UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Long Island Power Authority,
Complainant

v.

New York Independent System Operator, Inc.,
Respondent

Docket No. EL07-16-000

ORDER DENYING COMPLAINT

(Issued February 15, 2007)

1. In this order, the Commission denies a complaint by the Long Island Power Authority (LIPA) alleging that the New York Independent System Operator, Inc. (NYISO) violated its capacity market rules. The Commission finds that NYISO properly complied with its tariff provisions[1] regarding its capacity market, and we therefore deny LIPA's complaint.

Background

The NYISO Tariff and Capacity Market Rules

2. In order to ensure reliability in New York, NYISO is required by the New York State Reliability Council (Reliability Council) to ensure that sufficient generating capacity is always available in the market to prevent possible service interruptions. The

[1] NYISO Market Administration and Control Area Services Tariff, FERC Electric Tariff, Original Volume No. 2 (Services Tariff).

Reliability Council's minimum capacity requirement for New York is currently 18 percent over the system's anticipated peak load. Therefore, NYISO is required to ensure that there is available sufficient generating capacity[2] to meet 118 percent of peak load.[3]

3. To meet this obligation, NYISO places a capacity requirement, *i.e.*, the Minimum Capacity Requirement,[4] on each of its member Load Serving Entities (LSEs). Each LSE has an individual Minimum Capacity Requirement, based on forecasts of that specific LSE's peak load, and the system's total capacity requirement. LSEs may meet this obligation through self-supply, through bilateral contracts, or through participation in the capacity auctions operated by NYISO.

4. NYISO holds auctions through which LSEs can obtain capacity on a long-term forward basis, and also holds a spot market auction at the beginning of each month. Each LSE within NYISO is required to participate in the monthly spot market auction by certifying to NYISO how much capacity it has already obtained through self-supply or bilateral contracts for that month.[5] For each spot market auction, NYISO constructs supply curves for the entire New York control area, and also for the two transmission-

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[2] For purposes of this order, the term "capacity" will include both Installed Capacity (ICAP) (*i.e.*, generating capacity) and Unforced Capacity (UCAP) (*i.e.*, generating capacity that experiences a limited number of forced outages).

[3] Complaint at 9, Answer at 2.

[4] NYISO refers to this as the "NYCA [New York Control Area] Minimum Unforced Capacity Requirement."

[5] Complaint at 6. *See also* Services Tariff at section 5.11.2 ("[a]ll LSEs shall participate in the [capacity] Spot Market Auction pursuant to Section 5.14.1 of this Tariff") and section 5.14.1(a):

> When the ISO conducts each ICAP Spot Market Auction it will account for all [capacity] that each . . . LSE has certified for use . . . to meet [its Minimum Capacity Requirement] or [Locational Requirement]. . . . The ISO shall receive offers of [capacity] that has not previously been purchased . . . . The ISO shall also receive offers of Unforced Capacity from any LSE for any amount of Unforced Capacity that LSE has *in excess of* its [Minimum Capacity Requirement or Locational Requirement], as applicable.

constrained localities within the state of New York (New York City and Long Island). The supply curves are then combined with the administratively-determined demand curve previously approved by the Commission,[6] and the intersection of those curves determines the resulting capacity obligations, and price for capacity obtained through the spot market auction.[7] This process thus creates the monthly Minimum Capacity Obligation for each LSE in New York, and also the separate locational obligation for LSEs providing service in New York City and Long Island.[8]

5. Thus, in any given month, LSEs that have obtained enough capacity to meet their Minimum Capacity Requirement need do no more. However, LSEs that have procured capacity in excess of their Minimum Capacity Requirement provide that capacity to NYISO through the certification process, essentially providing that capacity to NYISO for reallocation, and LSEs that are deficient with regard to their Minimum Capacity Requirement will be allocated (and must pay for) sufficient additional capacity through the spot market auction to meet their Minimum Capacity Requirement. The parties do not enter directly into transactions with one another in the spot market auction; rather, NYISO (in addition to determining each LSE's Minimum Capacity Requirement and the price for capacity) reallocates the excess capacity from "long" LSEs to "short" or deficient LSEs. The long LSEs receive, and the short LSEs pay, the price set through the auction.

6. LSEs serving New York City and Long Island must procure a specific percentage of their Minimum Capacity Obligations from capacity resources located within those constrained localities (the locational component of the Minimum Capacity Requirement, or Locational Requirement).[9] LSEs meet the remainder of their capacity obligation from

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[6] *New York Independent System Operator, Inc.*, 103 FERC ¶ 61,201 (Capacity Market Order) at P 7 n. 5, *reh'g. denied*, 105 FERC ¶ 61,108 (2003), *aff'd sub nom. Electricity Consumers Resource Council* v. *FERC*, 407 F.3d 1232 (*ELCON*) (2005).

[7] Answer at 5-6.

[8] In any month, depending on the capacity that is entered into the spot market auction, an LSE's Minimum Capacity Requirement may be greater than its initial share of the 118 percent capacity requirement for the NYISO system. If more capacity is submitted to the spot market auction than is necessary to meet that 118 percent figure, the Minimum Capacity Requirement of each LSE is increased on a load ratio share basis. Complaint at 6.

[9] Answer at 3, *citing* Services Tariff at section 5.11.4.

capacity located in the rest of the state (the Rest of State or ROS component of the Minimum Capacity Requirement).[10]

7. Prior to May 2006, LSEs certified their capacity to NYISO before the spot market auction took place through the manual submission of spreadsheets. Beginning in May 2006, however, NYISO automated the format of its certification process, and required LSEs to enter this information online.[11]

LIPA's Complaint

8. On November 17, 2006, LIPA filed the instant complaint with the Commission. It alleged that, for the May 2006 spot market auction, LIPA's total Minimum Capacity Requirement was 5,577 MW, and its Locational Requirement was 4,724 MW. LIPA states that for the May 2006 auction, it had procured a total of 5,547.6 MW of capacity, of which 4,995.9 MW was located on Long Island, and that it certified these amounts for the May 2006 auction using NYISO's new automated certification process. Thus, according to LIPA, it had completely fulfilled its Locational Requirement and had 271.9 MW in excess of its locational capacity requirement. LIPA states that it believed that it could count that 271.9 MW of Long Island Capacity to meet its ROS Requirement, and therefore considered that it was, therefore, only 29.4 MW deficient in fulfilling its total Minimum Capacity Requirement.[12] A LIPA representative states that he provided this information to NYISO through the automated certification procedure.[13]

9. LIPA states that, before implementation of the automated certification system, while it had "typically" offered its excess capacity on Long Island into the Long Island portion of the spot market auction (by certifying it specifically as Long Island capacity), "such offers were solely economic decisions by LIPA," and not required by the tariff.[14]

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[10] Thus, for example, if a Long Island LSE's Minimum Capacity Requirement was 100 MW, and the required Locational Requirement was 99 percent of its Minimum Capacity Requirement, that LSE would be under two obligations: it would have to provide 99 MW of capacity from resources located on Long Island to meet its Locational Requirement, and one additional MW to fulfill its total Minimum Capacity Requirement.

[11] Complaint at 11.

[12] *Id.* at 10-14.

[13] Affidavit of Peter Andolena, Exhibit A to Complaint (Andolena Affidavit) at pages 7-8, paragraphs 21-23, *citing* Exhibit E to Complaint.

[14] Complaint at 11.

LIPA further states that, in May 2006, however, LIPA did not separately offer any of its Long Island capacity (in excess of its Locational Requirement) into the spot market auction, but rather chose to certify all of its capacity as self-supply for its total Minimum Capacity Requirement[15] (so that, in effect, the Long Island capacity in excess of LIPA's Locational Requirement would be used to meet the ROS component of LIPA's Minimum Capacity Requirement).

10. LIPA states that it thus anticipated that it would be considered to have incurred little or no deficiency for May 2006.[16] However, when NYISO posted the auction results, it required LIPA to purchase 148.8 MW of capacity to meet the remainder of LIPA's Minimum Capacity Requirement.[17] LIPA later ascertained that NYISO had excluded from its calculation of LIPA's Minimum Capacity Requirement the 271.9 MW of Long Island capacity that LIPA states that it had intended to meet the ROS component of its Minimum Capacity Requirement.[18]

11. LIPA asserts that this action by NYISO is harmful in two ways. First, LIPA alleges that this action required LIPA to purchase more capacity through the spot market auction than it should have been required to purchase. Second, LIPA alleges that NYISO's exclusion of the 271.9 MW from the supply curve for the Long Island spot market auction caused an incorrect calculation of the clearing prices for Long Island and for the rest of the state. Thus, according to LIPA, if NYISO had included the 271.9 MW

[15] *Id.* at 11-12

[16] *Id*. at 12.

[17] LIPA does not state how it derived this 148.8 MW figure, but NYISO in its answer states that, for the May 2006 period, LIPA was "long" 271.9 MW on locational capacity (*i.e.*, had 271.9 MW in excess of its Locational Requirement). However, since NYISO did not permit LIPA to use its excess Long Island capacity to meet its ROS requirement, NYISO considered LIPA to be deficient 301.3 MW in meeting its ROS Requirement. Subsequently, due to adjustments in the spot market auction made through NYISO's usual process of solving the spot market auction and combining the supply and demand curves, and thus determining each LSE's ultimate Minimum Capacity Obligation (as discussed above), LIPA's original ROS deficiency was reduced from 301.3 MW to 148.8 MW. *See* Affidavit of Matt Rodgers, Exhibit IV to NYISO Answer (Rodgers Affidavit) at 14-15.

[18] Complaint at 13.

in the supply curves, market clearing prices for all LSEs purchasing capacity in the May 2006 spot market auction would have decreased.[19]

12. LIPA states that it has raised these issues with NYISO, and has expressed its views that (a) NYISO improperly failed to account for 271.9 MW of Long Island capacity that LIPA sought to bid into the May 2006 spot market auction, in violation of section 5.14.1(a) of the Services Tariff, and (b) NYISO improperly considered LIPA not to have offered the 271.9 MW into the spot market auction at all.[20] LIPA views the 271.9 MW of Long Island capacity to be self-supply, and states that NYISO should also have viewed it as such.

13. LIPA states that it and NYISO have failed to reach agreement on this matter.[21] LIPA further states that, in light of NYISO's position, since May 2006, in each month, LIPA has been offering the amount of its Long Island capacity in excess of its Locational Requirement into the Long Island spot market, rather than using that excess to self-supply the remainder of its Minimum Capacity Requirement. LIPA considers NYISO's position on this question to be (a) inconsistent with the principle articulated in the Services Tariff that LSEs should be permitted to self-supply their capacity needs, and (b) contrary to good market design principles. LIPA states that NYISO's actions with regard to the May 2006 spot market auction violate section 5.14.1 of the Services Tariff. LIPA points to a May 17, 2006 e-mail from NYISO employee Matt Rodgers, stating that:

> [Long Island] capacity cannot be used to fulfill the non-[Long Island capacity] requirement except to the extent that it is (a) sold into the [Long Island] spot market auction, and (b) purchased by LIPA in its role as a [Long Island] LSE. This statement is true now and was also the case prior to the implementation of the [automated certification procedure.][22]

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[19] LIPA estimates that, as a result of what LIPA views as NYISO's error, all LSEs overpaid as much as $4/kW-month for Long Island capacity, and as much as $0.46/kW-month for capacity in the rest of the state. Complaint at 14.

[20] Complaint at 15.

[21] *Id.* at 16.

[22] Complaint at 22, citing to E-mail of Matt Rodgers, Exhibit J to Complaint (Rodgers E-mail).

Thus, according to LIPA, NYISO took the position (and continues to take the position) that, if any LSE has capacity in a constrained location in excess of its Locational Requirement, it may not use that capacity to meet the ROS component of its Minimum Capacity Requirement.

14. According to LIPA, this position is incorrect: LIPA takes the view that Long Island capacity can be certified and self-supplied toward LIPA's Minimum Capacity Requirement, without limitation, pursuant to section 5.14.1(a) of the Services Tariff. According to LIPA, this tariff provision requires NYISO to allow LSEs to offer all capacity into the auction, and to use all such capacity to meet its Minimum Capacity Requirement.[23]

15. LIPA additionally asserts that NYISO's position is inconsistent with the Capacity Market Order. LIPA cites to the Commission's statement in that order requiring NYISO to revise its tariff to provide that capacity procured by LSEs prior to the monthly spot market auction can be counted towards meeting those LSEs' capacity requirement,[24] and states that NYISO provided current section 5.14.1(a) precisely to address this problem, and NYISO is now violating that section. LIPA further argues that, as part of its planning process, LIPA has invested significant resources in attracting new capacity to Long Island, which provide reliability benefits to Long Island customers. Because of these investments, LIPA is frequently in the position of having more Long Island capacity than it needs to meet its Locational Requirement; yet, LIPA states, because of NYISO's interpretation of section 5.14.1(a), LIPA is prohibited from using this excess to self-supply the ROS component of its Minimum Capacity Requirement.

16. To redress this wrong, LIPA asks the Commission to restate the prices to all buyers and sellers of capacity in the May 2006 spot market auction to reflect the prices that would have resulted, if LIPA had been permitted to use its excess Long Island capacity to meet its Minimum Capacity Requirement.[25]

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[23] Complaint at 25-26.

[24] *Id.* at 26, *citing* Capacity Market Order at P 7 n. 7.

[25] Complaint at 31-32. LIPA further proposes that, since this restatement will result in the need to make "make-whole" payments to LSEs, NYISO should recover such "make-whole" payments through an uplift charge that will recover those amounts on a locational basis.

NYISO's Answer

17. In its answer, NYISO first states that prior to May 2006, LIPA was aware of NYISO's market rules, and of the fact that NYISO did not permit LSEs holding excess capacity in a constrained location to use that capacity to meet the ROS component of their Minimum Capacity Requirements. NYISO notes that, in 2004, it informed LIPA that LIPA might be artificially raising Long Island prices by offering excess Long Island capacity into the auction as ROS capacity, because such bidding tactics effectively withdrew Long Island capacity from the Long Island market, and after that discussion, LIPA voluntarily changed its offering behavior and consistently offered its excess Long Island capacity into the auction in the manner approved by NYISO until May 2006.[26] NYISO states that the automated version of its certification procedure does not differ in any meaningful way from the prior method of manually submitting spreadsheets,[27] and that the individual who bid LIPA's capacity into the May 2006 spot market auction attended training by NYISO representatives on how to use the automated system, during which the trainer specifically stated that locational capacity could not be offered as ROS capacity.[28] The trainer also passed out information sheets during the training confirming that LSEs should be offering capacity into the market in the same manner as had been done prior to the new automated procedures.[29] Thus, NYISO asserts, LIPA's representative simply made a mistake during the process of using the automated certification system for the first time, and now LIPA's filing of this complaint is "a self-serving attempt to avoid the financial consequences of its own error."[30]

18. NYISO disagrees with LIPA's interpretation of the Services Tariff. It states that LIPA is quoting selectively from the tariff, and ignores the procedures that state that NYISO must account for locational capacity separately from ROS capacity.[31] Rather, according to NYISO, LIPA now seeks to create a different market design, under which its

[26] Answer at 7, *citing* Affidavit of John Charlton, Exhibit I to Answer (Charlton Affidavit) at paragraph 3.

[27] Answer at 20.

[28] *Id*. at 8.

[29] *See* Attachment A to Affidavit of Michele Goyette, Exhibit II to Answer (Goyette Affidavit).

[30] Answer at 9.

[31] Answer at 10-12, citing Services Tariff at section 5.14.1(a).

excess Long Island capacity would be used to meet its ROS obligation, even though the Long Island capacity is needed to meet the system's total capacity requirements on Long Island. NYISO states that this interpretation by LIPA is inconsistent with the market design and rules, and would produce suboptimal results and distort market pricing signals.[32]

19. NYISO asserts that, pursuant to section 5.14.1(a) of the Services Tariff, it is required to distinguish capacity located in New York City or Long Island from capacity located in the rest of the state. It states that, as NYISO derives the capacity requirement for each LSE and the capacity price in each spot market auction, that derivation must reflect the fact that some capacity is within a constrained location, and other capacity is not. NYISO states that its rules must account for the fact that some LSEs have a Locational Requirement, and others do not, in order to ensure that, when LSEs located outside of New York City and Long Island become buyers in the spot market auction, they are not required to procure capacity in those constrained locations where it is generally more expensive than capacity elsewhere in New York State.

20. NYISO states that LIPA is ignoring the language in section 5.14.1(a) of the Services Tariff that provides that "[t]he [Independent System Operator, or ISO] shall also receive offers of Unforced Capacity from any LSE for any amount of Unforced Capacity that LSE has in excess of its NYCA Minimum Unforced Capacity Requirement or Locational Minimum Unforced Capacity Requirement, as applicable."[33] NYISO states that this provision requires NYISO to allow LSEs to submit all offers of capacity in excess of their Minimum Capacity Requirement, but (because LSEs must accurately state the location of their capacity) ensures that all capacity receives a market value commensurate with its location relative to transmission constraints, so that capacity within a constrained area will be valued more highly than capacity outside of a constrained area.

21. NYISO further notes that, since capacity within constrained localities has historically been more expensive than capacity in the rest of New York State, LIPA is not financially harmed by NYISO's interpretation of the Services Tariff. NYISO's representative Matt Rodgers states that "the NYISO rule does not prohibit LIPA from using its Long Island resources to meet its share of the [total NYISO Minimum Capacity Requirement], that is, to self-supply Capacity. It merely requires that LIPA offer its Long Island resources to meet its NYCA requirement in a way that ensures that those resources

[32] *Id*. at 10-11.

[33] *Id*. at 13.

are also counted in determining the adequacy of the Capacity resources on Long Island."[34] LIPA can self-supply its Locational Requirement with its own Long Island Capacity. And, with regard to any Long Island capacity owned by LIPA that is in excess of its Locational Requirement, even if it cannot use its excess capacity on Long Island to fulfill its ROS obligation, LIPA can, in essence, "sell" that Long Island capacity to NYISO (at the appropriate price for capacity on Long Island) and having NYISO reallocate that capacity to deficient Long Island LSEs. Thus, to the extent that LIPA is building additional capacity on Long Island, it will be able to benefit from that capacity. According to NYISO, if LIPA properly offers its excess locational capacity into the Long Island spot market auction rather than using that capacity to meet its ROS obligation, then it will be required to purchase ROS capacity; but, it will be able to sell its excess locational capacity at higher prices than the price it pays to NYISO for the ROS capacity that NYISO will reallocate to it.[35]

22. NYISO argues that the only reason that any LSE would wish to take the position that LIPA is taking here would be if it wished to exercise market power: according to NYISO's market advisor, Dr. David Patton, if Long Island capacity can be offered to the market as ROS capacity, that capacity is in effect withdrawn from the market, thus creating a shortage of Long Island capacity, and a seller with extensive Long Island capacity to sell (as is the case with LIPA) will thus be able to command a higher price for that capacity.[36]

23. In addition, NYISO argues that its current approach provides accurate price signals to the market, and thus promotes a core purpose of the NYISO capacity regime, namely, providing appropriate price incentives for the development of new capacity.

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[34] Rodgers Affidavit at page 11, paragraph 16.

[35] Under NYISO's interpretation of the Services Tariff, if LIPA had properly offered its excess locational capacity into the spot market auction, it would have received a price for that capacity that was higher than the price LIPA had to pay for its deficiency in its ROS requirement. For instance, assuming, for the purpose of argument, that at the conclusion of the May 2006 auction, Long Island capacity cleared at $2/MW and ROS capacity cleared at $1/MW, LIPA would have offered its excess Long Island capacity into the market, and received $2/MW for it. At the same time, LIPA would have had to purchase an equal amount of ROS capacity in the spot market auction, but it would only have had to pay $1/MW to make up its ROS deficiency.

[36] Affidavit of Dr. David Patton, Exhibit III to NYISO Answer (Patton Affidavit) at page 4, paragraph 12.

NYISO states that its rules are designed so that the spot market auction price accurately reflects the actual supply of locational capacity, while at the same time giving LSEs an incentive to offer excess locational capacity into the spot market by giving them the benefit of such higher locational prices. By contrast, according to NYISO, LIPA's approach would distort these price signals by enabling and encouraging LSEs to withhold capacity from the locational market by instead providing it to the market for ROS capacity, and in this fashion artificially inflating prices for locational capacity. Dr. Patton states that, if the Commission rules for LIPA in this complaint proceeding, based on his belief that the conduct LIPA seeks to sanction constitutes improper withholding, he will be obligated to recommend that NYISO implement market mitigation measures that would restore the current market outcomes.[37] NYISO further states that the remedy method sought by LIPA (restatement of the market) is not justified, and asks the Commission to deny LIPA's complaint.

<u>Protests and Comments</u>

24. The Commission noticed the filing of LIPA's complaint,[38] with answers, protests and comments due on December 7, 2006. The Commission subsequently extended that date to January 7, 2007. NYISO filed a timely answer, and motions to intervene and protest were filed by Calpine Corporation (Calpine), NRG Companies (NRG) and Independent Power Producers of New York (IPPNY). Additionally, the KeySpan Companies, Energy East Companies, New York State Public Service Commission, and the New York Transmission Owners filed motions to intervene, and the New York Municipal Power Agency, Mirant Parties, Astoria Generating Company, AES Eastern Energy, and Constellation Energy Commodities Group filed motions to intervene out of time.

25. IPPNY states that the Commission's policy is to exercise great restraint before resettling market outcomes, and that the instant situation does not justify such a radical remedy. Further, IPPNY argues that resettlement would damage the market by making market participants less certain that outcomes would be settled, and thus would encourage market participants to bid too high to hedge against the risk of resettlement. Calpine supports IPPNY's arguments.

26. NRG states that the tariff clearly required LIPA to offer its excess Long Island capacity into the Long Island spot market auction, and that LIPA either did not

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[37] Answer at 23-26, *citing* Patton Affidavit at page 6, paragraph 19.

[38] 71 Fed. Reg. 69106 (November 29, 2006).

understand or purposely decided not to follow the tariff requirements. Now, according to NRG, LIPA is seeking retroactively to change those requirements. NRG states that LIPA has not justified the harm that would occur to the market through such resettlement, and its proposed remedy would distort the efficient market outcome. NRG further argues (similarly to the arguments made by Dr. Patton, *supra*) that LIPA is seeking to manipulate the market, in that LIPA is willing to absorb an immediate loss in terms of the Long Island capacity that it wishes to have considered as ROS capacity, so as to realize longer-term benefits from the higher prices that would artificially be created for Long Island capacity overall.

LIPA's Response

27. LIPA filed a motion for leave to answer and an answer to NYISO's answer and the NRG and IPPNY protests. LIPA states that it is not seeking to withhold Long Island capacity – rather, it seeks only to ensure that all of the capacity that it purchased for the May 2006 period is recognized by NYISO. LIPA states that the question before the Commission is solely whether NYISO's exclusion of 271.9 MW of LIPA's certified capacity from the May 2006 spot market auction violated section 5.14.1(a) of the Services Tariff.

Discussion

Procedural Issues

28. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.214 (2006)), all timely filed motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to an answer unless otherwise ordered by the decisional authority. We are not persuaded to accept LIPA's answer and will, therefore, reject it.

Analysis

29. The Commission denies LIPA's complaint, and finds that LIPA has not met its burden of showing that NYISO violated a statute, regulation, or its own tariff. The Commission finds that NYISO's interpretation of section 5.14.1(a) of the Services Tariff is more reasonable than LIPA's interpretation. In fact, as discussed below, we find LIPA's interpretation may lead to unjust and unreasonable results.

30. Section 5.14.1(a) states (emphasis added):

> When the ISO conducts each [capacity spot market] it will account for all [capacity] that each . . . LSE has *certified* for use in the [New York Control Area] to meet their [Minimum Capacity Requirement or Locational Requirement], *as applicable*, whether purchased through Bilateral Transactions or in prior auctions.

This provision puts LSEs on notice that, since the NYISO must account for capacity as either locational capacity or ROS capacity, LSEs must certify whether the capacity that they are providing to the market is locational capacity or ROS capacity.[39] The "as applicable" phrase applies to those LSEs that are subject to locational requirements and requires such LSEs to specify their capacity as locational capacity or ROS capacity; it does not apply to LSEs that are in the rest of the state. Further, this provision requires positive action by LSEs, *i.e.*, certification; it does not provide a default mechanism by which NYISO can make an assumption as to how capacity should be accounted for if the LSE does not abide by the terms of the Services Tariff.

31. There is no evidence that any New York LSE other than LIPA has a contrary view. NYISO representative Rodgers stated, without contradiction, that the language of the tariff, as repeated in section 5.4 of NYISO's ICAP Manual, "indicates that offers for long Locational Capacity shall be received by the NYISO in the Spot Market Auction, thus ensuring that the price of Long Island Locational Capacity is determined taking into account all Long Island resources" and that "these requirements of the Tariff and ICAP Manual have long been widely understood by the Market Participants."[40]

32. Additionally, section 5.14.1(a) provides that

> The ISO shall also receive offers of [capacity] from any LSE for any amount of [capacity] that LSE has in excess of its [Minimum Capacity Requirement or Locational Requirement], as applicable.

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[39] The screen shot of the form showing LIPA's market position prior to the May 2006 spot market auction (Exhibit E to Complaint), which is generated through the automated certification procedure as part of LSEs' certification of their capacity, shows a Long Island or "LI" category and a Rest of State or "ROS" category (along with categories for New York City and other control areas outside of NYISO). As NYISO representative Rodgers points out in NYISO's answer, the acronym ROS is not equivalent to the acronym NYCA, which would denote the entire New York control area (Rodgers Affidavit at pages 10-11, paragraph 15).

[40] Rodgers Affidavit at page 11, paragraph 16.

As NYISO points out in its answer, it is required to accept all offers of capacity,[41] and it then reallocates that capacity to deficient LSEs as necessary. NYISO reallocates locational capacity specifically to LSEs that are deficient in their Locational Requirement, and reallocates ROS capacity to LSEs located in constrained areas that have met their Locational Requirement but not their Minimum Capacity Requirement or to deficient LSEs that have no locational requirement. NYISO will not, however, automatically reallocate any excess capacity that an LSE offers into the auction to whatever category of capacity that LSE may be deficient in. Absent clear notification by LSEs of the nature of the capacity that the LSEs are offering back into the system, NYISO cannot properly fulfill its task of reallocation.

33. Thus, the Commission finds that NYISO's actions with regard to LIPA's certification for the May 2006 spot market auction complied with the Services Tariff.

NYISO's Interpretation of the Tariff Is Consistent with the Purpose of its Capacity Market Rules

34. We further find that NYISO’s interpretation of section 5.14.1(a) is consistent with the purpose of its capacity market rules. Before NYISO implemented its current capacity market rules, NYISO's prior capacity pricing mechanism created a vertical demand curve for capacity prices: capacity required to meet the system's total capacity requirement received a price that reflected its value, but the price of any capacity above that amount would fall to zero. As discussed in the Capacity Market Order, NYISO considered that mechanism flawed because it:

> produce[s] volatile prices and does not signal investment beyond the minimum ICAP requirement. . . . NYISO explains that financing for new generating facilities in New York has become scarce because investors do not perceive a reasonably reliable stream of revenues destined for those facilities. As a result, the rate of capacity additions has not kept up with needs and there is the potential for a capacity deficiency.[42]

35. The Commission found that the sloped demand curve proposed by NYISO would "encourage greater investment in generation capacity and thus improve reliability, by reducing the volatility of ICAP revenues," and would "reduce the incentive for suppliers

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[41] Answer at 13.

[42] Capacity Market Order at P 3-4.

to withhold ICAP capacity from the market."[43] The Commission concluded that "NYISO's analyses adequately demonstrate 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 . . . will reduce incentives to withhold capacity."[44]

36. The Commission further noted, on rehearing, that NYISO's plan appropriately sought to set the value of capacity in constrained locations differently from the value of capacity in unconstrained locations. It stated:

> The Commission did not ignore in the [Capacity Market] Order the point that capacity needs of New York City requires a specific solution different from the remainder of New York State. The [capacity] Demand Curve does use [a capacity requirement] for New York City that is different from the rest of the state. The use of the resultant [capacity] prices in conjunction with New York City's locational [capacity] requirement provides specific New York City price signals.[45]

37. Thus, the Commission expressly approved the feature of NYISO's capacity market design under which NYISO seeks to value capacity in constrained areas more highly than capacity in unconstrained areas, so as to send appropriate price signals for the development of such higher-valued capacity. LIPA is, in essence, seeking the ability to obtain or develop capacity in a constrained area (therefore, valuable capacity), and then offer it into the market as if it were capacity in an unconstrained area (and therefore less valuable). Such actions, if permitted, would be inconsistent with the intent of the capacity market rules to ensure that prices reflect the true value of capacity in constrained areas and thus serve as an incentive for capacity providers to develop or maintain capacity in those areas. LIPA's interpretation of the tariff section in question, therefore, runs counter to that policy goal, whereas NYISO's interpretation supports it.

38. Further, the Commission finds that LIPA's interpretation of the Services Tariff could lead to withholding of capacity, which would be contrary to the intent of NYISO's capacity market design. Dr. Patton describes how this could happen:

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[43] *Id.* at P 13.

[44] *Id.* at P 35-36.

[45] Capacity Market Rehearing Order at P 25.

> If LIPA has the ability to use its excess Long Island Capacity to satisfy its [New York control area] obligation without offering it into the . . . Spot Market Auction, it would be withholding that Capacity from the distinct Long Island market, in a situation in which other Long Island LSEs may be deficient and there are not effective substitutes for the withheld Capacity. This withholding would have the effect of artificially raising prices for Capacity on Long Island, and could force additional investment in expensive locational Capacity on Long Island when such Capacity is not required.[46]

39. When any LSE has the potential to withhold capacity and thereby raise prices, that LSE has market power. LIPA's interpretation of the tariff could result in withholding or provide incentives for manipulating the market price, as discussed in Dr. Patton's affidavit. Such an interpretation thus could lead to unjust and unreasonable results. Accordingly, the Commission rejects LIPA's interpretation of the Services Tariff.[47]

The Commission orders**:**

LIPA's complaint is hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

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[46] Patton Affidavit at page 5, paragraph 14.

[47] To avoid future misunderstandings, we note that NYISO might wish to amend the language of the Services Tariff explicitly stating that when an LSE offers its excess capacity into the spot market auction each month, it must certify either that such capacity is in a constrained area and is therefore being offered into the spot market auction for that location, or that the capacity is not in a constrained area and is being offered into the spot market auction for use as ROS capacity.