Attachment III

DECISION OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR BOARD OF DIRECTORS ON APPEAL OF MANAGEMENT COMMITTEE ACTION REGARDING NEW METHODOLOGY FOR CALCULATING LOCATIONAL CAPACITY REQUIREMENTS

APRIL 24, 2018

INTRODUCTION

Long Island Power Authority ("LIPA"), Helix Ravenswood, LLC ("Ravenswood"), and NRG (together "Appellants") have each appealed the February 28, 2018 Management Committee decision approving a proposal to modify the present method for calculating locational capacity requirements ("LCRs") ("Alternative LCR Methodology") citing several objections. The motion passed with a 77.55% affirmative vote. Direct Energy filed a motion in support of the appeals, and Multiple Intervenors and the City of New York jointly filed a motion in opposition.¹ The Board of Directors heard oral arguments on April 16, 2018. For the reasons indicated below, the Board denies the appeals.

BACKGROUND

The NYISO maintains a statewide margin of installed capacity—an Installed Reserve Margin ("IRM")—in excess of forecast peak demand sufficient to meet reliability standards designed to ensure a Loss of Load Expectation ("LOLE") of not more than 0.1 (1 day in 10 years).² In addition, the NYISO's market design includes certain LCRs reflecting constraints on the transmission system and the need to locate an adequate amount of generation in certain locations. The NYSRC is responsible for setting the IRM each year, and the NYISO then calculates LCRs while maintaining the state-wide IRM to satisfy the 0.1 LOLE. The current approach for determining both the IRM and LCRs was first adopted for the 2006-2007 Capability Year. This is often referred to as the "TAN 45" methodology.

The TAN 45 method attempts to balance the amount of capacity carried between the Upstate and Downstate regions. However, suboptimal and counterintuitive results have been observed since the implementation of the G-J Locality³ in the Lower Hudson Valley, which was not in place when the TAN 45 method was developed. The TAN 45 method tends to increase the local requirement in the Lower Hudson Valley as more capacity is added there, while reducing the requirements for New York City and Long Island. Market participants, especially loads in the Lower Hudson Valley, have asked that this methodology be revisited.

In March 2015, the NYISO initiated a review of LCR calculations. The NYISO later engaged General Electric ("GE") and worked with the NYSRC's Installed Capacity Subcommittee

¹ The papers filed in this appeal are available on NYISO's website at:

http://www.nyiso.com/public/markets_operations/committees/appeals/index.jsp .

² New York State Reliability Council ("NYSRC") Policy No. 5-11, 3.1 NYSRC Resource Adequacy Criterion. The NYSRC shall establish the IRM requirement for the NYCA such that the probability (or risk) of disconnecting any firm load due to resource deficiencies shall be, on average, not more than once in ten years.

³ For purposes of this discussion, the terms "capacity zone" and "locality" are used interchangeably.

("ICS") to explore a method for setting LCRs based on economics, *i.e.*, the lowest cost to supply capacity to meet New York's needs while satisfying the 1 day in 10 years LOLE reliability criterion. This approach has been recommended by Dr. David Patton of Potomac Economics in his State of the Market reports.

The proposed Alternative LCR Methodology was developed using four guiding principles. It should be least cost, stable, robust, and predictable. The development process had three phases: the proof of concept under the guiding principles, refining the methodology, and market simulations. In 2016, stakeholders were presented with initial results from a GE study, and briefed on the ongoing development of the methodology. The methodology was further discussed and developed in the ICAP working group and the ICS throughout 2017 before ultimately being approved by the Management Committee on February 28, 2018.

SUMMARY OF PLEADINGS

LIPA, Ravenswood, and NRG each appeal the Management Committee's decision approving Alternative LCR Methodology and request that the Board decline to approve the proposed filing. LIPA and NRG both request that the Board instead require NYISO staff to further study potential alternative methods for calculating LCRs. Ravenswood requests that the Board decline to file the Alternative LCR Methodology, but urges that if the Board does proceed it should develop a transition methodology of some kind.

Appellants argue that further analysis is needed before implementing the Alternative LCR Methodology. LIPA argues that additional sensitivity cases are necessary to address changes in the generation mix, system topology, and cost assumptions and submits a list of analyses and modeling sensitivities that it believes are needed. Similarly, NRG states that further analysis is necessary to address the evolving landscape and potential changes to energy policy.

Ravenswood asserts that certain assumptions in modeling the new methodology resulted in the potential for an increase in the required capacity for a particular locality. Similarly, LIPA asserts that the assumptions in modeling underestimated the capacity costs for a new unit in Zone K, which incorrectly shifts locational capacity requirements to Long Island. Ravenswood and NRG argue that the Alternative LCR Methodology is flawed because it does not account for a varying statewide IRM.

LIPA argues that the economic optimization in the Alternative LCR Methodology results in Long Island subsidizing New York City's generation requirement. LIPA states that the subsidization is due to the "flawed estimate of the Unit Net Cone value for Zone K" and "the significant mismatch from the increased LCR for Zone K for 2018." LIPA emphasizes that the LCR for Long Island is expected to increase to over 100% of peak load, which is well above that expected for New York City at just under 80%. LIPA alleges that the cost to customers would be much greater than estimated if LIPA were required to add capacity to meet the higher LCR. It further asserts that "[b]y shifting locational MWs from New York City to Long Island, the NYISO is essentially giving New York City the long-term value and reliability benefit of Long Island capacity—without commensurate allocation of costs to Zone J."

LIPA states that the projections under the Alternative LCR Methodology are outside the historic range in year-to-year LCR values, and the drastic swing will result in significant volatility. Ravenswood also claims that this volatility will distort market signals and harm reliability by discouraging investment. It further states that the optimization of LCRs only provides approximately 1% in overall cost savings over the current process, which does not justify the need for an alternative methodology at this time.

Direct Energy filed a motion in support of the appeals, agreeing that additional analysis is necessary. Specifically, it states that a comprehensive analysis of system conditions, zone elimination, and rate impacts associated with potential changes to the IRM is warranted.

Multiple Intervenors and the City of New York (together "Opponents") filed a Motion in opposition to the Appeals, stating that the Appellants' concerns regarding the potential effects of LCR on certain Localities lack merit, as they are based on comparisons against the flawed baseline of the status quo. Opponents argue that precluding or delaying implementation of the Alternative LCR Methodology would not only prevent the realization of statewide consumer savings, but also would perpetuate existing subsidies. Opponents urge the Board to reject LIPA's argument regarding cost allocation. They state that regional impact, while an important consideration, should not be a determinative consideration for measures intended to address a statewide issue. They emphasize that the Alternative LCR Methodology is intended to minimize costs to consumers on a statewide basis.

Opponents dismiss assertions by Ravenswood and NRG that the methodology for calculating LCRs should not be modified without also changing the methodology for calculating the statewide IRM, noting that the NYISO lacks authority to do so.

BOARD DECISION

After carefully considering this matter and the positions of the parties, we deny the appeal.

The NYISO and its consultants have performed extensive work in collaboration with stakeholders to develop the Alternative LCR Methodology, which will lower the overall cost of capacity in the NYCA and address suboptimal and counterintuitive results that have been observed using the existing TAN 45 methodology. NYISO staff have conducted numerous analyses and sensitivities regarding the Alternative LCR Methodology, and stakeholders have had ample opportunity for input. The proposal has been carefully developed, thoroughly vetted, and received widespread support from Market Participants with an affirmative Management Committee vote of 77.55%.

The Alternative LCR Methodology is a significant improvement over the current TAN 45 approach—lowering the overall statewide capacity costs and addressing suboptimal outcomes. It provides a robust, transparent, and intuitive process for developing proper capacity requirements that maintains reliability while reducing overall costs when compared to the current approach. Contrary to Appellants' assertions that the new approach would introduce volatility, analysis indicates that the Alternative LCR Methodology will provide results that are more stable than the current approach.

Appellants argue that the Alternative LCR Methodology is flawed because it does not optimize the IRM calculation along with the LCR calculations. This ignores the fact that the IRM is set by the NYSRC—not the NYISO. The NYISO lacks authority to modify the IRM methodology to co-optimize the IRM and LCR calculations. The NYSRC has stated that extensive analytic evaluations are required before it could change the current methodology for setting the IRM. The NYISO will work with the NYSRC to further explore potential development of a cooptimized approach. While co-optimization might yield additional benefits, the Alternative LCR Methodology is a clear improvement over the current approach that should be put into effect.

Concerns over "rate shock" are unpersuasive. Under current conditions, the Alternative LCR Methodology produces an LCR for Zone K that, at 107.5% for 2018, is consistent with historic ranges. Neither consumers nor suppliers have a reasonable expectation that LCRs will remain constant. By their nature they change along with changing conditions. Moreover, the prior LCRs were developed using a methodology that is being improved under the new approach.

LIPA's subsidization arguments do not support a decision to maintain the status quo. First, the baseline against which LIPA measures the anticipated impacts of the Alternative LCR Methodology is misleading because the current method is less than optimal. Second, shared benefits are inherent in many aspects of system planning, including the setting of the IRM and LCRs. This issue is not unique to the Alternative LCR Methodology. The NYISO is open to further discussion on this topic and potential alternative approaches to cost allocation. Such discussion is outside the scope of the instant proposal, however, and should not delay the implementation of the Alternative LCR Methodology.

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