To: NEPOOL Markets Committee

From: Mark Karl

Date: April 28, 2015

Subject: Deferral of Sloped Zonal Demand Curve Proposal

After further considering the sloped zonal demand curve design and in light of changes to the zone configuration, the ISO has decided not to propose the sloped zonal curves and administrative pricing changes for the tenth Forward Capacity Auction (FCA 10). Topology and other changes in the system and the current process for modeling capacity zones required the ISO to file the proposed zonal boundaries for FCA 10. Layering the sloped zonal curve changes, in light of potential reliability implications discussed below, on top of the zone changes may not be prudent at this juncture. The ISO will discuss this matter with stakeholders at the upcoming NEPOOL Markets Committee meeting on May 5-6, 2015.

The system-wide demand curve that was implemented for FCA 9 is designed to meet the 1 day in 10 years loss of load expectation (LOLE) planning criterion by seeking to procure sufficient resources from all areas of the system on an unconstrained basis to meet the net Installed Capacity Requirement. While developing the sloped zonal curves and after updating the simulation model, the ISO identified that the sloped zonal curves could reduce the expected reliability performance and shared this information with stakeholders in October of last year. The ISO proposal explicitly acknowledged the trade-off of accepting limited worsening of system price volatility and reliability performance in exchange for improvements in zonal price and reliability metrics. The trade-off was identified as a key design issue. Based on the FCA 7 system configuration, the expected system LOLE with the proposed sloped zonal curves was projected to be less than 1 day in 10 years. Preliminary analysis indicates with the potential FCA 10 zonal boundaries and proposed sloped zonal curves, the expected system LOLE may be worse than 1 day in 9 years.

The system-wide sloped demand curve, even without sloped zonal curves, provides substantial pricing and reliability benefits for all zones. In the near term, the incremental benefits of the proposed sloped zonal curves no longer appear to present a reasonably balanced set of trade-offs. The ISO believes that continuing the existing design will provide more stability during the present system configuration change and will more effectively meet the net Installed Capacity Requirement.

The convergence of zone modeling process and sloped zonal curve design highlights that further assessment is essential for the stability of the Forward Capacity Market. Subsequent to completion of

1 http://www.iso-ne.com/static-assets/documents/2014/10/a02_item_1_iso_presentation_10_07_14.pptx
2 http://www.iso-ne.com/static-assets/documents/2015/04/a04_iso_presentation_04_15_15.pptx
that assessment, options may exist that could allow for zonal curves to meet the LOLE requirements over time and over a variety of zonal configurations. Several stakeholders have expressed a desire to see this type of outcome. However, the ISO needs more time to complete that assessment and Market Participants will also need to understand and evaluate any changes to formulate their plans to respond to the market. At this point into the preparations for FCA 10, and especially with anticipation that more reforms would be necessary for future auctions, the ISO believes rushing a revised design for this auction is unwise and has the potential for unintended results.

The ISO will be assessing the possible sloped zonal curves design reforms and anticipates beginning discussion of the ISO’s proposed direction with stakeholders in the fourth quarter of 2015.