Attachment V

NYISO BOARD OF DIRECTORS' DECISION ON APPEAL OF THE MANAGEMENT COMMITTEE'S ACTION ACCEPTING A PROPOSAL TO AMEND TARIFF PROVISIONS REGARDING CONSTRAINED LOCALITY CAPACITY EXPORTS

November 21, 2016

INTRODUCTION

Independent Power Producers of New York, Inc. ("IPPNY") appeals the Management Committee's October 26, 2016 approval of a motion to revise the NYISO's installed capacity rules. The Management Committee approved a mechanism proposed by the NYISO staff to address a market design flaw that would cause inefficient price increases when generators export capacity from constrained localities ("zones"), which are the Lower Hudson Valley zone and New York City ("NYISO Proposal"). The Management Committee also modified the NYISO proposal by adopting a one-year transition mechanism (also referred to by the parties as a "phase-in") that would limit price increases within the Lower Hudson Valley zone for the first year. The Management Committee's motion passed with a 63.62% affirmative vote, gaining support from four of five sectors. IPPNY's appeal does not oppose the NYISO proposal but objects to the Management Committee's adoption of a one-year transition mechanism. Six motions in opposition were filed by stakeholders.[1] The Board of Directors heard oral arguments on November 14, 2016. For the reasons set forth below, the Board denies IPPNY's appeal.

BACKGROUND

In its 2016 State of the Market Report, Potomac Economics identified a design flaw in the NYISO's capacity market that would cause inefficient price increases when generators export capacity from constrained zones. Potomac's initial report indicated that, if left unaddressed, this flaw would adversely impact New York capacity market prices starting in 2018. NYISO staff intended to address the issue through a market design project in 2017. However, subsequent revisions to ISO New England's ("ISO-NE's") market rules to permit capacity imports as early as Summer 2017 have created an urgent need to address the issue now.

Stressing the many complexities of the issue, the NYISO requested that FERC defer for one year the effective date of ISO-NE's new capacity market rule revisions as they apply to constrained zones in New York to allow adequate time to develop necessary revisions to the NYISO tariffs. FERC denied this request, but encouraged the NYISO and stakeholders to address the market design problem in a timely fashion.[2] The NYISO Proposal was developed on an expedited basis in order to avoid inefficient price increases that would otherwise result. The NYISO was unable to fully explore other potential approaches to address the problem due to the very limited time available.

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[1] Motions in opposition were filed by: Multiple Intervenors, the City of New York, and the New York State Energy Research and Development Authority ("Consumer Parties"); New York Department of State Utility Intervention Unit ("UIU"), New York Transmission Owners, Long Island Power Authority, and New York Power Authority ("NYTOs"); New York State Department of Public Service ("DPS"); and Direct Energy ("Opponents"). NRG also filed a motion in opposition, but raised different concerns.

[2] *ISO New England Inc*., 157 FERC ¶ 61,025 (2016).

The NYISO Proposal establishes a methodology to determine the portion of exported capacity that can be replaced by resources located outside the constrained zone (a "Locality Exchange Factor" or "LE Factor"). Specifically, the NYISO will use power flow analyses to determine the amount of exported capacity that can be replaced with lower priced resources located in the upstate New York ("rest-of-state") region and the amount that must be replaced by higher priced generation inside the constrained zone. The NYISO will then apply the LE Factor in the capacity market auctions to make related pricing adjustments. To ensure reliability, the NYISO Proposal makes clear that an exporting generator must respond to a supplemental resource evaluation ("SRE") to make its generation available when needed.

The NYISO's preliminary results produced an LE Factor of 48%, indicating that 48% of exports to New England from the Lower Hudson Valley could be replaced with rest-of-state generation, while 52% must be replaced by generation physically within the constrained zone. NYISO's proposed capacity auction rules would produce clearing prices consistent with the LE Factor. If left uncorrected, the NYISO's current market rules would produce clearing prices that treat the exporting generator as though it no longer exists. This would require 100% of the export to be replaced with capacity inside the constrained zone and would produce inefficient price signals and adverse consumer impacts.

As noted above, the Management Committee approved the NYISO Proposal with one modification – a one-year economic transition mechanism that would allow more exported capacity to be replaced in the auction with lower cost generation from rest-of-state than would be allowed under the NYISO proposed methodology. Specifically, the LE Factor would be fixed at 80% for Lower Hudson Valley zone in the first year rather than the approximately 48% determined in accordance with the NYISO staff methodology.

SUMMARY OF PLEADINGS

IPPNY requests that the Board decline to adopt the Management Committee's proposed transition plan to fix the LE Factor at 80% for the first year of exports from the Lower Hudson Valley zone to ISO-NE. IPPNY neither endorses nor criticizes the NYISO Proposal's methodology that produced a 48% LE Factor under current conditions. IPPNY emphasizes that the Market Monitoring Unit endorsed the original NYISO proposal without a one-year transition. IPPNY argues that the 80% figure is arbitrary and inaccurate, would result in inefficient market outcomes, and would harm reliability. IPPNY also argues that FERC precedent does not support the "phase-in." Finally, IPPNY asserts that approving the 80% figure would set a "dangerous precedent that will embolden load interests to establish prices by exploiting the stakeholder process, thereby undercutting competitive markets."

All Opponents, except NRG, support the use of the transition mechanism approved by the Management Committee. With the exception of NRG, Opponents make the following key assertions: The NYISO's proposed value of 48% was developed as part of its accelerated analyses, and it is not yet clear if the proposed value is correct. For this reason, Opponents argue that it is appropriate to fix the LE Factor at 80% for the first year until NYISO can explore other alternatives. Opponents also argue that the 80% transition represents a fair compromise that is

more favorable to suppliers than the NYISO's initial proposal to defer the ISO-NE capacity import rules by one year. A deferral, they point out, would have completely precluded generators' ability to export capacity and any related increase in capacity prices. Opponents argue further that, contrary to IPPNY's claims, the proposed transition mechanism will not harm reliability because there is currently a surplus of capacity and capacity prices will increase in 2017/2018, discouraging generator retirements.

Opponents also argue that the transition mechanism will not mute or distort market signals due to its limited nature and the transient price signals sent by temporary capacity exports. Opponents explain that FERC has previously allowed the phase-in of a new rate in appropriate circumstances. In addition, Opponents assert, counter to IPPNY's arguments, that approving the temporary 80% figure will not encourage abuse of the NYISO's stakeholder process and NYISO's governance history bears this out. Finally, Opponents argue that consumers should not bear the costs of a market design flaw or an interim methodology that was developed in a highly compressed timeframe.

NRG separately opposes the entire Locality Exchange Factor proposal, without regard for the transition component, and argues that the Board should not authorize a FERC filing at this time. NRG asserts that the proposal raises fundamental questions about capacity market design and requests that the Board direct an appropriate review of the underlying issues.

BOARD DECISION

Because FERC denied the NYISO's request to defer ISO-NE's tariff amendments, which would have permitted a more comprehensive examination of alternative approaches, the NYISO now must act immediately to avoid inefficient price increases and adverse consumer impacts as early as June 2017.[3] We believe that the NYISO Proposal, including the LE Factor methodology, is a reasonable solution – at least in the near term. NYISO staff has committed to further examine this issue and explore alternative approaches with stakeholders in the coming year. The question before us is whether to file the transition mechanism approved by the Management Committee along with NYISO staff's proposal.

We have carefully considered the Management Committee's proposal and find it to be reasonable under the present circumstances. The Management Committee's tariff amendments would (i) not limit capacity exports, (ii) avoid inefficiently high prices, (iii) send a market signal to encourage investment, (iv) provide consumers with a modicum of protection against unforeseen price increases in 2017, and (v) permit further examination of alternative market designs for possible future implementation.

We reject IPPNY's claim that fixing the LE Factor at the 80% for exports from the Lower Hudson Valley zone to ISO-NE for one year would create a "reliability gap." IPPNY has not provided any evidence that resource adequacy requirements would not be met, nor has it described any transmission security or other operational problems that would arise by doing so. The proposed transition would not compromise New York's ability to satisfy the New York State

[3] The actual economic impacts of ISO-NE's new rules cannot be ascertained until the amount of New York exports is determined in New England's 2017 reconfiguration auctions.

Reliability Council's Installed Reserve Margin ("IRM") or the Locational Minimum Installed Capacity Requirement ("LCR") in any import constrained zone. Sufficient resources exist where they are needed to satisfy the IRM and LCRs under the one-year 80% LE Factor. Furthermore, we note that the NYISO staff's proposal addresses potential operational needs by making it clear that exporting generators must respond to SREs.

Similarly, we find IPPNY's claim that the 80% LE Factor would distort price signals and fail to encourage needed investment to be greatly overstated. The 80% LE Factor would still send a price signal in the first year that would be followed in subsequent years by an LE Factor calculated in accordance with the NYISO's methodology. We do not believe that the one-year transition will impact significant investment decisions.

IPPNY correctly points out that NYISO's 48% LE Factor is based upon a power flow model and that the Management Committee's 80% figure has no such foundation. Nevertheless, the Management Committee's overall package of changes, including the one-year transition period, represents a reasonable approach to address an urgent market design problem. We are also not persuaded that the Management Committee's action in this case amounts to an abuse of the NYISO's shared governance model or creates a dangerous precedent. While not dispositive of this appeal, we note that stakeholders from four out of five sectors supported the proposal.

It is important to emphasize that the LE Factor methodology, while reasonable, was developed in a very compressed time frame. The NYISO used conservative parameters that assume both New York's and New England's power systems are operating under highly stressed conditions. Further analyses will examine alternative approaches, including probabilistic methods, that may produce different – and possibly higher – LE Factors. The Management Committee proposal is a fair and equitable approach in this light, and we find no compelling reason to set it aside.

After carefully considering the positions of the parties and the factual record before us, we deny IPPNY's appeal and direct the NYISO management to file the proposal approved by the Management Committee pursuant to Section 205 of the Federal Power Act.

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