



**Jackson D. Morris**  
*Director of Strategic Engagement*  
Pace Energy and Climate Center  
744 Broadway  
Albany, NY 12207

[jmorris@law.pace.edu](mailto:jmorris@law.pace.edu)  
(m) 914.539.1985  
(f) 914.422.4180

## MEMORANDUM

March 2, 2012

TO: Steve Whitley, James Gallagher, Rana Mukerji, Ric Gonzalez

FROM: Jackson Morris, on behalf of the five voting Environmental Parties

RE: NYISO Capacity Markets Study—Treatment of Energy Efficiency

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Pace is pleased to see the NYISO following through on its commitment to market participants to conduct a review of New York's capacity market. As the scope of work is completed and rolled out for bids from consultants, we would like to echo a point raised by a number of parties regarding process—we urge the NYISO to present the scope of work to stakeholders for feedback in advance of its release, and to provide opportunities for periodic review and feedback while the study is underway. Direct interaction between market participants and the consultant will ensure the final product is as useful as possible to inform any changes being considered.

### **Energy Efficiency as a Capacity Resource**

In addition to the above process suggestion, one substantive issue that must receive full consideration and study by the consultant is how the NYISO can move to correct a significant market failure in the status quo—the fact that energy efficiency (EE) does not currently receive compensation for the capacity value it provides to the grid.

In contrast, for years both ISO-NE and PJM have permitted EE to bid into their capacity markets. In both cases FERC approved of the addition of EE, and in so doing reinforced their position that EE resources should be treated comparably to generation and transmission; including full compensation for the capacity (and other) values these resources provide to the system.<sup>1,2</sup>

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<sup>1</sup> "As the Commission indicated in our June 25, 2007 Order, currently, PJM does not treat investment in energy efficiency as a type of capacity resource eligible to participate in the capacity market. The Commission further found that "to the extent possible, energy efficiency solutions should be able to compete on an equal footing with demand response, generation, and transmission solutions." We commend PJM for developing a proposal to incorporate energy efficiency into its capacity markets. We believe that energy efficiency is a critical part of efficient energy markets, and should be treated comparably to other types of resources, by being allowed to participate in base residual auctions and be paid the auction clearing price when they are accepted in the auction." FERC Order Accepting Tariff Provisions in Part, Rejecting Tariff Provisions in Part, Accepting Report, and Requiring Compliance Filings, Docket Nos. ER05-1410-000, EL05-148-000, ERO5-1410-010, EL05-148-010, ER05-1410-011, EL05-148-011, March 26, 2009, at ¶130.

The timing of the New York study is ideal, as the consultant can access multiple years of auction results and EE installation performance data from neighboring RTOs, assess the impact of EE in those markets to date, identify strengths and weaknesses in each approach, and thereby inform best practices for the NYISO to pursue regarding the inclusion of EE.

As it stands, NYISO rules discriminate against EE by excluding it from bidding into the capacity market, despite the many benefits it provides to the system, including but not limited to:

- **Consumer benefits:** As a least cost and least risk resource, energy efficiency can put direct downward pressure on capacity prices.
- **Environmental benefits:** As a zero emissions resource that need not purchase emissions allowances or incur other emissions control costs, increased penetration of EE that would result if it were fairly compensated would improve air quality and reduce the compliance costs of the state's supply mix—costs that are ultimately borne by load.
- **Reliability benefits:** Along with demand response, EE projects—particularly when installed in targeted load pockets—can improve reliability by reducing congestion and strain on transmission and distribution infrastructure.

The inclusion of EE in NYISO's capacity markets should be one of the top items addressed in the study, and we look forward to providing more specific feedback on the topic as the study proceeds.

### **Multi-Year Forward Capacity Markets**

The study should also fully explore the costs and benefits of adopting a Forward Capacity Market (FCM) construct in some form. Again, both ISO-NE and PJM include some version of an FCM. In particular, the consultant should explore how an FCM may add value by identifying units needed for reliability sooner, and send clearer market signals (with longer lead times) to drive economic entry and the orderly retirement of older, inefficient and heavily polluting units.

Recent discussions amongst market participants have exposed some potential shortcomings in the existing New York procedures for retirement notification and the reliability threat such announcements may trigger. Troubling proposals for reliability must run constructs have been floated in working groups. While an FCM in and of itself is not the complete remedy for these concerns, it may be a valuable tool in the NYISO's quest to maintain reliability in a fair, efficient manner. Unlike other RTOs, to date the NYISO has not been forced to resort to inefficient and costly out of market payments to maintain reliability—but if this track record it to me maintained some changes to the capacity markets may be needed.

And finally, while we support the full consideration of FCMs as part of this study, the adoption of an FCM need not be a prerequisite to allowing EE to participate in the NYISO capacity markets. While the two issues are related, if the consultant and market participants ultimately conclude it is not in the best interest of the NYISO to pursue some form of an FCM, there are certainly options that could allow EE to receive multiple years of capacity payments within the current one year structure (such as permitting EE to bid into the market for the life of the efficiency measures, subject to rigorous monitoring and verification protocols).

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<sup>2</sup> *Id.*, at ¶ 137. "We believe that EE providers should have the ability to obtain the full economic benefits of their investments."