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Senior Director,
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March 14, 2018

VIA E-MAIL AND FEDERAL EXPRESS

Mr. Michael Bemis
Chairman of the NYISO Board of Directors
c/o Mr. Brad Jones
President and CEO
New York Independent System Operator
10 Krey Boulevard
Rensselaer, NY 12144

Re: Appeal of the Management Committee's Rejection of the Motion to Establish a Method for Eliminating Localities and to Revise the Existing Rules to Create a New Locality

Dear Chairman Bemis:

Pursuant to the Procedural Rules for Appeals to the ISO Board, please find enclosed an original and three copies of a joint Central Hudson Gas & Electric Corporation (Central Hudson) and New York Power Authority (NYPA) appeal of the Management Committee's February 28, 2018 decision to reject Motion 5, which recommended that the Board support a tariff filing at the Federal Energy Regulatory Commission that would establish a method for eliminating capacity zones or Localities and to revise the existing rules to create new capacity zones or Localities. A copy of the enclosed Notice of Appeal has been delivered to Diane Egan today for circulation to all members of the Management Committee via electronic mail.

Central Hudson and NYPA respectfully request that it be given the opportunity to present oral argument before the Governance Committee with respect to this appeal.

Very truly yours,

A handwritten signature in black ink, appearing to read "JJB", written over a light blue horizontal line.

John J. Borchert

Enclosures

cc: Diane Egan, via e-mail
Robert Fernandez, Esq., via e-mail

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NOTICE OF APPEAL
SUBMITTED BY
CENTRAL HUDSON GAS & ELECTRIC CORPORATION
AND
THE NEW YORK POWER AUTHORITY

In accordance with Article 5 of the Independent System Operator (“ISO”) Agreement and Section 1.02 of the New York Independent System Operator’s (“NYISO”) Procedural Rules for Appeals to the ISO Board, Central Hudson Gas & Electric Corporation, (“Central Hudson”) and the New York Power Authority (“NYPA”) submit this notice of appeal of the Management Committee’s decision not to approve a NYISO staff proposal to revise to the Market Administration and Control Area Services Tariff (“Market Services Tariff”) and the Open Access Transmission Tariff (“OATT”) to establish a method for eliminating capacity zones of Localities and to revise the existing rules to create new Localities.

On February 28, 2018, the Management Committee declined to approve revisions to the Market Services Tariff and the OATT to establish a method for eliminating Localities and to revise the existing rules to create a new Locality. The proposal was presented in the On Ramps and Off Ramps: Complete Market Design presentation.¹ The motion in support of the NYISO staff’s proposal affirmatively received 54.12% of the votes cast by Management Committee members, but failed to achieve the 58.0% super-majority vote needed for Management Committee approval.²

Central Hudson and NYPA appeal the Management Committee’s action on the grounds that the Management Committee’s decision was unsustainable and should be set aside because

¹ http://www.nyiso.com/public/webdocs/markets_operations/committees/mc/meeting_materials/2018-02-28/On%20and%20Off%20Ramps%20021418%20BIC.pdf

² http://www.nyiso.com/public/webdocs/markets_operations/committees/mc/meeting_materials/2018-02-28/MC_Final_Motions_0228.pdf

the existing tariff rules for the creation of capacity zone localities are deficient and the absence of tariff rules providing for the elimination of capacity zone localities is unjust and unreasonable. The failure to provide rules to eliminate capacity zone localities will create barriers to new entry through unnecessary mitigation rules, result in unwarranted higher costs for consumers, and hinder economic development opportunities.

Central Hudson and NYPA also appeal this decision on behalf of New York State electric consumers, who will continue to be exposed to the potential of significantly higher capacity prices for localities that may no longer be needed.

The New York Public Service Commission (“Commission”), the New York Transmission Owners (“NYTOs”), and members of the End-Use Sector have raised the need for tariff provisions governing capacity zone elimination through their protests of 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”).³ The NYTOs, Commission, and consumers protested the NYISO’s omission of rules governing capacity zone elimination, 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. The continuation of the price separation will cause consumers in the G-J locality to pay too much for capacity and will send the wrong incentives to generation and transmission developers.⁴ In its August 13, 2013 Order, the FERC agreed that price separation may well continue after the constraint leading to the creation of a new capacity zone disappears.⁵

While the 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

³ New York Independent System Operator, Inc., 144 FERC ¶ 61,126, at PP 69-73 (2013) (August 13, 2013 Order).

⁴ Id.

⁵ Id. at P 83.

⁶ Id. at P 82.

In its order rejecting the Commission's, NYTOs' and the New York Power Authority's requests for rehearing on this matter, the 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

Consequently, Central Hudson and NYPA request that the NYISO Board exercise its authority and responsibility to set aside the decision of the Management Committee in this matter, and take all appropriate actions to obtain authorization from the FERC to revise its Market Services Tariff and OATT to correct the deficiencies in the existing zone creation rules and to adopt zone elimination rules.

Purpose of Capacity Localities

The NYISO utilizes localities in its capacity market to attract and retain resources where needed to maintain system reliability over the planning horizon, and to provide stable and predictable market outcomes to avoid out-of-market interventions. The purpose of the capacity market is to provide a stable and predictable price signal not merely to incent new entry but also to retain required existing generation to meet reliability requirements. To achieve this goal, the NYISO uses defined capacity localities along with locational capacity requirements and a demand curve capacity auction process based on a proxy unit for each of its capacity localities. The NYISO estimates the costs that developers would incur to develop and construct a proxy unit in each capacity locality and then subtracts out the forecasted net revenue that each of these proxy units would be expected to earn in the energy and ancillary services markets (after accounting for the variable costs incurred to provide energy). Based on the inherent differences

⁷ New York Independent System Operator, Inc., 147 FERC ¶ 61,152, at P 45 (2014) (May 27, 2014 Order).

in the localities, these proxy unit costs vary from locality to locality, regardless of the transmission topology or the level of generation.

Conversely, it is important that when the topology of the transmission and generation system changes and that change eliminates the need for a local capacity market signal, there should be a methodology to eliminate the capacity locality, eliminate capacity price separation, and eliminate capacity mitigation rules. The NYISO tariff rules do not have a capacity locality elimination method it (only has a Capacity Locality Creation method). The NYISO tariff's failure to include a methodology to eliminate capacity localities creates an unfair and unbalanced regulatory scheme for the capacity markets. The absence of such a methodology has the potential to lead to larger capacity surpluses than required to maintain reliability and the cost of this unneeded capacity will be shouldered by customers within the unneeded capacity locality. In addition, Central Hudson has from the onset of the capacity zone creation rules pointed out the deficiencies of NYISO's current zone creation rules based on deliverability concept, which provide more of an indication of upstate capacity surplus than reliability and capacity needs within a locality.

NYISO Staff Proposal

The NYISO's Market Services Tariff mandates that the NYISO use a deliverability test to assess if additional capacity localities need to be created.⁸ The NYISO Staff Proposal is to move away from the deliverability test and align the locality creation and elimination rules with a reliability planning process. Importantly, in the discussions of this matter, NYISO Staff has acknowledged that the existing rules are deficient and a different approach is needed.

Over the past few months, the NYISO has engaged stakeholders in discussions to develop a new methodology under the guiding principles of creating an open, transparent, robust, predictable, and stable process. This process has concluded with the NYISO proposing a new methodology with similar and consistent rules for governing the creation and

⁸ NYISO Tariff M 5.16.1.1.5

elimination of capacity zones.⁹ The NYISO proposal use an accepted and familiar reliability planning approach, use established planning cases from the existing Reliability Planning Processes and Gold Book assumptions, and focuses primarily on transmission transfer capability between LBMP zones. The proposal had creation and elimination tests that assessed the transmission system impact upon the removal of certain amounts of transmission and generation, called “headroom.” The Locality Creation Test consists of an N-1-1 transmission security test with headroom of 2 generator contingencies and the Locality Elimination Test would use the same N-1-1 transmission security test with headroom of 4 generator contingencies. Also, if the NYISO identifies a resource adequacy need within a locality (*e.g.*, G-J locality) in the first 5 years, then that locality must remain in place and the Locality Elimination Test will not be performed during that cycle. According to the NYISO, the asymmetrical headroom between the Locality Creation Test and the Locality Elimination Test is intended to prevent toggling and provide for capacity market stability.

In addition to these tests, zones J and K due to their unique current transmission topology, were considered not subject to these proposed locality elimination rules.

Management Committee Decision

Despite the clear rationale for the NYISO staff’s proposal and the well-established need to both develop a methodology to eliminate a capacity locality when it is no longer needed and an improved methodology to create capacity localities to address the existing flaws of using a deliverability test, there was sufficient opposition in the Management Committee to prevent the super-majority vote of 58% needed for approval. The Generation Owners sector and the Other Suppliers sector voted almost unanimously against the proposal with a number of abstentions. These two market sectors have a clear commercial interest to maintain the highest possible capacity prices and prevent the elimination of capacity localities.

⁹ http://www.nyiso.com/public/webdocs/markets_operations/committees/bic_icapwg/meeting_materials/2017-11-06/On%20and%20Off%20Ramps%20171106%20ICAPWG%20Presentation_171101%20Final.pdf

The Long Island Power Authority (LIPA) was the sole other stakeholder voting against the NYISO staff's proposal, due to the forecasted consumer impacts to LIPA customers if the G-J capacity zone were to be eliminated.

This is precisely the type of circumstance for which the NYISO Board was given the authority to overturn Management Committee determinations. Central Hudson and NYPA fully support the NYISO's governance process, which provides to market participants the primary responsibility for determinations that affect the NYISO's markets and for resolving differences among market participants through the NYISO's governance process. However, in establishing the NYISO's governance process, it was understood that there could be times when the Management Committee determinations would be in error and inconsistent with the NYISO's obligation to ensure that its market rules promote just and reasonable prices and to ensure that all segments of the NYISO's markets are treated fairly. In this case, it is clear that retaining the status quo which continues to rely on a deliverability test instead of methodology that uses a reliability criteria to create capacity zones and has no existing process to eliminate a capacity locality is inconsistent with the NYISO's fundamental responsibilities, and could impose unnecessary higher capacity prices on New York consumers. The impacts to consumers of retaining a locality longer than needed is easily calculated based on the capacity price separation between that locality and the Rest of State region multiplied by the locational capacity requirement, which for zone G-J has been more than \$7/kW-month in the summer and \$2.95/kW-month in the winter.¹⁰ Based on this current price differential and the 2018 locational capacity requirements, this is approximately \$60 million in excess costs for zone J consumers and \$280 million in excess costs for zone G-I consumers.

Conclusion

Even though the justification for the development of a new methodology to create and eliminate capacity localities was repeatedly provided by NYISO Staff and recognized by a majority of the stakeholders, the Management Committee was unable to gain the necessary

¹⁰ http://www.nyiso.com/public/webdocs/markets_operations/committees/bic_icapwg/meeting_materials/2017-11-06/CIA%20-%20On%20Ramps%20and%20Off%20Ramps.pdf Table 1A

super-majority vote needed to approve the NYISO staff proposal. The failure of the Management Committee to authorize the necessary revisions to the Market Services Tariff and OATT presents a direct conflict with the NYISO's fundamental obligation to eliminate impediments to the efficiency of the markets it has been entrusted to administer, and to ensure that all market segments are treated fairly. Consequently, Central Hudson and NYPA urge the NYISO Board to exercise its authority to grant this appeal and overturn the Management Committee's decision not to approve NYISO staff's proposal to revise the Market Services Tariff and OATT to establish a new methodology for the creation of capacity localities and adopt a methodology for the elimination of unneeded capacity localities.

Further, given that NYISO Staff has acknowledged deficiencies in the existing zone creation rules, and the NYISO is concomitantly aware that its existing tariff rules have the potential to (i) prevent it from developing reasonable and efficient prices in its capacity markets and (ii) impose unnecessary and unreasonable costs on consumers, the NYISO has a responsibility to take all necessary action to remedy this situation. Central Hudson and NYPA urge the NYISO Board to exercise its authority to make a filing with the FERC under Section 206 of the Federal Power Act acting on NYISO Staffs proposal on the grounds that the existing tariff rules do not result in just and reasonable prices in its capacity markets. In the alternative, as NYISO Staff has indicated that it will no longer progress this matter following the Management Committee vote, Central Hudson and NYPA urge the NYISO Board to reject the status quo capacity locality creation process, which does not presently include a capacity locality elimination process, and direct the NYISO Staff to return this issue to the stakeholder process and direct NYISO Staff to continue its efforts this year to develop a proposal for the creation and the elimination of capacity localities that will address these market concerns.