

STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

THREE EMPIRE STATE PLAZA, ALBANY, NY 12223-1350

Internet Address: <http://www.dps.state.ny.us>

PUBLIC SERVICE COMMISSION

MAUREEN O. HELMER

Chairman

THOMAS J. DUNLEAVY

JAMES D. BENNETT

LEONARD A. WEISS

NEAL N. GALVIN



LAWRENCE G. MALONE

General Counsel

JANET HAND DEIXLER

Secretary

April 9, 2002

Honorable Magalie R. Salas,
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Room 1-A209
Washington, D.C. 20426

Re: Docket No. RM01-12-000 - Electricity
Market Design and Structure

Dear Secretary Salas:

For filing, please find the Comments of the New York State Public Service Commission in the above-entitled proceedings. Should you have any questions, please feel free to contact me at (518) 473-8178.

Very truly yours,

David G. Drexler
Assistant Counsel

Enclosures

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Electricity Market Design and Structure) Docket No. RM01-12-000
(RTO Cost Benefit Analysis Report))

**COMMENTS OF THE
PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK**

Pursuant to the Notice of Technical Conference on Results of RTO Cost Benefit Report, issued March 8, 2002, the Public Service Commission of the State of New York (NYPSC) hereby submits its Comments.

Copies of all correspondence and pleadings should be addressed to:

Lawrence G. Malone, Esq.	Ronald Liberty
David G. Drexler, Esq.	Director Fed. En. Interv.
Public Service Commission	Public Service Commission
of the State of New York	of the State of New York
3 Empire State Plaza	3 Empire State Plaza
Albany, NY 12223	Albany, NY 12223
david_drexler@dps.state.ny.us	ronald_liberty@dps.state.ny.us

INTRODUCTION AND SUMMARY

As the Commission's "Economic Assessment of RTO Policy" (RTO Assessment) suggests, larger Regional Transmission Organizations (RTO) lead to greater economic benefits. We continue to firmly support FERC's vision for a fully integrated

RTO with a single set of market rules and one market design for the Northeast, including ISO-NE, NYISO and PJM.¹

It is essential that the greater benefits of a 3-ISO RTO in the Northeast are not lost as the NYISO, ISO-NE and market participants discuss a potential 2-ISO merger.² The decision whether to merge NYISO and ISO-NE will be based, in part, on cost-benefit studies conducted by the ISOs. Unless these studies clearly demonstrate that the benefits of a 2-ISO RTO are superior to a 3-ISO RTO, the Commission should reiterate its position that a 3-ISO RTO in the Northeast is necessary to meet the scope and configuration requirements established in Order No. 2000.³

We laud the Commission for preparing the RTO Assessment. Preparing a study to examine the economic costs and benefits associated with establishing RTOs is extremely difficult and time consuming. Most significantly, identifying the major assumptions and scenarios and obtaining the proper data is fraught with difficulty. Moreover, capturing all of the benefits of specific regional RTOs with a national study seems

¹ NYISO, Order on RTO Compliance Filing, issued July 12, 2001.

² In a letter dated January 29, 2002, the NYISO and ISO-NE informed Chairman Wood of their intent to develop a common market design and evaluate the feasibility of forming an RTO encompassing New York and New England.

³ See, Regional Transmission Organizations, 92 FERC ¶ 61,048, issued July 20, 2000.

unlikely. In a very short time, the Commission's consultant has made a good first step at quantifying some of the benefits. However, there are significant advantages that have not been quantified. For example, a larger RTO will result in more efficient transmission planning and better transfer capabilities to relieve transmission constraints. It will also reduce the ability of suppliers to exert market power and create greater opportunities for new entrants. Unaccounted for in the study are the increased reliability and efficiency that should accompany the sharing of generation capacity reserves. Also, the study shows increases in load payments that should not occur as a result of a larger Northeast RTO.

The assumptions and model inputs underlying the RTO Assessment demand close scrutiny. The modeling of transfer capabilities and flows between Canada and the United States and between New York City and New Jersey is important to accurately evaluate the benefits of a Northeast RTO. It does not appear that the consultants accurately modeled these transfers.

The assumptions regarding seams issues, generation capacity, reserve margins⁴, efficiency gains and reliability are equally important. These assumptions should be made available to the parties. Attached is a list of questions and information necessary to more fully evaluate the RTO Assessment.⁵

In sum, the Commission should move forward expeditiously with implementation of its RTO policy, despite any shortcomings in properly identifying the costs and benefits.⁶ With regard to the transitional issues, including the shifting of revenues within the region under a larger RTO, we propose that workshops, technical conferences or meetings be organized to begin discussing what could possibly be one of the most difficult issues delaying the move to large RTOs.

⁴ It is likely that decreases in operating reserve requirements could be attributed to the formation of RTOs. For example the combined operating reserve requirements right now, for NY, NE, and PJM are probably over 6,000 MW at any given time. Under a larger RTO, the suppliers of operating reserves would be competing in a larger and more competitive market and therefore the price of operating reserves should fall. In addition, operating revenues could be reduced by as much as several hundred MW with increased coordination.

⁵ See, Appendix A.

⁶ We recommend the Commission act on the September 17, 2001 Administrative Law Judge Mediator's Report to the Commission.

DISCUSSION

I. Benefits of a 3-ISO RTO Have Not Been Fully Captured By The RTO Assessment

The RTO Assessment was completed in a relatively short time and covered the entire nation. Consequently, it is not surprising that there are major benefits of a larger Northeast RTO which are not included.

A. The Study Does Not Address The Benefits Of Regional Transmission Planning

The Study did not address the benefits associated with transmission planning. An RTO, or similar organization, is the ideal entity to undertake transmission planning on a regional level, due to its oversight of a broader market. With improved regional transmission planning, it is likely that system reinforcements will benefit the entire region. The planning for new transmission, especially transmission that would cross the boundaries of the existing smaller ISOs/RTOs, could be more efficient by bringing together disparate parties. The RTO could then assist in recommending who should build and pay for new facilities, with accommodations made to smooth out the short term intra-regional concerns. We would hope states that have the responsibility for siting new transmission would be able, with RTO assistance, to more expeditiously review proposed transmission lines. After all, the construction of new lines should reduce congestion and lower energy prices by allowing

more energy imports within the larger trading area. Over time, increased trading should bring more competition and lower prices throughout the region.

B. The Study Does Not Address The Impacts Of Decreasing Market Power In A Larger RTO

The consultants made a conscious decision not to model the impacts of a larger RTO on market power. Consequently, the benefits of reduced market power went uncounted. A larger RTO will readily remove the artificial seams that restrict commerce between the existing ISOs and increase competition, which will reduce the ability of suppliers to exert market power. With effective competition, bidding should more closely reflect suppliers' marginal costs. In fact, the RTO Assessment assumes that generators will always bid their marginal costs in each one of the scenarios, including the existing configuration. We seriously question that assumption. Existing market mitigation does not result in bids that are driven down to marginal costs. For example, generators in New York are permitted to bid three or four times their marginal costs without triggering mitigation. Moreover, with larger RTOs bringing increased competition, market power and the need for mitigation measures should be reduced.

C. The RTO Assessment Does Not Accurately Reflect
The Transfer Capabilities In The Northeast

The RTO Assessment uses a static model to represent the Canadian System and, therefore, does not accurately reflect its role in the PJM-NY power transfers. Moreover, the transmission lines between New York City and New Jersey are not properly represented in the model. Without proper representation of those connections, the RTO Assessment's transfer capability of 1,000 MW incorrectly accounted for. This omission substantially understates the benefits of the RTO.⁷

D. The Study Shows Increases In Load Payments
That Will Not Occur As A Result Of A Larger
Northeast RTO

The RTO Assessment assumes that as a result of broader markets, the cost of wholesale power in areas which now have relatively low cost generation will increase. While it is true that additional revenues would accrue to generators in low cost regions like PJM, these incremental revenues should be captured for customers in those regions either through ratemaking adjustments for vertically integrated utilities or in the sales price of the units if the generation facilities are sold.⁸ In

⁷ Moreover, the Study did not take into account the benefits of a larger RTO in mitigating the effects of fuel price increases.

⁸ The sales price of generation should approximate the present value of its future earnings potential. If earnings prospects are enhanced because regional markets increase profitability, the sale price should increase accordingly.

either instance, the increased profitability will reduce payments for distribution of electricity, thereby offsetting increases in wholesale prices.

For example, according to the PJM Cost/Benefit Analysis for Northeast RTO,⁹ load payments will decrease throughout the Northeast region by \$299 million. The RTO Assessment shows that PJM customers will pay an additional \$71 million under the 3-ISO RTO scenario. However, this increase will be offset by the increase in generator net revenues in PJM of \$259 million (\$511 million minus \$252 million in generations production costs). Under normal ratemaking practice, a vertically integrated utility is able to earn no more than it needs to service its capital. Consequently, the increased generation revenues should go to reduce increased load payments in PJM. The additional profits on the wholesale component should result in a compensating adjustment in delivery rates.

CONCLUSION

There are limitations that make it difficult to accurately evaluate the costs and benefits of forming RTOs. The benefits are likely more substantial than presented in the RTO Assessment. Regardless of the RTO Assessment's shortcomings, the Commission should move forward with a 3-ISO Northeast RTO.

⁹ See, RTO Assessment at p. 20, Table 1.2.

Interested stakeholders should be brought together to address the transitional issues associated with intra-regional impacts.

Respectfully submitted,

Lawrence G. Malone
General Counsel
By: David G. Drexler
Assistant Counsel
Public Service Commission
of the State of New York
3 Empire State Plaza
Albany, NY 12223-1305
(518) 473-8178

Dated: April 9, 2002
Albany, New York

APPENDIX A

April 9, 2002

Via Electronic Mail

Re: Questions Regarding Regional Transmission
Organization Cost Benefit Analysis

- 1) Provide an assessment of the results of the RTO Policy scenario with 4 RTOs (Table 3.8) compared with the Small RTOs scenario (Table 3.16), as they pertain to the 4 sub-regions in New York, using 2010 as an example.
- 2) Provide all input data and assumptions, including a description of the methodology used to develop the numerical results in the report.
- 3) What are the input differences between the 9 RTO scenario and the 4 RTO scenario, as they relate to the Northeast?
- 4) How are the Northeast seams issues treated in the 9 RTO scenario and the 4 RTO scenario?
- 5) What are the assumed transmission transfer capabilities/limits into and out of the 4 sub-regions in New York?
- 6) What is the basis for New York's reserve margin reduction assumptions? If the reserve margins were not reduced, but instead, larger amounts of additional generation were assumed, would a larger RTO be relatively more beneficial than the smaller RTOs?
- 7) What assumptions were made about retiring or re-powering any existing generators?
- 8) On page 49, the study indicates that it "treats power markets as spot pools that clear on a marginal cost basis within a set of defined demand segments." What are these demand segments? How many are there?
- 9) On page 19 of the summary, what does the "3.5% reduction in peak beginning in 2006" refer to (i.e., was it a capping of the demand at 96.5% of the projected peak in 2006 and in each year thereafter)?

- 10) While an efficient dispatch would not produce power flows from a higher cost region to a lower cost region, such flows are possible at the seams via external transactions. Does your analysis incorporate such "backwards" flows and the benefits of eliminating them?
- 11) Explain how the "hurdle rates" were developed.
- 12) What values were assumed for "hurdle rates" between the 4 New York sub-regions in the base case, 4 RTO scenario, and 9 RTO scenario?
- 13) What can the increase in power flows to the South be attributed to?
- 14) Does the model include the transmission paths between the United States and Canada?
- 15) The report stated that the analysis does not address the savings to buyers that would occur if a larger RTO reduced market power. What is your estimate of these savings?

CERTIFICATE OF SERVICE

I, Naomi Tague, do hereby certify that I will serve on April 9, 2002, the foregoing Notice of Intervention and Comments of the Public Service Commission of the State of New York by depositing a copy thereof, first class postage prepaid, in the United States mail, properly addressed to each of the parties of record, indicated on the official service list compiled by the Secretary in this proceeding.

Date: April 9, 2002
Albany, New York

Naomi Tague