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January 18, 2001

Honorable Patrick H. Wood, III
Chairman
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: Docket Nos. RT01-2-001, RT01-2-002, RT01-86-001,
RT01-95-001, RT01-99-000, RT01-99-001, and RT01-99-002

Dear Chairman Wood:

I am writing in response to your letter dated December 10, 2001, soliciting input on a number of issues regarding the formation of Regional Transmission Organizations (RTOs). As you are aware, I firmly support establishing a regional RTO and look forward to working with you on this important initiative.

In sum, wrangling for control over the Northeast RTO (NERTO) has resulted in a divisive rivalry among the three Northeast Independent System Operators (ISOs). Thus, formation of a NERTO or any other regional organization could be stalled until the Commission resolves the issue of RTO governance. By assigning an equal number of representatives from New England ISO, New York ISO and PJM ISO to serve on the NERTO Board, FERC can reduce the turf wars and the parties can begin the difficult task of designing an RTO. The costs of this new organization should be equally allocated among the three ISOs during the initial years. In addition, the Board should have independent authority to seek FERC's approval of additions or revisions to the NERTO's governing documents. While stakeholder input is critical, it should not delay Board action or hamper the Board's ability to independently determine the best policy.

Once the Commission addresses issues related to governance and composition, the NERTO Board may then address the myriad of issues identified in Judge Young's mediation report, including the "best practices" from each of the three ISOs. The Commission could move this along by establishing a process that will promptly resolve the Standard Market Design (SMD) issues.

I also recognize that the Commission may take an alternative approach in light of the concerns raised about moving to an RTO before the SMD and seams issues have been resolved. Any interim process to establish a "virtual" RTO should not unnecessarily delay the creation of a single Northeast market. The parties are fully aware of the seams issues and what the categories of standard market rules should be. Therefore, the next step is to assess and implement the best technical approach.

Furthermore, the state commissions are concerned with creating proper incentives for new generation and transmission, while protecting consumers. An organization of multiple state commissions could most efficiently advise FERC and the RTO. In order for interested states to comment on such matters to the Commission and the RTO, we will need access to market information.

While it is difficult to take a position on the issue of an Independent Transmission Company (ITC) and its relationship to an RTO without a specific ITC proposal, we anticipate that further discussions will provide the necessary details on the specific responsibilities of each of the entities. In any event, the Commission should provide sufficient flexibility to allow for the development of alternative models within the basic construct of an RTO, including ITCs.

Finally, it is particularly important that the Canadian entities that are such a vital component of the Northeast marketplace be invited to participate.

I. Commission Guidance on NERTO Formation

A. Board Composition/Governance

The Board should reflect the experience of the existing ISOs. We strongly urge the Commission to provide for equal representation on the NERTO Board by NE-ISO, PJM and NYISO. A Board weighted in favor of one ISO could interject favoritism, or at least the appearance of favoritism, toward that ISO's practices.

Requiring two or no more than three members from each ISO will ensure impartiality and the requisite experience and expertise for the Board to successfully manage the NERTO. Individuals should be required to resign from their respective ISO Boards as a condition of accepting a position on the NERTO Board. In this way, the Board's duty will be to the NERTO exclusively. Moreover, equal representation could be upset by a voting Chief Executive Officer (CEO) and, therefore, the CEO should not have a vote on the Board if that individual would weigh the Board in favor of a particular ISO.

In addition to an equal number of Board members from each of the ISOs, a small number of independent members should be chosen by stakeholders. A Board comprised of independent members unassociated with the existing ISOs will avoid parochialism and ensure the necessary impartiality and independence to protect the interests of consumers.

Moreover, the Board should have the independence to file additions or revisions to the RTO's governing documents, such as tariffs and market rules, pursuant to §205 of the Federal Power Act. Our experience in New York is that stakeholders' advice is important but, at times, stakeholder control has hampered the ISO's ability to take appropriate actions before FERC in a timely manner.

B. Reliability and the RTO Structure

State regulators have a long history in overseeing the reliable operation of the electric systems within their states. Our experiences during the blackout of 1977 and the most recent World Trade Center disaster reinforce the importance of tailoring the new RTO system to incorporate both system-wide and local reliability requirements. The move to a larger regional organization raises additional concerns about the reliable operation of the system.

Until a more efficient and reliable process is developed, the current system and rules for ensuring local reliability should be maintained. Thus, there is broad agreement among the Northeast ISOs that the three existing control area operators should be maintained as currently configured. While the RTO would optimize markets across the entire Northeast, the existing ISO control areas would be responsible for maintaining reliability by responding to real-time system conditions.

C. "Best Practices"

If the Commission continues down the path of a single Northeast RTO immediately, which I would prefer, it should also require a SMD for the region. During the 45-day mediation process, the NE-ISO and NYISO identified what they considered to be crucial "best practices" in addition to PJM's approach.¹ The SMD should incorporate "best practices" from each market. To the extent there are situations requiring additions to the SMD, the RTO Board should incorporate those prior to the start-up of the RTO. In addition to New York's local reliability rules and market monitoring/mitigation measures discussed herein, simultaneous optimization of energy and ancillary services markets, as well as real-time pricing incentives, should be incorporated into the SMD or considered as necessary additions to the SMD.

1. Simultaneous Optimization of Energy and Ancillary Services Markets

New York's ancillary services markets are currently integrated with the Day-Ahead energy market. This simultaneous coordination of energy and ancillary services markets results in important efficiency and reliability gains. These gains should be maintained with an RTO.

2. Real-Time Pricing Incentives

Due to the highly congested nature of New York's transmission system, an adequate generation dispatch incentive structure is needed before RTO start-up. For example, New York requires generators to maintain their dispatch levels and penalizes them for failure to do so. In addition, the pricing system for must-run units needs to provide appropriate incentives so that those units remain available for dispatch.

D. Market Monitoring

During the transition to a workably competitive wholesale market, market monitoring is necessary to maintain reasonable prices and instill confidence in the market. New York has worked diligently to develop effective mitigation measures that reflect local market conditions. Currently, New York stakeholders are working to meet the Commission's requirement regarding development of uniform and comprehensive market monitoring provisions for the summer of 2002. Those measures, or similar ones, should be implemented prior to start-up of the NERTO.

E. Assignment of RTO Costs

Cost responsibility for the RTO budget should be apportioned equally among the ISOs. Apportioning administrative costs equally among the existing ISOs is consistent with equal representation. As the RTO evolves, there may be a fairer way to allocate costs. Thus, it may be appropriate for FERC to require the RTO to submit a report within 24 months of start-up that explains whether or not costs should be allocated differently.

II. State Commission Relationship With RTOs

State involvement is especially important in laying the groundwork during the transition to a fully operational RTO. Unlike other stakeholders, state regulators can provide independent input to the RTO that reflects their responsibilities in ensuring local reliability, reasonable prices, siting of generation and transmission, and effective market monitoring. We have significant experience in these areas and bring an independent and unbiased perspective to the process. Consequently, the Commission should express an expectation that the RTO's structure will reflect the unique role of the states.

¹ See, Business Plan for the Development and Implementation of a Single Regional Transmission Organization for the Northeastern United States (Business Plan), accompanying Administrative Law Judge Mediator's Report to the Commission, issued September 17, 2001, at Appendix B, p. 2.

For example, one model would be to establish a multi-state organization to formally interact with and advise the RTO and the Commission. The organization would be permitted to send a representative(s) to RTO Board meetings, including decision-making sessions. A representative(s) could also attend RTO committee meetings. The goal of this multi-state organization would be to reach consensus among the Northeast commissions on key issues and provide advice to the RTO Board. Presenting the RTO with consensus and minority opinions would be more efficient than having each state present its own position. Where consensus does exist, we would hope that FERC's rules would require the NERTO to follow our advice or provide reasons for not doing so.

Finally, market data collected by the RTO should be available to the states, on a confidential basis, in order for us to effectively monitor the market. To the extent there is market power, we share an obligation to ensure that rates are just and reasonable. The data collected by the NERTO will facilitate our inquiry.

III. In the Alternative, the Commission Should Establish a Firm Date for Standardizing the Market Rules in the Northeast and for Resolving the Seams Issues

As you are aware, there are some who think that if the market rules and the market interface issues are addressed first, the structure will fall into place. While I am not prepared to endorse that approach at the expense of the establishment of the NERTO, I am committed to resolving the SMD and seams issues by the summer period. It is imperative that the Commission establish a process that will promptly resolve these issues in time for next summer. Any move to reorder the priorities from governance to market rules and seams should not be viewed as a signal that the work of establishing a region-wide market can be delayed.

The 45-day mediation resulted in consensus that a common market design must maintain existing levels of reliability; there should be a standard market for energy, capacity and ancillary services; and that the NERTO should include day-ahead and real-time markets. Pricing in the energy market must include the cost of transmission congestion, and adequate mitigation must be in place to address market power problems on a regional, state and local load pocket basis. Moreover, the parties have been working on seams issues for over two years and should be aware of which issues need to be resolved.

Thus, major work has been accomplished. If the Commission moves first to a "virtual" RTO and then to a real RTO with one centralized dispatch, the focus should be on implementation of a SMD and elimination of seams inefficiencies. Judge Young recommended that a technology assessment be performed before establishing an RTO due to the complexity of the technology it will take to implement and administer a single Northeast RTO. If the Commission adopts a "virtual" RTO in which there are common market rules across the three ISOs and the seams issues are resolved, this same technical assessment should be done, but should take far less time.

I recommend that the technology assessment for an actual and "virtual" RTO begin immediately. As Judge Young recommended, it should be performed by independent non-vendor experts. The "virtual" RTO assessment would focus on how to efficiently optimize the economies among the three ISOs. The technical requirements for an RTO that would include a single market dispatch should be worked on concurrently. These assessments by independent non-vendor expert(s), as proposed in the mediation process, will resolve exactly what is required for the Northeast market to function efficiently as a "virtual" RTO and what is required to implement an actual RTO.

However, these assessments should not be used to delay moving forward. The parties should be directed to fix the seams problems immediately, and if they do not, the Commission should order the elimination of these inefficiencies before this summer.

If the Commission chooses this approach, it should give the parties a limited time to establish a work plan with a timetable for meeting the deadlines. If parties do not meet your deadlines, the Commission's alternative dispute resolution staff should step in and make decisions. I urge you to consider the approach taken under the Telecommunications Act of 1996. Section 252 of the Act authorizes private negotiations between parties, while recognizing that regulators may need to resolve any disputes. It sets specific deadlines for negotiations or the regulators will make decisions. I am painfully aware of the slow progress that has been made since Order 2000 and this approach could open the bottleneck.

In sum, my major concern is that if the Commission decides to focus on market design and seams issues first and then address the structure, it should insist upon prompt resolution of the issues or it should act on its own.

Thank you for the opportunity to convey these comments. I look forward to working with you.

Sincerely,

A handwritten signature in cursive script that reads "Maureen O. Helmer".

Maureen O. Helmer
Chairman