

NYISO Management Response to Analysis Group Report: “New York Capacity Market – Evaluation of Options” (May 2015)

Introduction

In September 2014, in response to stakeholder requests that the NYISO evaluate the relative benefits and costs of administering a three year forward Capacity market, the Analysis Group was engaged to provide assistance to the NYISO through both qualitative and quantitative analysis of the potential costs and benefits of the NYISO transitioning from its monthly ICAP Spot Market Auction construct to a forward capacity market structure. Specifically, the Analysis Group was asked to conduct a quantitative analysis to (1) specifically model quantifiable consumer and supplier impacts associated with a potential forward market; (2) measure quantifiable consumer and supplier impacts associated with a forward market that features a seven-year price lock-in feature for new entry; (3) identify, qualify and quantify (where possible) additional benefits and costs associated with a forward market design such as reliability benefits, system efficiency improvements, likely resource additions, attrition, and improvements; and (4) provide a qualitative assessment of the relative positives and negatives (*i.e.*, “pros and cons”) of changes to the current capacity market construct. The Analysis Group worked closely with NYISO Staff and the independent Market Monitoring Unit for the NYISO, Potomac Economics Ltd., in conducting its analysis and completing its assessment. Analysis Group presents its analysis and conclusions in its May 2015 report: *New York Capacity Market – Evaluation of Options*.¹

Analysis Group’s Findings

“Overall, based on the modeling of potential market outcomes and our evaluation of many tradeoffs between market structures, we conclude that the move to a forward capacity market structure in New York is not warranted.”²

Analysis Group bases its findings on several key factors, including: (1) the NYISO currently has an existing, functioning, stable capacity market in place that is paired with a well-designed and functioning energy market and supported by a comprehensive planning process to identify reliability and resource adequacy needs; (2) the results of modeling differences between forward and spot capacity market structures on clearing prices, quantities, and costs to load/payments to suppliers do not suggest potential benefits to warrant a switch in market structure at this time, and; (3) a transition to a forward market would involve significant costs and resources over several years and introduce considerable uncertainty in the market that will negatively impact short term investment decisions and disrupt the financial markets that have developed around the NYISO’s spot market structure. Differences identified by Analysis Group between a forward and spot market were driven less by the fundamental differences

¹ Analysis Group, *New York Capacity Market – Evaluation of Options* (May 2015), available at: http://www.nyiso.com/public/webdocs/markets_operations/committees/bic_icapwg/meeting_materials/2015-02-25/AG%20Capacity%20Market%20PDF.PDF (the “Analysis Group Report”).

² Analysis Group Report at ES-2.

between market structures, and more by the specific design choices and administration of a forward market structure – namely, (a) whether or not an optional price lock-in for new resources is allowed in the forward capacity market structure; (b) whether advanced notice of retirement is a feature of the forward market structure but not the spot market structure; and (c) whether and to what extent a forward market structure leads to an over-forecasting of supply needs on a systematic basis. These drivers of modeling results are separate from the narrower question of whether to administer a forward or spot market structure, as it might be possible to obtain the potential benefits (or avoid the potential costs) of these features through some other less expensive mechanisms that can be more readily implemented. Analysis Group concludes that “[g]iven these circumstances, the decision to move forward must be based on strong and convincing evidence of long-term benefits, and we are not convinced that evidence is present.”³

Market Monitoring Unit (“MMU”) Comments

The MMU provided comments on the Analysis Group Report.⁴ The MMU found the report provided a particularly detailed evaluation of the effects of incorporating a seven-year lock-in as a component of the capacity market, and attributed a high level of cost savings to the lock-in feature. The MMU found that the Analysis Group’s cost to load benefits associated with the optional price lock-in feature were substantially overstated, and in fact that the lock-in provision would significantly increase overall costs to loads. Accordingly, the MMU agreed with Analysis Group’s recommendation to not transition to a forward capacity market.

NYISO Management Response

The findings in the Analysis Group Report, along with the MMU comments, suggest the potential benefits of instituting a forward market into the NYISO’s administered capacity market are uncertain, and include significant potential risks of increased costs. Further the Analysis Group Report indicates significant increased uncertainty and costs with any transition from the current spot market design to a forward market structure. The NYISO has reviewed the Analysis Group’s assessment, as well as comments provided by the MMU and stakeholders, and concurs with the report’s findings that a transition to a forward capacity market structure is not warranted at this time.

The NYISO continues to believe that the existing robust and stable spot market design is the correct foundation upon which to procure system capacity needs. The near-term focus enables more certainty in the accuracy of load forecasts, providing greater assurance that the prices established are truly reflective of current market needs. Near term markets react quickly to dynamic market conditions and

³ Analysis Group Report at p. ES-9.

⁴ Potomac Economics Ltd., Comments on Analysis Group Report on the NYISO Capacity Market (March 17, 2015), available at: http://www.nyiso.com/public/webdocs/markets_operations/committees/bic_icapwg/meeting_materials/2015-02-25/MMU%20Comments%20on%20AG%20Report__3172015.pdf.

allow the markets to respond quickly to emerging system needs. The NYISO's market rules also provide visibility into longer-term capacity needs through the Comprehensive Reliability Planning Process (CRPP). This long-range reliability planning assessment complements the near-term capacity market by providing Market Participants and potential developers with visibility into future capacity needs that can be used to guide investment decisions.

While the NYISO concurs with the Analysis Group Report's findings, it remains committed to enhancing its existing market construct to provide some of the benefits stakeholders were seeking from a forward capacity market, including improved long-term transparency, by evaluating the desirability and feasibility of extending the Demand Curve reset period, enhancing the forecast methodology utilized in the Demand Curve Reset to project energy and ancillary services revenues, increasing transparency of retirements by lengthening the retirement notice period, and enhancing its long-term planning process to help it identify and develop solutions to potential generator retirements.

The NYISO wishes to thank the Analysis Group for their comprehensive review and the depth of their quantitative and qualitative analysis in evaluating the potential benefits and costs of transitioning the NYISO's capacity market design from a spot market to a forward market.