

November 4, 2016

Hon. Kimberly D. Bose, Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

Re: New York Independent System Operator, Inc. Informational Report in Docket No. AD16-26-000

Dear Secretary Bose:

In accordance with Paragraphs 1 and 32 and Ordering Paragraph (B) of the Commission's October 18, 2016 *Order Accepting Market Rule Changes and Requiring Informational Report* ("Order"),¹ the New York Independent System Operator, Inc., ("NYISO") hereby submits this informational report.

I. Informational Report

A. Background

Under the NYISO's current capacity market design, a generator that exports capacity from a Locality is treated in the capacity market auction as though it no longer exists. This means that its continued operation is not properly reflected in the NYISO's capacity market clearing prices. As a result, a portion of capacity exports from the NYISO could inefficiently increase capacity market clearing prices in the NYISO.

In its 2015 State of the Market Report ("SOM Report"), issued in May 2016, the independent Market Monitoring Unit for the NYISO (the "MMU") recommended that the NYISO "[m]odify the capacity market and planning process to better account for capacity that is exported to neighboring control areas from import-constrained capacity zones."² The SOM

¹ *ISO New England Inc. and New England Power Pool Participants Committee*, 157 FERC ¶ 61,025 (2016).

² See *2015 State of the Market for the New York ISO Markets* at xii, 117 (May 2016), available at: <http://www.nyiso.com/public/webdocs/markets_operations/documents/Studies_and_Reports/Reports/Market_Monitoring_Unit_Reports/2015/NYISO%202015%20SOM%20Report_5-23-2016-CORRECTED.pdf>.

Report specifically referenced capacity exports ISO New England Inc. (“ISO-NE”) awarded to capacity located in the G-J Locality³ in FCA 9 (2018/2019) and FCA 10 (2019/2020).⁴

The SOM Report emphasized that the NYISO should act promptly because the MMU anticipated that “capacity clearing prices in the Lower Hudson Valley could rise far above competitive levels . . . at least during the two years for which capacity has already been sold into ISO-NE.”⁵ At the time the SOM Report was published it was understood that those detrimental effects would not begin to occur until June 2018.⁶

The NYISO was working expeditiously to address this issue before the expected detrimental effects were to begin taking place in June 2018. However, ISO-NE’s and the New England Power Pool Participants Committee’s “FCM Enhancements” filing with the Commission accelerated the need for NYISO action on this issue.⁷ The FCM Enhancements Filing included revisions which would, among other things, permit resources that have been qualified to sell capacity in a later ISO-NE Capacity Commitment Period to submit offers in reconfiguration auctions and enter into “Capacity Supply Obligation Bilaterals” for earlier periods (the “RA Import Proposal”). Because the RA Import Proposal exposed New York customers to serious pricing inefficiencies under NYISO rules a year sooner than initially expected, the NYISO requested that the Commission defer for one capability year the implementation of the RA Import Proposal as to imports from NYISO Localities.⁸

The Order accepted the FCM Enhancements Filing including the RA Import Proposal and its requested effective date. While denying the NYISO’s request to defer the implementation of the RA Import Proposal, the Commission “acknowledge[d] NYISO’s concerns about a potential flaw in its market rules.”⁹ It also encouraged the timely completion of NYISO stakeholder discussions, and urged the “NYISO to make the anticipated tariff filing with the Commission to address these concerns before the relevant market and implementation deadlines.”¹⁰ The Order also stated that “in order to provide the Commission with timely, actionable information we

³ Capitalized terms not otherwise defined herein shall have the meaning specified in the NYISO’s Market Administration and Control Area Services Tariff (“Services Tariff”), and if not defined therein, then the meaning specified in the “NYISO Proposal” (as defined in Section I.B below.)

⁴ SOM Report at n. 103.

⁵ SOM Report at 117.

⁶ *Id.*

⁷ *ISO New England Inc. and New England Power Pool Participants Committee*, Forward Capacity Market Enhancements, Docket No. ER16-2451-000 (August 19, 2016) (“FCM Enhancements Filing”).

⁸ Docket No. ER16-2451-000, *ISO New England Inc. and New England Power Pool Participants Committee*, Motion to Intervene and Limited Protest of the New York Independent System Operator, Inc. (Sept. 9, 2016).

⁹ Order at P 32.

¹⁰ *Id.*

direct NYISO to file an informational report addressing its progress in preparing any tariff filing with the Commission.”¹¹

B. NYISO Proposal Developed in Stakeholder Governance Process

1. Stakeholder Process

The NYISO began discussions regarding the market design issue with its stakeholders and sought their input on the development of a proposal at the August 2, 2016 meeting of its Installed Capacity Working Group (“ICAP Working Group”). Those discussions continued at the August 23, 2016 ICAP Working Group meeting at which the NYISO presented the framework of a proposed immediate solution. The NYISO presented a detailed proposal and draft proposed tariff revisions to stakeholders at the September 19, 2016 ICAP Working Group meeting. The NYISO also presented a consumer impact analysis in which it used a hypothetical example to show the potential impact of a capacity export from an Import Constrained Locality under the NYISO’s current rules, and the potential impact of that same export under the NYISO’s proposal.¹² At the October 7, 2016 ICAP Working Group meeting, the NYISO presented further analysis and incremental draft proposed tariff revisions based on stakeholder input (the “NYISO Proposal”).¹³

The NYISO also made presentations to, and discussed the matter and evolving NYISO Proposal with, the New York State Reliability Council’s (“NYSRC”) Installed Capacity Subcommittee on August 30, October 5 and November 2, 2016, and the NYISO’s Executive Committee on October 14, 2016.

2. The NYISO Proposal

The NYISO Proposal is designed to address the pricing inefficiency under its existing rules that is triggered when a Generator exports capacity to an External Control Area over an AC interface from an Import Constrained Locality. Import Constrained Localities would be defined as New York City (Load Zone J) and the G-J Locality. The NYISO Proposal would recognize that an exporting Generator continues to operate in the Locality.

¹¹ *Id.*

¹² *Consumer Impact Analysis: Exports Capacity Exports from Localities* (Sept. 19, 2016), available at: http://www.nyiso.com/public/webdocs/markets_operations/committees/bic_icapwg/meeting_materials/2016-09-19/CIA%20-%20Capacity%20Exports%20from%20Localities.pdf.

¹³ See *Locational Export Capacity Proposal* (Oct. 26, 2016), available at: http://www.nyiso.com/public/webdocs/markets_operations/committees/mc/meeting_materials/2016-10-26/Agenda%2006_Locational%20Export%20Capacity%20Proposal.pdf (“NYISO Presentation”), and *Locational Capacity Exports - Mitigation* (Oct. 26, 2016), available at: http://www.nyiso.com/public/webdocs/markets_operations/committees/mc/meeting_materials/2016-10-26/Agenda%2006_Locational%20Capacity%20Exports_Mitigation.pdf.

The NYISO developed a design that was implementable for the 2017/2018 Capability Year. Throughout the stakeholder process, it committed to continue to work with stakeholders in 2017 to determine whether additional changes were warranted.

a. Determination of ICAP Requirements and Auction Rules

Under the NYISO Proposal, the Installed Capacity (“ICAP”) market would reflect the portion of Locational Export Capacity that must be replaced in the Locality and the portion that can be replaced by capacity located outside of the Locality while maintaining the same level of reliability. The NYISO would reduce the relevant Locational Minimum Installed Capacity Requirement by the portion that can be replaced by capacity outside of the Locality; such portion referred to as the “Locality Exchange Factor.” It would then determine Load Serving Entities’ Locational Minimum Unforced Capacity Requirements. Thus, when the NYISO runs the ICAP Spot Market Auction, the Import Constrained Locality’s requirements would be satisfied by the appropriate amount of capacity located in the Locality, and capacity available outside the Locality that can be imported into it. The overall requirements of the NYCA, and capacity needed to satisfy it, would not change.

The NYISO Proposal also describes the inputs and the methodology that it would use to perform a power flow based analysis to determine the Locality Exchange Factors for each Import Constrained Locality relative to each neighboring Control Area prior to the start of each Capability Year.

b. Application of NYISO Proposal

The NYISO presented its preliminary analysis of how the Locality Exchange Factor for exports from the G-J Locality to ISO-NE would be determined under the NYISO Proposal.¹⁴ Its presentation included an example with a description of the inputs and the power flow analysis used to determine the shift factors on the applicable interfaces. The example showed the calculation of the Locality Exchange Factor formula, which is the ratio of the shift factor on the SENY interface for the transfer of an export from Load Zones G, H, or I (within the G-J Locality) to ISO-NE divided by the shift factor on that same interface from a transfer from Rest of State to Load Zones G, H, or I. This preliminary analysis resulted in a Locality Exchange Factor of 47.8%. That means that a price signal to replace 52.2% of the MW exported from the G-J Locality to ISO-NE within G-J Locality would be efficient.

Under the NYISO Proposal, the NYISO would decrease the Locational Minimum Installed Capacity Requirement by 47.8% of the MW to be exported from the G-J Locality. The remaining 52.2% of the ICAP export would directly impact the G-J Locality ICAP Spot Market Auction clearing price as a loss of supply. The portion of the Locality export that is replaceable from outside the Locality (47.8% of the MW) does not create any additional need in the Locality and therefore a price signal to replace that portion in the Locality would be inefficient. The G-J ICAP Spot Market Auction clearing price will rise in order to send a price signal that 52.2% of

¹⁴ See NYISO Presentation at pp. 14 - 22.

the ICAP export should be replaced in the locality. Because the NYCA encompasses all Localities, the NYCA clearing price will rise by the full amount of the export to appropriately reflect that the entire system has less capacity.

c. Generator Obligations to Export from Import Constrained Localities

In order to timely obtain the information needed to implement the NYISO Proposal, Generators exporting from an Import Constrained Locality would be required to provide notice to the NYISO approximately one month before the ICAP Spot Market Auction certification period, identifying the ICAP MW to be exported. The NYISO Proposal would also make clear that exporting Generators, even if they are not an ICAP Supplier in the NYISO's market, are required to respond to an energy market Supplemental Resource Evaluation ("SRE"). As with any other resource responding to an SRE, exporting Generators would be entitled to Bid Production Costs including valid lost opportunity costs.

d. Revisions to Supplier-Side Market Power Mitigation Rules

The NYISO Proposal would also revise the supplier-side capacity market mitigation rules. Revisions are necessary because the current tariff language is applicable only to entities that are ICAP Suppliers. That definition would be modified to ensure that all exporting generators located in a Mitigated Capacity Zone are subject to the uneconomic withholding rules.

In addition, the NYISO proposal would enhance the tariff's existing penalty calculation provisions. With the implementation of "pay-for-performance" type initiatives in ISO-NE and PJM, the clearing price of an External Reconfiguration Auction may reflect an implicit risk premium for anticipated performance penalties. Thus, a comparison of clearing prices alone may tend to overstate the net revenues earned by a capacity export and comparatively reduce the calculated penalty amount. The NYISO Proposal's revisions are designed ensure robust results in situations where "pay for performance" penalties might influence the economics of an export.

C. NYISO Stakeholder Committees' Action on NYISO Proposal

On October 20, 2016, the Business Issues Committee voted to approve the NYISO Proposal.¹⁵ On October 26, 2016, the Management Committee considered the NYISO Proposal. Although a motion was made and seconded to approve the NYISO Proposal, including draft tariff revisions,¹⁶ that motion was amended. A supermajority of stakeholders, 63.62%, voted to

¹⁵ The motion approved by the Business Issues Committee is available at: http://www.nyiso.com/public/webdocs/markets_operations/committees/bic/meeting_materials/2016-10-20/102016%20bic%20final%20motions.pdf.

¹⁶ See http://www.nyiso.com/public/webdocs/markets_operations/committees/mc/meeting_materials/2016-10-26/Agenda%2006_Tariff%20Revisions_Exports%20Definitions.pdf ("NYISO Presentation A to Management Committee"), http://www.nyiso.com/public/webdocs/markets_operations/committees/mc/meeting_materials/2016-10-26/Agenda%2006_%20Tariff%20Revisions%20Exports_MST%2023%202%2023%204%205.pdf, and

make one modification to the NYISO Proposal. That modification would set the Locality Exchange Factor for capacity exports from Generators located in the G-J Locality to ISO-NE at 80% beginning June 2017 through May 2018 (*i.e.*, ISO-NE's capability year.)¹⁷ For all other pairings of Import Constrained Localities and neighboring Control Areas, and beginning June 2018 with respect to exports from the G-J Locality to ISO-NE, the Management Committee approved tariff provisions provide that the NYISO would determine Locality Exchange Factors annually, using prescribed inputs and methodology.

The amended motion indicates that "due to a very large and sudden impact of ISO-NE rule changes on New York consumers that gave rise to the NYISO proposal, the NYISO proposal will be phased in ... for ISO-NE's 2017/2018 Capability Year, the NYISO will set the Locality Exchange Factor for exports from the G-J Locality to ISO-NE to 80% to offset the impact of capacity exports." The motion also notes that there was a "lack of sufficient time to adequately analyze the NYISO's methodology" and that there would be "further analysis of the methodology and possible alternatives."¹⁸

The motions approved by the Business Issues Committee and the Management Committee both included a requirement that NYISO commits to work with Stakeholders further in 2017. The Management Committee-approved motion included a schedule for reporting by the NYISO:

The ISO will conduct an evaluation with its stakeholders of additional modifications to the rules addressing Locational Export Capacity from Import Constrained Localities presented at the October 20, 2016 [Business Issues Committee] meeting. The NYISO shall report on its progress at the January and April [Business Issues Committee] meetings in 2017, and to the NYISO Board at its January and April 2017 meetings. On or before June 1, 2017, the ISO will file with the Commission either an informational report on the evaluation or a filing proposing to amend the ISO Tariffs.

The stakeholders' guidance regarding further efforts to consider additional modifications is consistent with the NYISO Proposal as first presented to stakeholders. The NYISO Proposal was specifically developed to address the issue in a manner that could be timely implemented.

<http://www.nyiso.com/public/webdocs/markets_operations/committees/mc/meeting_materials/2016-10-26/Exports_Incremental_MST%2023%204%205%20revised%2020161021.pdf>.

¹⁷ The motion approved by the Management Committee is available at: <http://www.nyiso.com/public/webdocs/markets_operations/committees/mc/meeting_materials/2016-10-26/102616_MC_Final_Motionsv3.pdf>. Incremental tariff revisions in accordance with the Management Committee's approval were issued to stakeholders on October 28, 2016 for input. It was then approved by the Chairs of the NYISO's governance Committees as conforming to the approved motion, in accordance with procedures. *See* <http://www.nyiso.com/public/webdocs/markets_operations/committees/mc/meeting_materials/2016-10-26/Exports%20Tariff%20Revisions_Oct26MC_REVISED%20Oct28.pdf>.

¹⁸ *Id.*

However, the NYISO has always recognized that there are issues that merit further consideration in the stakeholder process.

D. Appeal of NYISO Proposal Pending Before NYISO's Board of Directors

On November 1, 2016, the Independent Power Producers of New York, Inc. ("IPPNY") filed an appeal, with the NYISO's Board of Directors, of the Management Committee's action to approve the Amended Proposal (the "IPPNY Appeal").¹⁹ It asks the Board to neither "sanction" the 80% Locality Exchange Factor for exports from the G-J Locality to ISO-NE beginning June 2017 through May 2017, "nor permit [NYISO] Staff to file it with FERC under [Federal Power Act] Section 205." The IPPNY Appeal is available on the NYISO's website.²⁰ In accordance with the rules for appeals to the NYISO's Board, motions in support and in opposition can be filed on or before November 8, 2016.²¹

E. Schedule and Next Steps

The Board of Directors will consider the IPPNY Appeal and stakeholder input in support of and in opposition to the appeal. Thereafter it will issue a decision on it. The NYISO presently anticipates that the Board will consider the IPPNY Appeal, and motions in support and opposition thereto, and the underlying amended version of the NYISO Proposal approved by the Management Committee at its regularly scheduled meetings on November 14 and 15, 2016.

As noted above and as the NYISO explained in its pleadings in Docket No. ER16-2451, it is critical that the NYISO have market rules in place quickly to prevent capacity exports which may begin as early as June 1, 2017 from inefficiently increasing NYISO capacity prices. The NYISO intends to act quickly on a filing with the Commission of revised rules in order to give the Commission appropriate time to act on proposed tariff revisions. As a practical matter, it will need to be clear what the revised rules will be by early 2017 so that the NYISO and Market Participants can account for them as part of auction activities in February for the start of the NYISO's 2016/2017 Capability Year.²² Doing so also will allow Market Participants that plan to export capacity²³ an opportunity to take available steps if they might be a Pivotal Supplier.²⁴

¹⁹ In accordance with the ISO Agreement, Sections 5.07 and 7.03, appeals can be take on any Management Committee Decision.

²⁰ The IPPNY Appeal is available at:
<http://www.nyiso.com/public/webdocs/markets_operations/committees/appeals/Appeals_to_the_BOD/November_1,_2016/IPPNY%20Appeal%2011-1-16.pdf>.

²¹ *Procedural Rules for Appeals to the ISO Board* at Section 4.01, available at:
<http://www.nyiso.com/public/webdocs/markets_operations/committees/appeals/procedural_rules_for_appeals_board.pdf>.

²² See, e.g., NYISO Presentation A to Management Committee at p. 31, and the ICAP Event Calendar available at: <http://icap.nyiso.com/ucap/public/evt_calendar_display.do>.

²³ See Proposed Tariff Section 5.9.2.2.

As indicated above, the NYISO developed a proposal that could be implemented in time for a potential June 1, 2017 export. It did so after determining that other potential options to address the market price inefficiency could not be timely implemented. The NYISO has already begun work on software revisions to accommodate the NYISO Proposal.

II. Service

The NYISO will send an electronic link to this Informational Report to the official representative of each of its customers, to each participant on its stakeholder committees, to the New York Public Service Commission, to all parties listed on the Commission's official service list in this Docket and to the New Jersey Board of Public Utilities. In addition, the complete filing will be posted on the NYISO's website at www.nyiso.com.

III. Conclusion

The NYISO respectfully submits this Informational Report in compliance with the Commission's Order. The NYISO is not seeking any further action by the Commission in this docket.

Respectfully submitted,

/s/ Gloria Kavanah

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²⁴ See Services Tariff Section 23.4.5.1. The NYISO Proposal's revisions to Services Tariff Section 23.4.5.1 do not alter the opportunity for Installed Capacity Suppliers seeking to export capacity to obtain an *ex ante* determination regarding withholding.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding in accordance with the requirements of Rule 2010 of the Rules of Practice and Procedure, 18 C.F.R. §385.2010.

Dated at Rensselaer, NY this 4th day of November 2016.

/s/ Joy A. Zimmerlin

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