KIRKLAND & ELLIS

Blog Post

Federal-State Capacity Market Tensions Shift into New York

28 February 2020

On February 20, 2020, FERC issued four orders addressing the scope of the buyer-side mitigation ("BSM") rules in the New York Independent System Operator, Inc.'s ("NYISO") capacity market, including the extent to which those rules apply to state-subsidized resources and certain resources that the NYISO has determined are needed to maintain reliability. FERC's orders are the latest in its effort to address what it has identified as a price-suppressive effect of the participation of state-subsidized resources, such as wind and solar, in certain FERC-jurisdictional capacity markets. The orders are generally consistent with FERC's recent order addressing that issue in the context of the capacity market administered by PJM Interconnection, L.L.C. ("PJM").[1]

Background: NYISO's Buyer-Side Mitigation Rules

NYISO's capacity market involves a series of auctions in which resources offer to be available to operate in a one-month or six-month future period. Suppliers whose offers are accepted are said to have "cleared" the auction, and receive a single clearing price set by the offer price of the most expensive resource that clears the auction. The capacity auction prices can vary by region because the state is divided into different pricing zones, which are based on constraints in the transmission system.

NYISO's BSM rules mitigate the potential exercise of market power by restricting the offer prices of certain suppliers to prevent them from offering their capacity at a level that would unfairly drive down the price received by other suppliers participating in the capacity auction. The BSM rules apply only to resources located in the Long Island, Lower Hudson Valley, and New York City localities (NYISO Zones G, H, I, J, and K); the rules do not apply to resources outside of these zones. Unless a resource qualifies for one of the exemptions set forth in NYISO's tariff, a mitigated resource must offer into a capacity auction at or above a particular floor price, and continue to do so until the resource's capacity clears 12 monthly auctions. The types and scope of the various exemptions to the BSM rules have changed over time and have been the subject of significant litigation at FERC over the past decade.

FERC's Recent NYISO Orders

Several recent FERC proceedings involving NYISO's BSM rules concern the extent to which the BSM rules should apply to (1) resources that receive state subsidies (e.g., wind and solar); and (2) resources that would have exited the market, based on their economics, but did not do so because they were needed to maintain reliability and thus were given out-of-market revenues to remain in operation (e.g., aging coal plants). In its February 20, 2020, orders, FERC ruled on both of those issues, acting in four pending proceedings concerning NYISO's BSM rules:

- *New York Independent System Operator, Inc.*, FERC Docket No. ER16-1404, in which FERC accepted certain elements of NYISO's proposed exemptions for self-supply resources and renewable resources but rejected other aspects, including NYISO's proposal to allow up to 1,000 MW of resources qualify for the renewables exemption. FERC directed NYISO to submit a compliance filing that, among other things, prohibits certain state instrumentalities from being eligible for the self-supply exemption and imposes a cap on the renewables exemption that is tailored to limit the exemption's impact on market prices. Notably, FERC concluded that the renewables exemption is not available to renewable resources that are paired with an electricity storage system.
- *New York State Public Service Commission, et al. v. New York Independent System Operator, Inc.*, FERC Docket No. EL16-92, in which FERC determined that certain new demand-side resources should be subject to the BSM rules. Although FERC found that the BSM rules should apply to all such resources, FERC determined that it is appropriate to calculate the offer floor differently for a subset of those resources. To address this issue, FERC set a briefing schedule for interested parties to file additional evidence.
- *New York State Public Service Commission and New York State Energy Research and Development Authority v. New York Independent System Operator, Inc.*, FERC Docket No. EL19-86, in which FERC declined to provide a blanket exemption from the BSM rules for electricity storage systems, but noted that such resources could seek to use other BSM exemptions (e.g., the self-supply and competitive entry exemptions).
- *Independent Power Producers of New York, Inc. v. New York Independent System Operator, Inc.*, FERC Docket No. EL13-62, in which FERC declined to expand the BSM rules to apply an offer floor to resources that would exit the market but that are

needed for reliability reasons and, therefore, receive out-of-market revenues in exchange for their continued operation. FERC found that it is appropriate for such resources to take that out-of-market revenue into account in determining their going-forward costs, and to submit low offers as a result, because those resources would clear the capacity market if the market properly reflected local reliability needs.

Takeaways

The general policy outcome of these FERC orders, viewed together, is that NYISO's BSM rules will (1) maintain the status quo with regard to resources that receive out-of-market revenue for reliability reasons, and (2) narrow the exemptions available to resources that receive state subsidies. However, the precise outcome of these proceedings, and their impact on the NYISO markets, is uncertain for three reasons. First, as noted, several important details of the resulting market design changes are unknown because FERC directed additional process in some of the proceedings. Second, although FERC's orders narrow certain aspects of the BSM exemptions, FERC left other, existing BSM exemptions available to renewable, demand response, and storage resources. Third, FERC's orders likely will be the subject of further litigation, including possible judicial appeals. That continued litigation risk was highlighted by the disagreement among the Commissioners as to the appropriate outcomes of these proceedings: Commissioner Glick issued separate statements in all four proceedings, three dissents and one concurrence, expressing his fundamental, philosophical disagreement with the majority over the proper use of buyer-side mitigation.

Many details remain to be determined, but it is clear that FERC's February 20, 2020, orders reflect a significant policy change in FERC's stance toward NYISO's BSM rules and that new policy is largely consistent with what was seen in FERC's recent order addressing BSM issues in the PJM region. However, the specific market rule changes that FERC directed in PJM and NYISO differ from each other in important ways.[2] For example, PJM's MOPR rules (which are analogous to NYISO's BSM rules) are market-wide, while NYISO's BSM rules remain limited in application to certain congested zones; in another example, FERC's NYISO BSM orders contain more specificity about treatment of battery storage and demand-side resources than was seen in the recent PJM BSM order. These differences indicate that FERC may be willing to provide some level of accommodation for region-specific or state-specific priorities. In addition, and as noted in a previous blog entry, states are actively considering their own regulatory responses to FERC's policy shift including, in the case of New York, considering an alternative mechanism for load-serving entities in New York to procure capacity, bypassing the NYISO capacity market.

In summary, although FERC's actions indicate that a change in policy direction is taking shape at the federal level, the regulatory framework for generation resources and demand-side resources remains in flux. As they develop, these FERC and state actions will set the revenue recovery rules for new and existing energy infrastructure, and thus have significant implications for infrastructure investment opportunities in PJM and NYISO.

---

1. For more information, see February 14, 2020, Kirkland blog post "MOPR Migration: Implications of FERC's PJM Capacity Market Order in the New York and New England Electricity Markets" and December 20, 2019, *Kirkland Alert* "FERC Orders PJM Capacity-Market Reforms, Addresses Uncertainty, Allows Auctions to Resume."↩

2. *See* December 20, 2019 *Kirkland Alert* "FERC Orders PJM Capacity-Market Reforms, Addresses Uncertainty, Allows Auctions to Resume."↩

Read more insights on Kirkland's Energy & Infrastructure blog.

Authors

Brooksany Barrowes

Partner / Washington, D.C.

Robert S. Fleishman

Partner / Washington, D.C.

Nicholas Gladd

Of Counsel / Washington, D.C.

Related Services

Practices

- Transactional
- Energy & Infrastructure