

45. On rehearing, Industrial Consumers reiterate objections that the ICAP Demand Curve will increase regional disparities and create a new obstacle to developing a regional approach to resource adequacy in the Northeast. However, Industrial Consumers introduce no new arguments to persuade us to depart from our findings in the May 20 Order.

Compliance Filing

46. The May 20 Order directed NYISO to submit revised tariff sheets eliminating the Supplemental Supply Fee and clarifying the extent of the capacity that counts toward an LSE's Minimum Installed Capacity Requirement. NYISO's June 19, 2003 compliance

filing states that it does this, and in addition it proposes certain ministerial changes to the Services Tariff. KeySpan filed comments in support of the June 19 compliance filing, asserting that no further changes are needed to comply with the May 20 Order. The Coalition conditionally protested the filing, stating that if NYISO files tariff revisions approved by its Management Committee, and they are accepted by the Commission, then its concerns about the compliance filing would be satisfied.

47. We will accept NYISO's compliance filing because it correctly implements our directions in the May 20 Order, to become effective May 21, 2003, as requested. The Coalition's conditional protest has been satisfied by virtue of NYISO's filing in Docket No. ER03-1296-000.

Docket No. ER03-1296-000

48. In the September 3 filing in Docket No. ER03-1296-000, NYISO proposes to implement a revised Supplemental Supply Fee provision for its ICAP Demand Curve in order to set the level of that fee equal to the ICAP spot market auction market-clearing price. NYISO states that its revisions to the Supplemental Supply Fee take into account the Commission's concerns in the May 20 Order and are intended to reduce any potential withholding in the ICAP spot market auction and to mitigate potential post-auction deficiencies, and clarify exactly how much it will pay suppliers for unforced capacity when the spot market auction clears below the 118 percent minimum reliability requirement. NYISO states that the filing "merely proposes a revised definition of the supplemental supply fee." NYISO has concluded that basing the deficiency charges on the market-clearing price is appropriate and will relieve potentially harsh effects of deficiency charges that were previously (as originally proposed) based on the costs that were fixed, independent of auction results and may have produced unreasonably high charges. NYISO requests a May 21, 2003 effective date.

49. KeySpan protests the proposed changes to the Services Tariff, arguing that limiting the Supplemental Supply Fee to the ICAP spot market auction market clearing price could result in reliability deficiencies and service interruptions if the NYISO fails to meet the Reliability Council's reserve requirements. KeySpan asserts that the investments necessary to bring new capacity to the market may cost in excess of the ICAP Demand curve market clearing price, and requests the Commission to acknowledge that it did not intend the May 20 Order to establish the Demand Curve clearing price, which will be at levels below the cost of entry during the first two years, as a price cap.

50. When we rejected the Supplemental Supply Fee in the May 20 Order, we intended for NYISO to use market clearing prices based on the Demand Curve as the basis for capacity procurement, both above and below the 118 percent minimum reliability requirement. The use of capacity prices above the Demand Curve as advocated by

KeySpan would have the same problems and incentive for capacity withholding that we addressed in the May 20 Order. Hence, KeySpan's interpretation is incorrect.

51. We also reject KeySpan's protest that limiting the Supplemental Supply Fee to the ICAP spot market auction market clearing price could result in reliability deficiencies and service interruptions as unsupported. KeySpan has not provided the Commission with any evidence in support of its assertion that the cost of ICAP during deficiency periods would be more than the spot market price, nor has it addressed capacity withholding concerns that would arise with its proposal to allow the NYISO to purchase capacity at prices higher than the market-clearing price. We agree with the NYISO's answer to KeySpan's protest that the risk of lower reliability is not increased with the proposal, i.e., "the NYISO has repeatedly explained that the risk of not meeting minimum NYSRC requirements is no more significant with a supplemental supply fee equal to the ICAP Spot Market Auction Market-Clearing Price than it was with the negotiated, fixed supplemental supply fees set forth in the original Services Tariff and used by the NYISO since its inception."²⁸ Moreover, one of the bases for our support of the Demand Curve has been our finding that the proposal will provide reliability benefits.²⁹ Accordingly, we find that NYISO's proposed tariff revisions and the proposed ministerial changes in Docket No. ER03-1296-000 are reasonable, and we will accept them for filing.

52. We will reject NYISO's request for an effective date of May 21, 2003 for the tariff revisions filed in Docket No. ER03-1296-000 as being unnecessary. NYISO already had the authority to charge a fee equal to the market-clearing price of Unforced Capacity as determined in the applicable ICAP spot market auction by virtue of our May 20 Order. Because NYISO has had the authority to charge a fee equal to the ICAP spot market auction market clearing price, it has not shown good cause that waiver of the Commission's notice requirement should be granted. The Commission will deny waiver of the 60-day notice requirement and will allow the tariff revisions to become effective November 3, 2003, the sixty-first day after filing.

²⁸ NYISO's answer dated October 8, 2003, at 4.

²⁹ See May 20 Order at P 13 (stating "[w]e agree with the NYISO that the proposal will encourage greater investment in generation capacity and thus improve reliability, by reducing the volatility of ICAP revenues" (emphasis added)).

Docket No. ER03-647-001, et al.

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The Commission orders:

(A) The Commission hereby denies the requests for rehearing and the motion for clarification of the May 20 Order.

(B) The Commission hereby accepts for filing the NYISO's compliance filing submitted in Docket No. ER03-647-002, to become effective May 21, 2003, as requested.

(C) The Commission hereby accepts for filing the proposed tariff revisions submitted in Docket No. ER03-1296-000, to become effective November 3, 2003.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.