

Comments on the NYISO Proposal for a Balanced Sanctions Program

By: Keith O'Neal, The E Cubed Company LLC on behalf of NRG

General Comments

1. *Unbalanced:* The proposal, while purporting to be balanced, is not. Assuming that penalties in (d) of the document apply to all parties equally, then it is the only one that applies to loads while (a) and (c) apply to suppliers and TOs and (b) to just suppliers. These are extra and new penalties on top of AMP and market mitigation penalties. While loads will be subject to market mitigation, they are not subject to AMP. Generators in the NY markets, it would seem, have a small red laser target pasted to the back of their heads.
2. *Sticks, not Carrots:* There has been, within the NYISO as manifested by this proposal, if not a sea change, then a major policy shift from development and implementation of incentives to ensure good behavior to development and implementation of penalties. This major policy shift was not the result of the direction of the NYISO committees. It was not even discussed at the committee level. This is the kind of policy making that should require market participant deliberation within the committee structure. There are means to deliver and ensure the desired kind of market participant behavior through incentives rather than penalties. An example with respect to operating reserves is provided under recommendations below.
3. *Hostile NY Energy Markets:* NY already has the reputation as the most hostile energy market to participate in. It is unknown how such an environment has already limited entry and restricted the product offers that have been bid into the NY markets even from existing NY resources that only bid into the NY markets. For this summer, the regulators and the NYISO have driven hard to implement AMP. And now, the same resolve and mindset seems to be driving toward implementation of broad and sweeping penalties for failure to perform. Interesting that no one pushed for AMP or such sweeping penalties prior to the utility sale of New York State generators. Instead of an incentives approach that could have been developed more than a year ago, the market participants are being forced into a rushed review of a quickly conceived penalties program largely driven by fear of California.
4. *Unintended Consequences Such as Reduced Reliability:* The problem with a rushed penalties program will be the unintended consequences. Some of them we suspect; reluctance to enter the market, restricted product offerings in the areas with penalties, higher ICAP prices based on a more hostile energy environment replete with new and major forms of risk. What we also know is that penalties

may ensure performance, though that is far from certain, but offsetting this will be reduced product offered into the operating reserve market. The reliability benefit could be more than offset by the energy not available for operating reserve. The net effect is likely to be less reliability (did the NYISO reliability folks and operating experts review this proposal?)

5. *ISO, the Regulator, NOT ISO the Facilitator:* For all of those who had a hand in the design of an Independent System Operator, or who were around when ISOs were being first designed, it is safe to say that most designers who assigned a market role to the ISO would have described that role as market facilitator. There already was a regulator, FERC, and for that matter, two regulators including the PSC. On its own motion, the implementation of penalties, and to a certain extent of AMP, led as it was by the NYISO, confirms the evolution of the NYISO from market facilitator to market regulator. It is not FERC that market participants fear when considering operation in the NY markets, nor is it the PSC who has limited authority. It has become the ISO itself. In fact, to many market participants, the regulator, in this case FERC, has become an ally, and the only one to turn to when the NYISO allows fear to dictate policy (fear, one supposes, of California). This is an unintended consequence.
6. *Penalty Uncertainty:* There is nothing in the document that describes the certainty of guilt that must be established before a penalty is applied. Before a penalty is executed, the NYISO must be certain that a quantifiable infraction has occurred.
7. *Emergencies:* The document does not define emergency operations.
8. *Operating Reserves:* The document does not define operating reserves.
9. *All Operating Reserve MWs are Not Equal:* Judge the value of an operating reserve MW that will be penalized if it does not materialize at the time directed by the ISO and a MW of reserve that will not be penalized. It seems that the MW with the penalty is more likely to respond, and if it is not more likely to respond then there is no value to the penalty. In this case the application of a penalty to operating reserve units will be unevenly applied since some providers will be subject to the penalty and others not. This is so because DAM operating reserve providers may be economically dispatched to levels where they cannot provide operating reserve in-day. The ISO does this only when other, non-contracted for or latent, reserves exist as it sometimes randomly does. Since latent reserve exists frequently on a daily basis, the ISO often “counts” latent reserve instead of DAM reserve allowing SCD to economically load units without regard to reserve status (until such time as reserve falls short of requirements). Therefore, the application of penalties is uneven in the sense that some units, on very nearly a daily basis, will have a penalty applied to them (DAM reserve providers) and others will not (those with latent reserve). From the ISO’s perspective (and the public’s) it is not getting the reliability that it should since a good portion of the operating reserves

that are being counted on are not subject to penalties. The ISO, in correspondence with the NYSRC, has stated that latent reserve MWs are equal in value to DAM MWs that are subject to penalties. If that is true then there is no value to applying penalties and these new penalties should not be implemented. If it is not true then latent reserve should be purchased and subjected to penalties. Right now it is not even being purchased, but rather, just counted on if it is there, without notification of being counted on by the ISO.

Recommendations

1. Include criteria for establishing the certainty that infractions have occurred and ensure that such criteria have been met beyond doubt before applying a penalty.
2. The definition of emergency operation should be operation in the major emergency state or operation that will imminently lead to operation in the major emergency state.
3. Operating reserves that could have penalty applications are ten minute spinning and non-spinning reserves, and therefore these are the reserve categories that the proposal should define. Thirty minute reserves do not need a penalty to ensure reliability.
4. While stick-type penalties can be applied quickly and therefore FERC may go along with them for this summer, the proposal should include a sunset or at least a review period to reassess the effect of the penalties. This review should include development of alternative incentives that might induce desired market participant behavior. The proposal itself should include the initiation of a parallel track to develop incentive type programs that can diminish or eliminate the need for penalties. An example that mirrors PJM ten minute reserves (but does not duplicate its market) would be the ability of the ISO to call in-day not only DAM operating reserves, but other operating reserve that exists at any given moment (non-contracted for or latent reserve). There will be no penalty for any failure to activate ten-minute reserves. Instead, all those who activate ten-minute reserves will be paid LBMP plus a premium. In this manner, everyone who can supply reserves will bid in levels that are more than just minimum (no fear if they don't make it). AND, others who were shut out of the market have a chance to earn their way back in by chasing the premium. This induces quick and full market response.
5. Pay for latent reserve that ends up being counted on by the ISO to provide reserves in-day, and apply the same penalties to these reserve carriers that are applied to DAM reserve providers. Otherwise, if latent reserve without penalties is equal in value to DAM reserves with penalties, then the penalties induce no extra value and should not be applied.