

139 FERC ¶ 61,001  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;  
Philip D. Moeller, John R. Norris,  
and Cheryl A. LaFleur.

New York Independent System Operator, Inc.

Docket No. ER09-1682-006

ORDER ON CLARIFICATION AND REHEARING

(Issued April 2, 2012)

1. In this order, the Commission grants clarification in part and denies rehearing of its May 20, 2010 order,<sup>1</sup> which found that three Specified Generators<sup>2</sup> breached the conduct and impact tests of section 3.2.3 of Attachment H of the New York Independent System Operator, Inc.'s (NYISO) Market Services and Control Area Administration Tariff (Services Tariff)<sup>3</sup> and conditionally accepted NYISO's proposed mitigation rules in a new Rate Schedule M-1, as modified, that applied to the three Specified Generators, effective September 8, 2009.

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<sup>1</sup> *New York Indep. Sys. Operator, Inc.*, 131 FERC ¶ 61,169 (2010) (May 20, 2010 Order).

<sup>2</sup> The Saranac, Sterling, and Batavia generators are owned, respectively, by Saranac Power Partners, L.P., Sterling Power Partners, L.P., and Seneca Power Partners, L.P. (Specified Generators).

<sup>3</sup> Under the eTariff system, which went into effect after the May 20, 2010 Order was issued, what was formerly section 3.2.3 of Attachment H of the Services Tariff is now section 23. Accordingly, former section 3.2.3 of Attachment H is now section 23.3.2.3. In this order, to avoid confusion, we will continue to refer to section 3.2.3 of Attachment H.

## I. Background

### A. NYISO's Filing Pursuant to Section 3.2.3 of Its Services Tariff

2. Attachment H (currently, section 23) of the Services Tariff sets forth market power mitigation measures that are designed to permit NYISO to mitigate the market effects of conduct that would substantially distort competitive outcomes in the NYISO markets.

3. At issue here is section 3.2.3, which states, in pertinent part:

[NYISO] shall make a filing under § 205 with the Commission seeking authorization to apply an appropriate mitigation measure to conduct that departs significantly from the conduct that would be expected under competitive market conditions but does not rise to the thresholds specified in sections 3.1.1 through 3.1.3 above if that conduct has a significant effect on market prices or guarantee payments as specified below . . . . For purposes of this section, conduct shall be deemed to have an effect on . . . guarantee payments that is significant if it exceeds one of the following thresholds:

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(2) an increase of 100 percent in guarantee payments to a Market Party for a day.

Similar to other mitigation provisions of NYISO's tariff, section 3.2.3 contains a "conduct" test and an "impact" test.

4. On September 4, 2009, NYISO submitted a filing under section 3.2.3 identifying bidding behavior (conduct) in the energy market by the Specified Generators, for about a three-week period in August of 2009 (when the generators were committed for reliability as Day-Ahead Reliability Units) which, NYISO asserted, departed from the conduct that would be expected under competitive market conditions. According to NYISO, the conduct consisted of the Specified Generators bidding at significantly higher prices than their respective reference levels during that period.<sup>4</sup> NYISO further asserted that this

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<sup>4</sup> Reference levels are price levels established by NYISO for each generator that are designed to reflect the specific generator's marginal cost of supplying energy (principally, fuel costs) to serve as default bids for mitigation purposes. NYISO Services Tariff, Attachment H, section 23.3.1.4.

bidding conduct resulted in the Specified Generators receiving more than a 100 percent increase in guarantee payments above what they would have received had they bid at their respective reference levels (impact).

5. In applying the impact test of section 3.2.3, NYISO interpreted “guarantee payments” the same as what is referred to in the Services Tariff as Bid Production Cost Guarantee (BPCG) payments, which are, in simple terms, equal to the difference between the revenues at the generator’s bid and the revenues at the Locational Based Market Price (LBMP) for the dispatched megawatts (MW).<sup>5</sup> NYISO calculated the percentage increase in guarantee payments received by the Specified Generators each day during the relevant period by comparing the actual guarantee payments per megawatt-hour the generator received at its actual bid price to the guarantee payments it would have received if it had bid at its reference level.<sup>6</sup> As the “appropriate mitigation measure” that NYISO was required to submit pursuant to section 3.2.3, NYISO proposed a new Rate Schedule M-1, a stand-alone rate schedule that would prospectively apply, effective September 8, 2009, only to the Specified Generators when they are called upon after that date to meet a reliability need in NYISO’s day-ahead energy market. Rate Schedule M-1 provided for mitigation of the applicable Specified Generator if the generator’s bid or bid components exceeded one of five thresholds. If triggered, NYISO would substitute a default bid at the generator’s reference level for the submitted offer when determining the generator’s guarantee payment. Rate Schedule M-1 also provided that NYISO would notify the generator who will then have the opportunity to challenge NYISO’s determination. The Specified Generators filed protests to NYISO’s filing.

### **B. Summary of the May 20, 2010 Order**

6. In its May 20, 2010 Order, the Commission found that NYISO had shown that the Specified Generators’ bidding conduct during the period in question breached the conduct and impact thresholds of section 3.2.3, that NYISO appropriately made a section 205 filing pursuant to the Services Tariff, and that its section 205 mitigation

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<sup>5</sup> NYISO’s witness Patton stated: “When a [generation] resource is committed out-of-market, it receives a payment equal to the difference between its offered cost and wholesale market LBMP. I refer to this as a ‘BPCG payment.’” NYISO filing of September 4, 2009, Docket No. ER09-1682-000, Attachment B, Affidavit of Dr. David Patton, at 3. *See* NYISO Services Tariff, Attachment C, section 18.

<sup>6</sup> *See, e.g.*, NYISO’s September 4, 2009 filing in Docket No. ER09-1682-000, Attachment C, Affidavit of Joshua Boles, at ¶ 29-30.

proposal was just and reasonable. Accordingly, the Commission accepted Rate Schedule M-1 subject to conditions, effective September 8, 2009, to apply only to the Specified Generators.

7. First, the Commission agreed with NYISO's interpretation and application of the conduct test. In the May 20, 2010 Order, the Commission found that the section 3.2.3 conduct test ("conduct that departs significantly from the conduct that would be expected under competitive conditions") was met. The Commission explained, at paragraph 75:

Although there is no definition of the term "significantly" as used in section 3.2.3, we agree with NYISO that, based on what the Specified Generators' respective reference levels were at the time of the subject conduct, the bids were substantially above their reference levels . . . . We agree with NYISO and find that the Specified Generators' bidding conduct during the period in question "departs significantly from the conduct that would be expected under competitive conditions' and, therefore, meets the conduct threshold of section 3.2.3."

The Commission held that the section 3.2.3 conduct test was breached by the Specified Generators because they bid at prices substantially above their respective marginal costs, as reflected in their respective reference price levels, during a three-week period in August of 2009 when the Specified Generators were called on for reliability purposes.<sup>7</sup>

8. Second, the Commission defined "guarantee payment" received by a generator called out of merit to generate power for reliability purposes as "an uplift payment equal to the difference between its bid and the LBMP."<sup>8</sup> The Commission clarified "[t]his payment is referred to as the Bid Production Cost Guarantee (BPCG) payment, or guarantee payment."<sup>9</sup> The Commission then agreed with NYISO that the section 3.2.3(2) impact test ("an increase of 100 percent in guarantee payments to a Market Party for a day") requires a comparison of (a) the guarantee payment received at its actual bid price to (b) the guarantee payment that it would have received had the generator bid at its reference level. The Commission also agreed with NYISO that the Specified Generators' bids during the three-week period in August of 2009 caused an increase in guarantee

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<sup>7</sup> May 20, 2010 Order, 131 FERC ¶ 61,169 at P 73.

<sup>8</sup> *Id.* P 2.

<sup>9</sup> *Id.*

payments that exceeded the section 3.2.3(2) impact test threshold and, coupled with the breach of the conduct test, warranted appropriate mitigation measures.<sup>10</sup>

9. Third, the Commission accepted NYISO's proposed mitigation measure, Rate Schedule M-1, subject to conditions. The Commission rejected protests that Rate Schedule M-1 should be rejected for the failure to allow the recovery of fixed costs. The Commission also directed NYISO to remove its designation of this market power mitigation measure as Rate Schedule Market Mitigation No. 1 and to place the provisions in Attachment H of the Services Tariff.

10. Finally, the Commission took note of the ongoing stakeholder efforts to develop a generally-applicable mitigation measure in instances where a generator located in the rest-of-state is the only solution to a reliability need.

## **II. Requests for Clarification or Rehearing of the May 20, 2010 Order**

### **A. Procedural Matters**

11. On June 21, 2010, Independent Power Producers of New York (IPPNY) and the Electric Power Supply Association (EPSA) filed requests for clarification or rehearing of the May 20, 2010 Order. NYISO submitted an answer to the requests for clarification or rehearing.

12. Rule 713(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d) (2011), prohibits an answer to a request for rehearing. While NYISO characterizes its answer as a response to the requests for clarification and affirmative relief, in the main, NYISO's answer addresses rehearing issues and does not assist us in the decision-making process. Accordingly, except to the extent NYISO's answer states its opposition to the motion for clarification, we reject NYISO's answer.

### **B. Requests for Clarification**

13. IPPNY and EPSA ask that the Commission clarify or rule on rehearing that its May 20, 2010 Order was limited to the facts and circumstances at issue in this proceeding and that it is not making any generic determinations on mitigation. IPPNY asks that the Commission clarify that the order was not intended to pre-judge the issues that will come

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<sup>10</sup> *Id.* P 85.

before the Commission when NYISO makes its generic mitigation filing.<sup>11</sup> Similarly, EPSA requests that the Commission clarify that the May 20, 2010 Order is not intended to set a new policy equating bids in excess of operating costs to the exercise of market power generally and that the generally applicable mitigation measures coming out of the NYISO stakeholder process will, once approved by the Commission, apply to all resources operating in the NYISO rest-of-state area, including to the Specified Generators and be limited to the specific circumstances.

### 1. Commission Determination

14. We grant clarification to the limited extent that as indicated in the May 20, 2010 Order, the decision in this proceeding to apply mitigation in the form filed as Rate Schedule M-1 applies only to the three Specified Generators whose specific bidding conduct was at issue in this proceeding.<sup>12</sup> As the Commission explained in the May 20, 2010 Order, this proceeding was the first time that the Commission specifically interpreted and applied section 3.2.3.<sup>13</sup> Hence, the Commission's discussion of these issues necessarily was new, but nonetheless was narrowly confined to the facts and issues before it.

15. On August 13, 2010 in Docket No. ER10-2220-000, NYISO filed proposed revisions to Attachment H of its Services Tariff to apply generally applicable mitigation measures to rest-of-state generators, which are the generators other than those in the New York City constrained area. Subsequently, the Commission accepted the proposed changes, made them effective October 12, 2010, subject to conditions, including the condition that NYISO remove rate Schedule M-1 from its Services Tariff.<sup>14</sup> Because NYISO's filing in Docket No. ER10-2220-000 prospectively implemented a generally-applicable mitigation provision which superseded the generator-specific Rate Schedule M-1 at issue in the instant proceeding, the request that we reserve judgment on the issues raised in the instant proceeding until after consideration of a generically-applicable filing

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<sup>11</sup> IPPNY June 21, 2010 Request for Rehearing at 5-6 (citing May 20, 2010 Order, 131 FERC ¶ 61,169 at P 73).

<sup>12</sup> May 20, 2010 Order, 131 FERC ¶ 61,169 at ordering para. A.

<sup>13</sup> *Id.*

<sup>14</sup> *New York Indep. Sys. Operator, Inc.*, 133 FERC ¶ 61,030, at P 43 (2010) (October 12, 2010 Rest-of-State Order), *reh'g denied*, 135 FERC ¶ 61,157 (2011) (May 19, 2011 Rest-of-State Order), *appeal pending*, Case No. 11-1258 (D.C. Cir.).

by NYISO is moot. That said, we stand by the Commission's discussion of general principles regarding what constitutes evidence of market power and noncompetitive bids. As the Commission noted in its October 12, 2010 Rest-of-State Order conditionally accepting NYISO's proposal to apply a similar mitigation provision to all rest-of-state generators in New York, "the mitigation principles articulated by the Commission in the May 20, 2010 Order apply to rest-of-state generators in a similar position as the Specified Generators."<sup>15</sup>

### **III. Requests for Rehearing of the May 20, 2010 Order**

#### **A. Interpretation of the Section 3.2.3(2) Impact Test**

##### **1. Rehearing Arguments**

16. On rehearing, IPPNY argues that the Commission erred in determining that NYISO properly applied the guarantee payment impact test under section 3.2.3(2) of the Services Tariff. IPPNY notes that the term "guarantee payment" is neither defined in NYISO's tariff nor does the tariff specify how guarantee payment impacts must be calculated in the market monitoring context. Thus, it asserts, in order to be permitted to institute this proceeding, NYISO was first required to determine how it must apply the guarantee payment impact test in the market monitoring context. IPPNY further states that NYISO used, and the Commission accepted, the formula in its tariffs that IPPNY asserts was expressly designed to calculate make whole payments in the context of energy settlements. IPPNY states that under NYISO's application of this approach, the section 3.2.3(2) impact test was deemed to be breached if the actual guarantee payment exceeded by 100 percent the guarantee payment at the reference level. Thus, IPPNY asserts, this approach, by definition, requires measuring a market participant's reference level against the market clearing price. However, IPPNY asserts that the Commission failed to address the fact that there is no requirement in NYISO's tariff to apply "guarantee payment" in the same manner as "clearing price" in the market mitigation context.

17. IPPNY also asserts that NYISO's methodology for determining impact produces irrational results and that the Commission failed to respond to hypothetical examples postulated by Saranac's witness Younger which purport to show certain mathematical anomalies resulting from NYISO's interpretation of the impact test of section 3.2.3(2). IPPNY asserts that one of Mr. Younger's hypotheticals that the Commission failed to address shows that NYISO's interpretation of the impact test can produce wildly different

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<sup>15</sup> October 12, 2010 Rest-of-State Order, 133 FERC ¶ 61,030 at P 44.

impacts that fall outside the 100 percent threshold on one day but within the 100 percent threshold on the next day solely due to changes in the market clearing price and not due to changes in either the generator's bid or its reference level.

18. IPPNY further asserts that another of Mr. Younger's hypotheticals shows that a small increase in the generator's bid over its reference level can result in a 100 percent increase in guarantee payment. IPPNY also asserts that NYISO's methodology runs contrary to what it asserts is the Commission's stated purpose for this section of the tariff's market power mitigation provisions. It quotes from the May 20, 2010 Order where the Commission stated: "[t]he purpose of this threshold, within the context of section 3.2.3, is to measure a significant change over a competitive bid as defined by a generator's reference level."<sup>16</sup> IPPNY asserts that NYISO's methodology fails to achieve this purpose because, as shown by Mr. Younger's hypothetical examples, it would impose mitigation on a generator bid that is not a significant change over a competitive bid.

19. IPPNY contends that another of Mr. Younger's hypotheticals shows, and NYISO itself conceded,<sup>17</sup> that the NYISO impact methodology produces the illogical result that an entity will be deemed to have the most extreme impact when the entity's reference price comes closest to equaling the market clearing price. IPPNY asserts that the exact opposite result should occur if the rule were structured properly; the closer to the market clearing price, the less impact the entity's behavior should be deemed to have on the market.

20. Finally, IPPNY asserts that NYISO's interpretation of the section 3.2.3 impact test that relies solely on the level of the market price should not be considered the appropriate method for determining whether an entity has exercised market power under this section of the market mitigation rules. More particularly, IPPNY continues, when the entity has no way of knowing at the time that it submits its bid what the market clearing price will be. IPPNY argues that the appropriate methodology for determining whether an entity's actions produced a 100 percent impact in guarantee payments would be to compare the generator's bid with its reference level, thereby removing the volatility of market clearing prices from the equation.<sup>18</sup>

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<sup>16</sup> IPPNY June 21, 2010 Request for Rehearing at 9 (citing May 20, 2010 Order, 131 FERC ¶ 61,169 at P 87).

<sup>17</sup> *Id.* at 10 (citing NYISO Response dated October 13, 2009, at 19-20).

<sup>18</sup> *Id.* at 11.

## 2. Commission Determination

21. Under section 3.2.3 of Attachment H of the Service Tariff, a generator may be subject to mitigation if it exceeds certain conduct and impact tests. IPPNY states on rehearing that it objects only to the Commission's decision that NYISO properly interpreted and applied the section 3.2.3(2) impact test.<sup>19</sup> In the May 20, 2010 Order, the Commission agreed with NYISO's interpretation and application of the section 3.2.3(2) impact test and found it to be just and reasonable. As discussed below, we deny IPPNY's request for rehearing of the May 20, 2010 Order.

22. On rehearing, IPPNY asserts that a more "appropriate" methodology for determining whether an entity's actions produce a 100 percent increase in guarantee payments would be to compare the generator's bid to its reference level.<sup>20</sup> We disagree with IPPNY, and as we explained in the May 20, 2010 Order, we agree with NYISO that the term "guarantee payment" as used in section 3.2.3(2) has the same meaning as BPCG which are calculated in accordance with formulas set forth in Attachment C of the Services Tariff. On that basis, the Commission agreed with NYISO that the section 3.2.3(2) impact test (the 100 percent increase in guarantee payments to a Market Party for a day) requires a comparison of (a) the guarantee payment that the Specified Generators received at their actual bid price to (b) the guarantee payments they would have received had they bid at their reference levels, that is at the competitive level. NYISO calculated the actual guarantee payments per MW-hour the Specified Generators received each day during the relevant period by subtracting the market price (LBMP) from their actual bid prices, then it calculated the competitive guarantee payments by subtracting the market price from the individual generator's reference level, and, finally, it measured the percentage increase in guarantee payments from the competitive guarantee payments to the actual guarantee payments.

23. It appears that IPPNY wants to use the conduct test of section 3.1.2 of Attachment H related to Economic Withholding, to measure impact of bidding conduct for purposes of section 3.2.3(2). The section 3.1.2 Economic Withholding conduct test requires a generator to bid below a specified percentage increase in bid or a minimum

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<sup>19</sup> *Id.* at 7.

<sup>20</sup> IPPNY June 21, 2010 Request for Rehearing at 11. The average increase in bid above reference level for the Specified Generators during the period at issue was less than 100 percent; therefore, under IPPNY's proposed interpretation, the section 3.2.3(2) impact test would not have been breached.

dollar increase above its reference level in order to avoid mitigation. Of note, section 3.2.1 also specifies certain impact thresholds for Economic Withholding which, like section 3.2.3(2), measures impact, *inter alia*, by increases in guarantee payments. IPPNY has failed to persuade us why it is appropriate to use a conduct test under one provision (section 3.1.2) to measure impact under another provision (section 3.2.3(2)). Thus, IPPNY misconstrues how guarantee payments are to be calculated in accordance with section 3.2.3(2) of the Services Tariff. We affirm that NYISO applied the proper interpretation of “guarantee payment” and correctly compared the payments as required by the impact test of section 3.2.3(2). We also find that the tariff methodology, which NYISO correctly applied, produces reasonable results. Therefore, we deny rehearing on these issues.

24. IPPNY observes that the term “guarantee payments” is not defined in the Services Tariff, as did Saranac in its original protest,<sup>21</sup> and as such, argues that its meaning is open to interpretation as it proposes. We disagree. The term “guarantee payment” is a commonly-used short hand term for a BPCG payment<sup>22</sup> that is calculated in accordance with Attachment C of the Services Tariff.<sup>23</sup> As noted above, a BPCG or guarantee payment is the difference between the bid and the market clearing price. We continue to find that NYISO’s properly interpretation of guarantee payments in the impact test of section 3.2.3(2) is both consistent with its meaning in Attachment C of the Services Tariff. Also, in the May 20, 2010 Order, the Commission observed that NYISO interpreted the section 3.2.3(2) impact test methodology in consistently with the impact test methodology in section 3.2.1(2) of Attachment H of its tariff which, like section 3.2.3(2), requires a certain percentage increase in guarantee payments from such

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<sup>21</sup> Saranac September 25, 2009 Protest at 13.

<sup>22</sup> NYISO’s witness Patton stated: “When a [generation] resource is committed out-of-market, it receives a payment equal to the difference between its offered cost and wholesale market LBMP. I refer to this as a ‘BPCG payment.’” NYISO filing of September 4, 2009, Docket No. ER09-1682-000, Attachment B, Affidavit of Dr. David Patton, at ¶ 6. Dr Patton uses the term BPCG payment interchangeably with “guarantee payment” throughout his affidavit. *E.g., id.* ¶ 10.

<sup>23</sup> NYISO Services Tariff, Attachment C, section 18, *Formulas for Determining Bid Production Cost Guarantee Payment*.

payments at Reference Price to such payments at bid level, i.e., a comparison using market clearing price.<sup>24</sup> As NYISO witness Boles explained:

The impact test that was calculated is consistent with the FERC-accepted real-Time Guarantee Payment (“RTGP”) Impact test. I calculated the impact on guarantee payments by comparing the original Bid Production Cost Guarantee payment based on the bids submitted by the generators with the BPCG payment based on the applicable references [reference levels] of the generators. This is the same methodology that has been consistently used by the NYISO to determine guarantee payment impact since the inception of the Market Mitigation Measures, and has been the subject of extensive stakeholder discussions and approval and prior Commission proceedings.<sup>25</sup>

25. We reject IPPNY’s claim that, because guarantee payments are not specifically defined in the tariff, the definition of that term is open to its proposed interpretation. Given that the market clearing price is necessary to calculate guarantee payments, IPPNY fails to explain how the phrase “an increase of 100 percent in guarantee payments” as used in section 3.2.3(2) can reasonably be read to omit the market clearing price from consideration so that the impact test consists solely of a comparison of the generator’s bid with its reference level.<sup>26</sup> The effect of IPPNY’s interpretation is to read the term “guarantee payments” out of this section.

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<sup>24</sup> May 20, 2010 Order, 131 FERC ¶ 61,169 at P 57 ((citing NYISO October 13, 2009 Answer at 17 (citing NYISO compliance filing, Docket No. ER07-1334-000, at 4 (filed August 31, 2007); *New York Indep. Sys. Operator, Inc.*, 121 FERC ¶ 61,112 (2007)). In the referenced August 31, 2007 compliance filing in Docket No. ER07-1334-000, at 4, NYISO explained that, in applying the Real-Time Guarantee Payment (RTGP) impact test in section 3.1.2, which assesses increases in “guarantee payments,” it “compares (i) the BPCG payment that a generator would receive if its Bids that fail the conduct test were replaced with reference levels . . . to (ii) the BPCG payment that the generator would receive if the generator were compensated based on the offers the NYISO used to run its Real-Time Market . . . .”

<sup>25</sup> Supplemental Affidavit of Joshua A. Boles, at ¶ 12, NYISO October 13, 2009 Response, Attachment B.

<sup>26</sup> IPPNY June 21, 2010 Request for Rehearing at 11.

26. IPPNY's interpretation therefore improperly conflates conduct (bidding behavior) with impact (increases in guarantee payments). The impact test of section 3.2.3(2) measures the impact of bidding conduct by reference to the increase in the generator's guarantee payments caused by that bidding conduct. In contrast, IPPNY's proposal to measure the percentage difference between a generator's bid price and a bid at its reference level does not measure impact, but rather measures bidding conduct as NYISO witness Boles correctly observed.<sup>27</sup> The basis for finding that the Specified Generators breached the section 3.2.3 conduct test was that the record reflected that their bids significantly exceeded a competitive bid, i.e., a bid at their respective reference levels. NYISO then applied the section 3.2.3(2) impact test to measure the impact of that bidding conduct based on whether the increase in guarantee payments caused by that uncompetitive conduct breached the 100 percent increase in guarantee payment threshold of section 3.2.3(2), consistent with the plain terms of that provision.

27. Accordingly, IPPNY misinterprets the Commission's statement from the May 20, 2010 Order that "[t]he purpose of this threshold, within the context of section 3.2.3 is to measure a significant change over a competitive bid as defined by a generator's reference level." The Commission was addressing issues raised regarding the impact test and, therefore, was saying that the impact test was intended to measure whether the generator's non-competitive bidding conduct caused a "significant change" in guarantee payments relative to what the guarantee payments would have been with a competitive bid, not whether the generator engaged in non-competitive conduct in the first place by bidding significantly more than its reference price. At issue here is the impact test, which measures the impact of conduct on guarantee payments, not the conduct test which precedes it.

## **B. Reasonableness of NYISO's Impact Test**

### **1. Rehearing Arguments**

28. IPPNY argues that it was error for the Commission to approve NYISO's proposed interpretation of section 3.2.3(2) given what it asserts is ample evidence that NYISO's methodology produces "arbitrary and counter-intuitive results." In particular, IPPNY asserts that the Commission ignored several hypothetical examples postulated by Saranac witness Mr. Younger that purportedly show the "absurd results" of NYISO's methodology and also support IPPNY's position that NYISO should eliminate market

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<sup>27</sup> Supplemental Affidavit of Joshua A. Boles, at ¶ 12, NYISO October 13, 2009 Response, Attachment B.

clearing price from the computation. IPPNY instead advocates the comparison of the total guarantee payment the generator receives at its bid to its reference level revenues.

29. Specifically, IPPNY argues that Mr. Younger's hypothetical examples show that NYISO's interpretation can produce an impact that falls well outside the 100 percent threshold on one day, but well within it on the next day due only to changes in the market clearing price rather than to changes in either the generator's bid or its reference level.<sup>28</sup> Mr. Younger postulated that if a generator with a reference level of \$40/MWh bids \$120/MWh and the market clearing price is \$30/MWh, NYISO's interpretation of the impact test would produce an 800 percent increase in guarantee payment impact,<sup>29</sup> while a change in market clearing price the next day to \$39/MWh would produce an 8,000 percent increase in guarantee payment impact without any change in bidding conduct by the generator.

30. IPPNY next asserts that NYISO's impact test methodology produces an absurd result because it can impose mitigation when a generator's bid is not a significant increase over a competitive bid (i.e., a bid at its reference level).<sup>30</sup> Using what it claims is NYISO's formula for determining the percentage increase in guarantee payment,<sup>31</sup> IPPNY postulates a hypothetical which assumes a generator bid of \$41/MWh, that is only a 5.1 percent increase (\$2/MWh) over its \$39/MWh reference level, results in a guarantee payment increase of 100 percent that breaches the impact test if the market clearing price

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<sup>28</sup> IPPNY June 21, 2010 Request for Rehearing at 9 (citing September 25, 2009 Attachment E Supplier Protest, Attachment C, Younger Affidavit, at ¶¶ 22-24).

<sup>29</sup> To determine the hypothetical first day's percentage increase in guarantee payments, IPPNY divided the \$80/MWh difference between the \$90 guarantee payment at bid (\$120/MWh - \$30/MWh) and the \$10 guarantee payment from a bid at reference price (\$40/MWh - \$30/MWh) by the \$10/MWh guarantee payment at reference price to yield 800 percent.

<sup>30</sup> IPPNY June 21, 2010 Request for Rehearing at 10.

<sup>31</sup> In making its argument, IPPNY does not, in fact, use NYISO's formula. *See* IPPNY Request for Rehearing at 10. The formula IPPNY uses incorrectly subtracts the bid price from the market clearing price which, under the facts of this case, would result in a negative percentage increase in guarantee payments because the Specified Generators' bids were above the market clearing price. If their bids had been below the market clearing price, they would have been accepted without generating guarantee payments.

is \$40/MWh. It asserts that it would be arbitrary and capricious for the Commission to find that such a bid would require mitigation.<sup>32</sup>

31. Finally, IPPNY asserts that Mr. Younger's hypothetical examples show that NYISO's impact methodology produces the "illogical result" that, if only the market clearing price changes, a generator's bid will result in the most extreme percentage impact when the market clearing price comes closest to equaling the generator's reference level. In this example, IPPNY shows that, under NYISO's impact test, if a generator's bid and reference price remain static at \$60 and \$50, respectively, a change in market clearing price from \$10/MWh to \$49.99/MWh changes the percentage increase in guarantee payment from 25 percent to 100,000 percent.<sup>33</sup> IPPNY asserts that the opposite should occur if the impact test were structured properly, namely, it asserts that the closer the bid is to the market clearing price, the less the impact the entity's bidding behavior should be deemed to have on the market.

## **2. Commission Determination**

32. As discussed below, we find that IPPNY's hypothetical examples are irrelevant and therefore deny rehearing on this issue.<sup>34</sup>

33. Mr. Younger's observations about the results of a carefully chosen set of assumed variables not of record here do not prove that NYISO's section 3.2.3(2) impact methodology produces absurd results or that it is unjust and unreasonable. All that these hypothetical examples show is the well-known mathematical proposition that, as Dr. Patton observed in his testimony, "a small increase in a small number can result in a large percentage increase."<sup>35</sup> In any event, it does not matter by how much (in terms of percentage or absolute dollars) a specified, numerical threshold is breached; if the threshold is breached, mitigation should be imposed. While the mathematics can be manipulated to achieve allegedly "absurd" results on paper, IPPNY neither claims that such results ever actually occurred; nor do they opine on the real world results contained

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<sup>32</sup> IPPNY June 21, 2010 Request for Rehearing at 10.

<sup>33</sup> IPPNY June 21, 2010 Request for Rehearing at 10, 11, n. 24 (citing, *inter alia*, September 25, 2009 Younger Affidavit ¶ 27).

<sup>34</sup> May 20, 2010 Order, 131 FERC ¶ 61,169 at PP 78-79.

<sup>35</sup> NYISO October 13, 2009 Response, Supplemental Affidavit of David B. Patton, at 9.

in the record in this proceeding. Thus, we also find that the hypothetical examples provided by IPPNY and Mr. Younger are irrelevant as they fail to consider the actual impact on guarantee payments of the actual bidding conduct of the Specified Generators, which, as NYISO witness Boles observed, is the matter at issue here.<sup>36</sup> That bidding conduct consisted of bidding significantly in excess of a competitive bid at their reference levels.

34. Further, IPPNY's claim that it is illogical that the closer the generator's bid is to the market clearing price, the greater the percentage impact the generator's bidding behavior has under NYISO's methodology, is based on an incorrect assumption. There is no relationship, illogical or otherwise, between the generator's bid when the generator is later dispatched out of merit order to meet a reliability need and the later market clearing price since its bid does not establish that market clearing price and, in fact, is made in advance of that market clearing price being determined in the auction. Additionally, as demonstrated by NYISO, the bids of the Specified Generators exceeded the market clearing prices by substantial amounts thereby rendering such speculation by IPPNY to be irrelevant to the case at hand.

35. We also note that IPPNY's assertion that NYISO's impact test methodology would impose mitigation when a generator's bid is not a significant increase over a competitive bid (i.e., a bid at its reference level) is, likewise, based on an incorrect assumption.<sup>37</sup> NYISO states that, if the scenario postulated by IPPNY and Mr. Younger above had actually occurred in this instance, NYISO would have determined that the guarantee payments received were due to competitive forces and, therefore, it would not have made its mitigation filing.<sup>38</sup> We agree that this is the right result because bidding conduct of this nature that is consistent with competitive bidding, as discussed in the May 20, 2010 Order, would not be deemed to breach the conduct test of section 3.2.3, a prerequisite to even reaching the section 3.2.3(2) impact test. In addition, we find such extreme examples of the application of the NYISO impact test, while mathematically possible, are implausible and is unlikely to arise because, as noted above, NYISO would

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<sup>36</sup> Supplemental Affidavit of Joshua A. Boles, at PP 14-16, NYISO October 13, 2009 Response.

<sup>37</sup> IPPNY June 21, 2010 Request for Rehearing at 10.

<sup>38</sup> NYISO October 13, 2009 Response at 19 ((citing Supplemental Affidavit of Joshua A. Boles, at ¶ 17) ("A bid that was only a minimal amount above a generator's reference level would not be found to be inconsistent with competitive market outcomes. That was not the case here.")).

not find that the generator breached the conduct test; therefore, the impact test would not be relevant.

36. IPPNY claims that, based on the above-referenced hypothetical examples of Mr. Younger, NYISO's interpretation of the section 3.2.3(2) impact test is unreasonable because the only relevant factor that determines the outcome of that impact test is market clearing price, which is beyond the control of the bidder and cannot be known in advance. As the Commission did in the May 20, 2010 Order, we reject this argument.<sup>39</sup> IPPNY wrongly claims that the only factor that determines if the NYISO impact methodology threshold is breached is changes in the market clearing price. As we explained above, prior to applying the impact test, NYISO must make the determination that the generator's bid significantly exceeded the bid expected in a competitive market, i.e., breached the conduct test.<sup>40</sup> The record reflects that the Specified Generators uniformly bid significantly in excess of both their respective reference levels and the prevailing market price on a consistent basis.<sup>41</sup> Thus, the determinative factors that led to the Specified Generators breaching the impact test were: (1) they acquired market power by being called on to meet a reliability need; and (2) they made uncompetitive bids significantly above their reference levels (thereby breaching the conduct test). While the first factor was not within the control of the Specified Generators, the second factor was within their control and not the result of changes in the market clearing price. Thus, as the Commission found in the May 20, 2010 Order, the generator need not actually change its bid if it already is consistently bidding at uneconomic levels substantially above its reference levels—a fact it would know in advance and could expect to continue.<sup>42</sup>

37. The record reflects that the Specified Generators consistently bid so substantially in excess of their reference levels on the days in question that the excess was enough to

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<sup>39</sup> May 20, 2010 Order, 131 FERC ¶ 61,169 at P 88.

<sup>40</sup> NYISO December 3, 2009 Filing, Attachment A, Affidavit of Joshua A. Boles, at ¶ 5.

<sup>41</sup> May 20, 2010 Order, 131 FERC ¶ 61,169 at P 26.

<sup>42</sup> *Id.* P 74, P 89, & n.86 (“We note that, under section 3.1.2, the Specified Generators know in advance that any bid substantially in excess of their marginal cost, i.e., reference level, could trigger mitigation, while bidding at marginal cost would ensure that they would not be mitigated. Likewise, we believe that Specified Generators should have had the same knowledge and expectation when considering the possibility of mitigation under section 3.2.3.”).

first breach the conduct test and then cause a substantial increase in guarantee payments that breached the impact test threshold, not the extremely small differences Mr. Younger had to assume in order to demonstrate what they assert are “absurd” results.<sup>43</sup> Therefore, we find IPPNY’s hypothetical to be irrelevant and affirm our determination that NYISO’s application of the impact test was reasonable.

**C. Fixed Cost Recovery for Generators Operating to Meet Reliability Needs**

**1. Rehearing Arguments**

38. IPPNY contends that to meet the statutory requirements of section 205 of the Federal Power Act (FPA), the Commission must direct NYISO to develop, as a supplement to Rate Schedule M-1,<sup>44</sup> comprehensive market rules for a defined payment mechanism for generators that are required to run for reliability to recover their fixed costs if such costs cannot be recovered in the market. IPPNY states that the Commission recognized the inherent problem faced by such generators that are dispatched to alleviate reliability concerns. IPPNY asserts that the requirement that generators operate for reliability purposes, and, for at least the Specified Generators, now do so with much tighter mitigation thresholds, while denying them a defined mechanism to recover fixed costs is unjust, unreasonable and confiscatory. IPPNY states that the development of comprehensive market rules cannot be left to open-ended stakeholder discussions.<sup>45</sup> It requests that the Commission direct NYISO to make a compliance filing proposing a fixed cost recovery mechanism within 120 days.

39. EPSA states that if its clarification request is not granted, it seeks rehearing of the ruling of the May 20, 2010 Order that including costs in energy bids in excess of actual operating costs, including fixed costs, when generators are required to run for reliability

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<sup>43</sup> As we noted earlier herein, *supra* P 35, NYISO stated that it would not pursue mitigation under section 3.2.3 under the factual scenario assumed by Mr. Younger. *See* NYISO October 13, 2009 Response, at 19-20.

<sup>44</sup> *See supra* P 15.

<sup>45</sup> IPPNY June 21, 2010 Request for Rehearing at 13 (citing NYISO, *Proposed Mitigation of ROS Generators Committed for Reliability and Next Steps* at 15 (May 28, 2010) available at [http://www.nyiso.com/public/webdocs/committees/mc/meeting\\_materials/2010-05-28/MC\\_ROS\\_Reliability\\_Mitigation5\\_28\\_10FINAL.pdf](http://www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2010-05-28/MC_ROS_Reliability_Mitigation5_28_10FINAL.pdf) at page 15).

is evidence of the exercise of market power. EPSA alleges that such a Commission determination is arbitrary and capricious and unsupported by the evidence. EPSA states that it recognizes that the May 20, 2010 Order limits its scope by stating fixed cost recovery issues may be addressed in other proceedings; however it is concerned the order could be read as setting a new policy that bidding above marginal costs indicates the exercise of market power.<sup>46</sup> According to EPSA, established economic theory, the Commission and court precedent require that utilities, including generators needed for reliability, have an opportunity to recover all of their costs, including a return of and on their fixed costs. It asserts that the Commission's ruling is unreasoned because it takes out long-term marginal costs by removing scarcity pricing from the equation. EPSA asserts that the Commission has found that "[m]arginal costs include not only variable costs but also the marginal opportunity cost of all legitimate opportunities, costs, and risks."<sup>47</sup> EPSA adds that, if only short-run costs are recovered by generators in a market, then there are no price signals to the marketplace to provide proper incentives for the development of future resource adequacy.<sup>48</sup> To support its arguments, EPSA cites an excerpt from an article on economic theory supporting bidding above marginal cost in energy markets,<sup>49</sup> and prior Commission orders regarding fixed cost recovery in energy prices.<sup>50</sup> Finally, EPSA states that, if the May 20, 2010 Order is not narrowly tailored to the Specified Generators and does set a new marginal cost recovery policy, then the order does directly affect fixed cost recovery, and is not just and reasonable because it

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<sup>46</sup> EPSA June 21, 2010 Request for Rehearing at n.14.

<sup>47</sup> EPSA cites "Strawman Discussion Paper on Market Power Monitoring and Mitigation," Docket No. RM01-12-000, February 7, 2002; *Midwest Indep. Transmission Sys. Operator, Inc.* 109 FERC ¶ 61,285 at P 221 (2004) (requiring the independent market monitor to consider legitimate risk and opportunity costs in marginal cost calculations).

<sup>48</sup> EPSA June 21, 2010 Request for Rehearing at 8.

<sup>49</sup> *Id.* at 8-9 (citing Peter Cramton, *Competitive Bidding Behavior in Uniform-Price Auction Markets*, Proc. of the Hawaii International Conference on System Sciences, at 1 (January 2004)).

<sup>50</sup> *Id.* at 10 (citing, *inter alia*, *Midwest Independent Sys. Operator, Inc.*, 102 FERC ¶ 61,196, at P 49 (2003); *Devon Power LLC, et al.*, 109 FERC ¶ 61,154, at P 43 (2004); *Devon Power LLC, et al.*, 103 FERC ¶ 61,082, at P 33 (2004); *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112, at P 39 (2004)).

tightens mitigation rules to the point where generators cannot recover their fixed and variable costs.<sup>51</sup>

## 2. Commission Determination

40. On rehearing, IPPNY and EPSA claim that the Commission erred by not directing NYISO to establish fixed cost recovery provision in its tariff for generators needed for reliability and also by not recognizing that such generators should be able to bid at prices that permit fixed cost recovery. We deny rehearing on these issues. The Commission addressed the issue of the recovery of fixed costs in energy market bids by generators needed for reliability in the May 20, 2010 Order, stating:

[a] desire for full cost recovery does not justify the exercise of market power. Generators needed mainly for reliability have other opportunities to receive compensation above their marginal costs. During periods of market-wide scarcity...the market clearing price will typically exceed the marginal costs of virtually all generators by a substantial amount, thereby allowing all such generators to receive revenues that contribute to fixed cost recovery. In addition, generators can receive revenues to contribute to the recovery of their fixed, *i.e.*, capacity, costs from the capacity market. While generators that are needed for reliability may have fixed recovery issues that need to be addressed, these generators remain subject to NYISO's market power mitigation measures, the application of which is the only issue in this proceeding.<sup>52</sup>

In addition, the Commission addressed and rejected similar fixed cost recovery arguments when it accepted generally applicable mitigation measures for rest-of-state generators needed for reliability in its October 10, 2010 Rest-of-State Order and in its May 19, 2011 Rest-of-State Order on Rehearing.<sup>53</sup> Thus, the Commission reaffirms the finding that proceedings such as this one, *i.e.*, that involve the application of mitigation procedures are not appropriate to deal with such cost recovery issues. We again note in this regard that NYISO's market design already provides various opportunities for generators needed for reliability to recover their costs through, for example, infra-

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<sup>51</sup> *Id.* at 11.

<sup>52</sup> May 20, 2010 Order, 131 FERC ¶ 61,169 at P 81.

<sup>53</sup> October 12, 2010 Rest-of-State Order, 133 FERC ¶ 61,030 at PP 50-51, 53-54; May 19, 2011 Rest-of-State Order, 135 FERC ¶ 61,157 at PP 26-28.

marginal energy revenues (i.e., revenues when market-clearing prices exceed a generator's marginal cost) and capacity market revenues.

41. In support of its arguments for permitting the inclusion of fixed costs in the Specified Generators' energy bids, EPSA cites excerpts from a paper by Professor Cramton where he argues that bidding above marginal cost in energy markets to maximize profits should be expected in, and is consistent with, competitive wholesale bid-based auction electricity markets. However, Professor Cramton's 2004 analysis of energy market bidding at that time predates the numerous market enhancements made since that time (including but not limited to the mechanisms listed in the prior paragraph), and other mechanisms for cost recovery are now available to NYISO generators that were not available in 2004.<sup>54</sup>

42. More importantly, we do not agree that it is just and reasonable to authorize NYISO generators with market power to exercise that market power for cost recovery purposes or indeed for any other reason. While including fixed costs in energy bids is not expressly prohibited by NYISO's market mitigation rules, and so they may do so, but generators that do so run the risk that their bidding conduct may trigger mitigation when they have market power, e.g., if they are in a must-run reliability need situation like the Specified Generators. Contrary to EPSA's assertion, section 3.2.3 thus does not prohibit infra-marginal bids and only subjects the bidder to mitigation if such bids significantly exceed a bid expected in a competitive market (that is, at marginal cost represented by the generator's reference price level) and thereby cause a substantial increase in guarantee payments.

43. EPSA also asserts that the Commission's statement, that "the ability to include and recover costs in excess of marginal cost, including fixed costs, in bids during periods when the generators are required to run for reliability is evidence of market power" is an unexplained departure from previous Commission orders in ISO-New England and PJM

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<sup>54</sup> We note that the PJM Frequently Mitigated Unit rules cited by EPSA predate recent market design changes including scarcity pricing and the PJM Reliability Pricing Model (RPM). See *PJM Interconnection, L.L.C.*, 114 FERC ¶ 61,076 (2006) (approving PJM settlement agreement addressing mitigation of market power, provisions for scarcity pricing, increased payments to frequently mitigated units, and competitive issues at PJM's internal interfaces); *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 (2006) (approving PJM settlement agreement concerning PJM's Reliability Pricing Model).

proceedings relating to the recovery of fixed costs.<sup>55</sup> We disagree; the Commission's statement was consistent with precedent. Indeed, in an order issued in the PJM proceeding cited by EPSA, the Commission stated: "When a unit bids above its marginal cost, that is evidence that the unit has some ability to control price, and hence, has market power."<sup>56</sup> Moreover, the cited PJM proceeding specifically dealt with cost recovery under PJM's system of setting price caps for generators required to run for reliability reasons. As a result of that proceeding PJM developed a fixed cost compensation mechanism that applies only to generators that notify PJM of a planned retirement and PJM determines that the unit must operate for reliability reasons. Likewise, the ISO-New England proceeding cited by EPSA dealt with cost recovery in ISO-New England's previous Locational Installed Capacity (LICAP) market. Subsequently, ISO-NE eliminated this fixed cost recovery mechanism for Reliability Must-Run units in the later full implementation of its Forward Capacity Market. In contrast, in the instant proceeding the issue is market power mitigation, not cost recovery. As noted above, NYISO's ICAP market is the primary vehicle for recovery of fixed costs, while revenues from the energy market and from shortage pricing situations may, as explained above, also provide some partial fixed cost recovery. But both the May 20, 2010 Order in the instant proceeding and the May 19, 2011 Rest-of-State Order in Docket No. ER10-2220 stated, and we have reaffirmed here, that the desire for fixed cost recovery does not justify the exercise of market power.<sup>57</sup> Further, to the extent EPSA questions NYISO's definition of marginal cost used to establish reference levels, which NYISO employs generally for all forms of mitigation in Attachment H of its Services Tariff, and seeks to include more costs in that definition so as to raise reference levels, that is a matter beyond the scope of this proceeding.

44. The instant proceeding relates solely to market power mitigation under section 3.2.3 of the Services Tariff for the Specified Generators who were called on to run out of merit order to meet reliability needs and, thus, the generic issue of fixed cost

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<sup>55</sup> EPSA Request for Rehearing at 10, n.18 & 20 (citing *Devon Power LLC, et al.*, 109 FERC ¶ 61,154 at P 43; *Devon Power LLC, et al.*, 103 FERC ¶ 61,082 at P 33 ; *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112 at P 39).

<sup>56</sup> *PJM Interconnection, L.L.C.*, 110 FERC ¶ 61,053, at P 25 (2005), *order on reh'g and compliance*, 112 FERC ¶ 61, 031, at P 85 (2005).

<sup>57</sup> May 19, 2011 Rest-of-State Order, 135 FERC ¶ 61,157 at P 27; May 20, 2010 Order, 131 FERC ¶ 61,169 at P 81.

recovery in energy markets for high cost units is beyond its scope.<sup>58</sup> IPPNY and EPISA's arguments have not convinced us to broaden its scope. Nor have they shown that NYISO's application of section 3.2.3 is unjust and unreasonable. Accordingly, we deny rehearing on this issue.

The Commission orders:

The requests for clarification are hereby granted in part, and rehearing is hereby denied, as discussed in the body of this order.

By the Commission.

( S E A L )

Kimberly D. Bose,  
Secretary.

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<sup>58</sup> May 20, 2010 Order, 131 FERC ¶ 61,169 at P 81.