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## MEMORANDUM

December 20, 2012

TO: Steve Whitley, Jim Gallagher, Henry Chao, Rana Mukerji, Ric Gonzalez, Leigh Bullock

FROM: Jackson Morris, on behalf of Pace, Association for Energy Affordability, NRDC, Environmental Advocates of New York, American Lung Association in New York, and Riverkeeper, Inc.

**RE: FTL Capacity Market Study—  
Lack of Sufficient Analysis of Energy Efficiency in Capacity Markets**

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Pace was pleased to see the NYISO follow through on its commitment to market participants to solicit an independent expert review of New York's capacity market. Unfortunately, the draft that has been posted for comment does not provide sufficient discussion of some key aspects explicitly included in the Scope of Work and Deliverables—specifically any robust analyses or meaningful discussion of energy efficiency (EE) in the capacity markets. Indeed, this item receives all of two pages of treatment, beginning on page 218 of the report<sup>1</sup>, and lacks any empirical analyses of how that resource has performed in neighboring RTOs, or potential impacts if it were eligible to participate in the existing NYISO one-year market.

This is disappointing; not because the FTL study ultimately recommends that the NYISO not pursue including EE in its capacity market, but because this conclusion was reached in the document with virtually no substance with which to support it.

For these reasons, we formally request that the NYISO direct FTL to revisit this issue, and to include the necessary robust analyses and discussion necessary in the next draft in order to better inform the discussion amongst market participants and NYISO staff. Failing to do so would equate to not meeting the requirements included in the Scope, and would deny stakeholders and ultimately ratepayers the return on what represents an investment of \$250,000 of their dollars.

### **FTL Failed to Fulfill the Scope of Work**

Taking into account the many comments from market participants, the NYISO developed a scope of work that would ensure the study analyzed and provided feedback on elements that were important to

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<sup>1</sup> This includes a footnote on page 220 that is not even completed, adding to the concern that the authors did not devote much effort to this issue.

stakeholders.<sup>2</sup> Yet in the case of EE in the capacity markets, FTL simply failed to complete the sufficient analyses to meet the Scope.

From the Scope of Work:

**5. Alternative Market Designs:** Evaluate the interrelationships among alternate capacity market constructs within the framework of NYISO's overall market structure, and whether they provide efficient price signals to various types of capacity resources, including those with longer and shorter lead times for construction, and varying fuel sources and technologies. For the PJM and ISO-NE capacity markets identify strengths and weaknesses to understand if there are features of those markets that might enhance the NYISO's capacity market design. **The consultant shall also consider the appropriateness of including energy efficiency in any capacity market construct.** The consultant is not limited to evaluating the PJM and ISO-NE market designs and may consider alternate market design approaches that likely may be viable. The consultant should also evaluate the slopes and shapes of the Demand Curves in the NYISO, PJM and ISO-NE markets, and evaluate alternatives to those used by the NYISO. The assessment of alternative market designs shall consider design elements, both price and non-price, that may minimize the need for out-of-market actions

**6. Review of Alternatives and Recommendations:** Based on the analyses and empirical evidence gathered in Objectives 1 through 5, the consultant shall assess the performance of the current capacity market construct in meeting the NYISO's reliability and market obligations in comparison to the alternate viable market design constructs the consultant identifies in accomplishing Objective 5. .<sup>3</sup>

In contrast to the above language, in the posted draft of the study FTL merely opines on why they do not recommend the NYISO allow EE to participate in its capacity market. There is no "empirical evidence", no data from PJM or ISO-NE (such as the MW of EE that have been clearing in both of those markets over time and the impact that has had on prices, etc.), and no discussion of "whether they provide efficient price signals to various types of capacity resources, including those with longer and shorter lead times for construction, and varying fuel sources and technologies."<sup>4</sup>

## Conclusion

Pace welcomes a robust and healthy debate around the pros and cons of including EE in the NYISO capacity markets, whether under the existing one-year construct or a potential multi-year Forward Capacity Market. But such a discussion is not possible in response to the FTL study because it lacks any in depth or meaningful analyses of the issue. For the aforementioned reasons, we respectfully request that the NYISO direct FTL to fulfill its Scope of Work by delivering a final draft that includes the necessary analyses of this issue.

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<sup>2</sup> Attachment A of this document includes the March 2, 2012 Pace comments on the Draft Scope.

<sup>3</sup> Capacity Market Study Scope of Work and Deliverables:

[http://www.nyiso.com/public/webdocs/markets\\_operations/committees/bic\\_icapwg/meeting\\_materials/2012-04-16/Capacity\\_Study\\_ICAPWG.pdf](http://www.nyiso.com/public/webdocs/markets_operations/committees/bic_icapwg/meeting_materials/2012-04-16/Capacity_Study_ICAPWG.pdf)

<sup>4</sup> *Id.*

## Attachment A

### 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>5,6</sup>

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

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<sup>5</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, ERO05-1410-010, EL05-148-010, ER05-1410-011, EL05-148-011, March 26, 2009, at ¶130.

<sup>6</sup> *Id.*, at ¶ 137. "We believe that EE providers should have the ability to obtain the full economic benefits of their investments."

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).