

# STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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## PUBLIC SERVICE COMMISSION

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April 10, 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 ) Docket No. RM01-12-000  
STRUCTURE )

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

Pursuant to the Notice of Working Paper on Standardized Transmission Service and Wholesale Electric Market Design (Working Paper), issued March 15, 2002, the New York Public Service Commission (NYPSC) hereby submits its comments.

**INTRODUCTION AND SUMMARY**

The Federal Energy Regulatory Commission's (FERC's or Commission's) initiative to create a standardized wholesale market design (SMD) is a major step toward establishing a competitive wholesale market. A SMD should enhance competition within and among regional markets across the nation, provided necessary regional differences are accommodated. We support the SMD's use of locational based marginal pricing as the system for congestion management and agree that price signals should support efficient decisions about consumption and new investment. It should be noted, however, that they are not complete substitutes for a transmission planning and expansion process.

The comments below reflect refinements that should be made to the SMD.<sup>1</sup> Most importantly, while we agree that RTOs will eliminate seams problems, there will still need to be room within the SMD to accommodate necessary reliability and economic conditions unique to a region. In particular, our experience in New York is that an installed capacity (ICAP) market is necessary to ensure that there is sufficient generation available to meet our reliability needs. Furthermore, New York market participants are considering market enhancements that may include an additional hour-ahead market for settling imbalances in the day-ahead market (DAM), which might be more efficient than settling all imbalances in the real-time market (RTM) only. Similarly, multi-part bids by generators capable of being committed in the hour-ahead or real-time markets could be very efficient.

Finally, a SMD should include market mitigation measures where appropriate until such time as the market power is eliminated. Most importantly, the Commission should obtain the

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<sup>1</sup>In addition to those issues described below, we request clarification in the Notice of Proposed Rulemaking (Notice) as to what the Commission intends the process to be for long-term planning and expansion. Moreover, the Commission should clarify that bidding restrictions on availability bids in the regulation and operating reserves markets may be necessary to prevent the exercise of market power. We assume that the Notice will not take issue with the long held principal that states control transmission planning by transmission owners (TOs) that have divested themselves from their generation.

data used by the RTO to establish marginal costs in those instances where the market is not competitive (i.e., establish reference prices). With the RTO acting as the surrogate for competition, the Commission will be unable to fulfill its responsibilities unless it is able to audit plant-specific costs.

## DISCUSSION

### I. The SMD Should Accommodate Regional Variations

We agree with the Working Paper's conclusion that "[d]eviations or changes from the [SMD]...must also be compatible with neighboring systems to prevent seams issues."<sup>2</sup> Currently, trades between regions are hampered because of a lack of coordination at the seams. Because we would expect that the establishment of regional transmission organizations will eliminate the existing seams problems within each RTO, variations from the SMD that address local conditions should be permitted. Identified below are New York market practices, which are not identified in the Working Paper but should be maintained. Of course, there may be different local practices that should also be permitted in other regions.

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<sup>2</sup> Working Paper at p. 6.

**A. Long-Term Generation Adequacy**

As the Working Paper notes, the SMD "may include measures to enhance adequate long-term generation supplies."<sup>3</sup> However, the need for national uniformity is not obvious, and therefore factors unique to each region must be accommodated. For example, in New York City (NYC) and on Long Island, where transmission and generation is limited, it is critical to ensure sufficient capacity exists by requiring forward contracts for capacity. The New York market ensures capacity via a requirement for installed capacity (ICAP). The ICAP market provides payments to generators in return for assurances that sufficient generation will be bid into the NYISO market in the DAM. To illustrate, peaking units which are important to maintain reliability, but do not run often enough to cover their costs, receive necessary revenues through ICAP payments.

On the other hand, regions which have different transmission/generation configurations and different reliability requirements may not need incentives such as ICAP. However, until a more optimal system of ensuring adequate long-term capacity is developed for New York, the current ICAP system for ensuring capacity availability is critical to maintaining reliability.

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<sup>3</sup> Working Paper at p. 24.

### **B. Day-Ahead Energy Market**

The Working Paper proposes that imbalances in energy scheduled to be bought and sold in the DAM "must be settled at the real-time energy price."<sup>4</sup> Although the NYISO already administers a day-ahead market and real-time market, New York market participants are currently involved in discussions which may consider a settlement process in the hour-ahead market. The SMD should not foreclose this option if it benefits the market.

### **C. Real-Time Energy Markets**

Another proposed guiding principle for SMD is that "[b]ids to sell in the real-time market must be one-part energy bids."<sup>5</sup> This principal should not be used to prevent bids of legitimate start-up costs of units that may be committed in an hour-ahead or RTM, such as quick-start gas turbines. Once real-time software is able to evaluate multi-part bids, a more efficient unit commitment and dispatch could result from the more precise identification of the fixed and variable components of a unit's costs. Such an approach should not be precluded.

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<sup>4</sup> Working Paper at p. 16.

<sup>5</sup> Working Paper at p. 17.

**II. The Commission Should Clarify and Expand Upon  
The Principals Identified in the Working Paper**

**A. Energy-Limited Resources**

The Working Paper identifies the need to develop options "to address the special conditions facing energy-limited resources (ELRs)" and suggests that "these additional options should be available to all generators..., unless such restrictions are necessary to mitigate market power that has arisen."<sup>6</sup> This approach is too broad in that it suggests that non-ELR generators are entitled to special treatment. In New York, ELRs are permitted to bid more energy than they can actually deliver, without penalty, to compensate for software shortcomings which are incapable of recognizing special circumstances facing ELR's. These rules, however, do not extend to all generators because they would invite gaming of the market. For example, a non-ELR generator could bid its energy at a very low price in the DAM, but deliver less energy in-day than was scheduled, without penalty. As a result, the ISO/RTO would be forced to replace that energy at a higher price in the RTM. Thus, it is appropriate to allow this option only for specific generators which qualify as energy-limited resources and whose bids can be carefully monitored to prevent abuse.

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<sup>6</sup> Working Paper at p. 14.

## **B. Market Power Monitoring and Mitigation**

While we agree with the Working Paper that market design flaws can create or enhance market power, not all market power problems can be solved with market design improvements. Consequently, effective market mitigation measures must be applied to load pockets, as recognized in the Working Paper, and must be available in other geographic areas during peak periods when the price elasticity of supply is low.

Until such time as market power is eliminated and significant real-time price responsive demand exists, wholesale electric markets are vulnerable to the exercise of market power at peak periods when the market clears on the steep portion of the supply curve. As has been demonstrated by the successful implementation of the Automated Mitigation Procedures (AMP) in New York, a well designed mechanism can properly distinguish between high prices caused by the exercise of market power that must be mitigated and scarcity prices that must be left alone.<sup>7</sup> The Commission's next step should be to incorporate a mechanism, such as the AMP, in its standardized market design to address possible market power in areas that may not be constrained.

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<sup>7</sup> FERC Docket No. ER01-3155-000, Order Approving Extension of Automatic Mitigation Procedures Subject to Conditions (issued November 27, 2001, p.10) The Commission's "review of the AMP indicates that it appropriately attempts to distinguish between market power and scarcity."

Moreover, the Working Paper does not address the process that the RTO should use to estimate generator-specific marginal costs in instances where generator-specific bid caps, such as reference prices, can be used in mitigating uncompetitive load pockets.<sup>8</sup> These reference prices must properly reflect the appropriate generator bids as if the market were unconstrained and competitive, thereby acting as a surrogate for "just and reasonable" rates. Consequently, a process must be established which would allow the Commission to audit the ISO's/RTO's findings. We therefore recommend that the SMD for mitigation include a requirement that generator-specific operating data be provided by the ISO/RTO to the Commission.<sup>9</sup>

### **C. Marginal Opportunity Costs**

While we agree with the theory that generators should be permitted to bid up to the marginal cost of a unit, there are practical reasons why administrative attempts to incorporate

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<sup>8</sup> These are generally referred to as "reference prices" or "reference values." The preferred basis for reference values is the average of a generator's bids during competitive periods. In many instances such data is inadequate and, in its place, the estimate of the generator's marginal cost is used.

<sup>9</sup> While we are not prepared to endorse any particular organizational structure for an "independent" market monitoring unit(MMU), our experience in New York is that the most effective MMU is one that has adequate personnel and resources with immediate access to market data and generator data. The MMU must be committed to fairly balancing the interests of generators and the consuming public, and have the authority to take necessary corrective action.

opportunities in different geographic markets will render market rules ineffective. Moreover, once seams issues, which currently inhibit the free transfer of power across geographic regions are resolved, the market price in a region will reflect prices in adjacent markets, making the opportunity cost adjustment redundant. Relying, instead, on markets to define opportunity costs is a more accurate and efficient solution than any administrative process could hope to bring.<sup>10</sup>

The difficulty and complexity of attempting to estimate geographic opportunity costs will turn the process into an administrative nightmare. Every day, the generation owner and the RTO would be required to make their own predictions of market prices in nearby markets for each hour of the next day. The generator would then bid to sell within its home RTO at prices which reflect these forecasts, while the RTO would establish reference values for each generator that reflects the RTO's own forecast of market prices in other geographic areas. The RTO would then compare its estimate to the generator's bid to determine which bids are non-competitive and require mitigation. To accomplish this, the RTO's Market Monitoring Unit (MMU) would need to be expert in forecasting the market

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<sup>10</sup> We agree that the temporal opportunity cost component, which for the most part applies only to hydro facilities, must be maintained because it enables generators to submit off-peak bids that are relatively high to reflect the opportunity of saving the water for use during peak periods.

prices of all nearby geographic markets and must be prepared to resolve disputes with generation owners that believe their own forecasts of nearby market prices are more accurate than the RTO's. More importantly, the days for which it is most difficult to make market price forecasts (i.e., peak or near-peak days), are the ones where proper mitigation, or a decision not to mitigate, is most important. It is on those days that the disputes will take place.

Instead, the Commission should recognize that currently the trading of power among and between markets generally yields prices that reflect the marginal costs in adjacent markets. While seams issues presently render the transfer of market impacts from one market to another imperfect, there is, nonetheless, a strong interdependence that works well much of the time, and causes the market price in a generator's home market to rise and fall as a function of factors at play in nearby markets. Relying on the market in this manner is more efficient than attempting to manage an entirely new system for estimating geographic opportunity costs.

**CONCLUSION**

The Commission's SMD should accommodate regional differences and carefully consider the changes recommended above as it prepares a notice of proposed rulemaking on a national SMD.

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 10, 2002  
Albany, New York

CERTIFICATE OF SERVICE

I, Naomi Tague, do hereby certify that I will serve on April 10, 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 10, 2002  
Albany, New York

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Naomi Tague