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Via Electronic Mail to deckels@nyiso.com

To: New York Independent System Operator, Inc. (NYISO)

From: Matthew Schwall

Date: 9/23/16

Re: IPPNY Comments on NYISO Elimination of Capacity Zone Proposal

Independent Power Producers of New York, Inc. (IPPNY) hereby responds to the NYISO's request for Market Participants to identify concerns with, or alternatives to, its concept for eliminating capacity zones, which was rejected by stakeholders at the December 9, 2015 Business Issues Committee meeting as unworkable. Initially, IPPNY wishes to emphasize that it is critical for the NYISO to consider the proposed major capacity market design rules pending before it in a coordinated manner to ensure that the capacity market provides just and adequate compensation to maintain long term reliability.[1]

The New York Public Service Commission (NYPSC) and the New York Transmission Owners (NYTOs) first raised the concept of eliminating capacity zones in their protests of the NYISO's filings with the Federal Energy Regulatory Commission (FERC) to establish rules for the creation of new capacity zones and to create a new capacity zone that would encompass NYISO Load Zones G, H, I, and J (the "G-J Locality").[2] The NYTOs and the NYPSC protested NYISO's omission of rules governing elimination of capacity zones, arguing that price separation will continue between the G-J Locality and the Rest-of-State (ROS) region even after the deliverability constraints have been eliminated, which they claimed would cause consumers to pay too much for capacity and send the wrong incentives to generation and transmission developers.[3] In its August 13, 2013 Order, FERC agreed that price separation may well continue

[1] The NYISO has issued a schedule to address the Demand Curve Reset Process, alternatives to its currently effective LCR process, export capacity and this issue. Per the NYISO's schedule, the LCR effort will be addressed at a series of six meetings in the next three months beginning next week.

[2] *New York Indep. Sys. Operator, Inc.*, 144 FERC ¶ 61,126, at PP 69-73 (2013) (August 13, 2013 Order).

[3] *Id.*

after the constraint leading to a new capacity zone disappears, but it found such a potential differentiation between prices legitimate.[4] FERC stated:

> As indicated by Dr. Patton, once a new capacity zone is created, price will be based upon the ICAP demand curve for the new zone, which, in turn, is based upon the Locational Capacity Requirement [(LCR)]. In other words, price separation reflects the cost of satisfying the [LCR] for the new capacity zone and is based upon reliability needs as indicated by [the Loss of Load Expectation (LOLE)]. The deliverability test, in contrast, is not designed to provide an accurate indication of the reliability needs in the new capacity zone in that it is not formulated using the LOLE. As Dr. Patton explains, as long as the cost of entry is higher in the new capacity zone than in the surrounding area, eliminating the new capacity zone and its associated higher demand curve when the deliverability constraint is temporarily eliminated, jeopardizes the market's ability to attract and maintain adequate resources for market reliability in the new capacity zone.[5]

While FERC noted that the NYISO could elect to work with its stakeholders to determine if zone elimination rules were deemed necessary, it expressly found that the impacts of failing to implement needed new zones were far more significant, and thus, there was no basis to further delay the creation of new zones.[6] In its order rejecting the NYPSC's, NYTOs' and the New York Power Authority's requests for rehearing on this matter, FERC stated that:

> NYISO is free to discuss with its stakeholders a mechanism to eliminate an unneeded capacity zone . . . [but] any new rules for discontinuing a capacity zone must apply to all capacity zones and not just the recently-approved new G-J Locality and, therefore, should be the subject of a separate proceeding that develops a record for establishing tariff criteria and procedures for eliminating any capacity zone, including any future new capacity zone and not just the new G-J Locality at issue here.[7]

Thus, to be clear, FERC did not order the NYISO to develop rules to eliminate capacity zones. Indeed, the adoption of such rules could lead to frequent zone creation and elimination, which will ultimately harm the ongoing development of competitive markets. The purpose of the capacity market is to provide a stable and predictable price signal not merely to incent new entry but also to send appropriate price signals to retain required existing generation to meet reliability needs. Otherwise, generation may prematurely leave NYISO's markets through retirements or by selling to other markets,

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[4] *Id.* at P 83.

[5] *Id.*.

[6] *Id.* at P 82.

[7] *New York Indep. Sys. Operator, Inc*., 147 FERC ¶ 61,152, at P 45 (2014) (May 27, 2014 Order).

thereby reducing the amount of capacity available to the NYISO to meet New York's reliability needs.

All of the capacity zones (Localities) that have been created in the NYISO are load pockets because the load within the Locality exceeds the capacity import capability into the Locality. This means that reliability can be maintained only if there is adequate capacity within the Locality. Capacity cannot be shifted from the G-I Locality to the ROS region (even if keeping New York City (NYC) and Long Island (LI) capacity at its minimum levels) without inducing a resource adequacy violation. The same is equally true of the NYC and LI Zones. Failure to maintain a price signal based on the need to keep capacity in the Locality creates the risk that capacity within the Locality would retire and create reliability needs. This would require either recreating the Locality or pursuing a Reliability Must Run (RMR) agreement or uneconomic entrant to maintain reliability. FERC has emphasized the need to avoid RMRs and uneconomic entrants, and the NYISO should not create rules that increase the risk of RMRs. Once a Locality has been created, it should be maintained as long as the Locality remains a load pocket.

The current and previous Demand Curve Reset (DCR) processes have shown that the net cost of new entry (Net CONE) for the G-I proxy unit is higher than for the ROS proxy unit. This has also been the case for all DCRs for the NYC and LI proxy unit. If transmission were added to eliminate the deliverability issue into a Locality, it would also reduce net energy and ancillary service revenues for the units in the Locality and cause the Net CONE to increase. This means that the NYISO cannot reasonably expect the Locality to attract and maintain capacity without having its own price signal. The increased Net CONE for the Locality would only cease to be a concern once the Locality ceases to be a load pocket. The NYISO should not eliminate a market mechanism that reinforces proper location of capacity.

The NYISO's external market monitor, Dr. David Patton, concurs that rules to eliminate capacity zones could put the NYISO in the position of having to define, un-define, and then re-define new capacity zones as system conditions change.[8] Equally important, in addition to adversely affecting reliability, the NYISO Consumer Liaison's analyses demonstrate that eliminating a zone prematurely will foist hundreds of millions of dollars in unnecessary costs on New York consumers. In contrast, maintaining an unneeded zone has very limited cost impacts. FERC reached a similar conclusion.[9]

Investments in new infrastructure require stable markets and price signals and are therefore threatened by rapid market changes. The creation of the G-J Locality has been a powerful signal on the need for capacity in that location and merchant generators have responded by returning capacity to the market and adding additional capacity. If the NYISO creates a rule that would allow a capacity zone to be eliminated when the costs in the Locality remain higher, merchant generators will be forced to bear additional risk associated with responding to a Locality need. The NYISO's proposed reference price

[8] August 13, 2013 Order at P 76.

[9] *See* August 13, 2013 Order at P 82.

points for the Localities in the current DCR process do not include this additional risk. If the NYISO were to move forward with zone elimination rules, the cost of capital and consequently the gross CONE for the proxy peaking plants in the Localities must correspondingly be increased to account for the additional risk.

Some parties opposed to the creation of new zones have asserted zone elimination rules are necessary because prices might continue to separate after a deliverability problem into the Locality has been eliminated. As noted above, FERC properly determined price separation is justified when cost differentials between the areas persist. Indeed, in addition to the basis cited by FERC, price separation is justified because: 1) the Locality may have less excess than the region outside the Locality; and, 2) the capacity market includes resources such as short term capacity imports and Special Case Resources that are not represented in the deliverability test.

For the above reasons, a test of whether to eliminate a Locality cannot be based upon eliminating a deliverability need, even with a predefined level of headroom, as the NYISO has proposed. Thus, if the NYISO decides that any zone elimination rules are warranted, whether a Locality should be eliminated should be driven by whether the load pocket that the Locality represents ceased to exist. While price separation may well be eliminated long before that point is reached, it remains important to maintain the Locality to immediately provide the proper price signals to address when load grows or when a unit retires in the Locality.

If the NYISO continues to pursue rules for the elimination of capacity zones, such rules would have to apply to all zones, not merely to those zones created using the NYISO's New Capacity Zone Study methodology, in compliance with FERC's May 27 Order. Moreover, as demonstrated above, eliminating capacity zones when a deliverability constraint is no longer binding overlooks the need to provide accurate, predictable, and stable price signals to ensure adequate new and existing resources in Localities. This risk would need to be represented in the market and thus would raise the Net CONE for the Locality. The costs of bringing such resources back into a Locality after a zone was eliminated outweigh the limited impacts of having the zone in place too long as reflected by the Consumer Liaison's analyses. IPPNY recommends that a better way to ameliorate the issue of Localities, if not eliminate it entirely, is for the NYISO to address the inadequacy of its current LCR setting process.