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May 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 Motion to File Late Comments and 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

**MOTION TO FILE LATE COMMENTS AND
COMMENTS OF THE
PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK**

INTRODUCTION

On April 10, 2002, the Federal Energy Regulatory Commission (FERC or Commission) issued a Notice of Options Paper entitled "Options for Resolving Rate and Transition Issues in Standardized Transmission Service and Wholesale Electric Market Design" (Options Paper). The Options Paper and Comments will be used to guide the Commission's establishment of a national Standard Market Design (SMD) through a pro forma tariff. More specifically, the Options Paper identifies various options for dealing with issues related to: 1) the manner in which embedded costs of the transmission system will be recovered; 2) the manner in which transmission rights will be allocated among customers; 3) the transition of customers under existing contracts (real or implicit) to the new service; and 4) how to ensure long-term generation adequacy.

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, the Options Paper and Notice Regarding Requests for Extension of Time, issued April 26, 2002, the NYPSC hereby

submits its Motion to File Late Comments and Comments on these issues and the options for resolving them. The Commission encouraged parties to file comments as soon as possible after the May 1, 2002 deadline, so that they may be considered in development of an upcoming Notice of Proposed Rulemaking. Because no party will be harmed or burdened by accepting these comments, we respectfully request that FERC grant the Motion and make our comments part of the record in this proceeding.

In sum, charges for the use of the transmission system raise a host of rate design issues which must be evaluated before shifting costs from one class of customers to another. Consequently, access charges should be paid by customers taking power off the grid. To do otherwise could lead to double charges or free riders. In order to avoid pancaking, access charges should not be applied to individual export and wheel through transactions. However, regions with net exports or wheel throughs should receive compensation from importing regions based on annual aggregate transactions. In addition, access charges should be based on monthly peak load for transactions within an Independent System Operator's/Regional Transmission Organization's (ISO/RTO) control area. This approach would ensure that the transmission system is used most efficiently, while imposing relevant costs on those that receive the greatest benefits of the transmission system.

The revised pro forma tariff that would implement a SMD should accommodate customers with existing wholesale contracts. For example, grandfathering existing contracts would avoid potential financial harm.

Initial transmission rights should be allocated based on existing customers' usage to avoid cost shifting. Future rights should be subject to an auction process. However, these auctions should be for short periods due to the immature nature of the market, the risk associated with longer auction periods, and the fact that insufficient revenues could cause end-use customers to make up the difference between the auction value and the actual cost of congestion.

Finally, we recommend that capacity obligations be imposed on load serving entities (LSEs) to ensure adequate long-term generation during the transition to competitive wholesale markets.

DISCUSSION

I. Embedded Cost Recovery/Rate Design

A. Access Charges Should Only Be Paid By Customers Taking Power Off The Grid

The Options Paper presents the following options for determining who pays the access charge for deliveries within the transmission provider's system: 1) access charges apply to anyone that schedules deliveries; 2) access charges are paid

only by customers that take power off the grid; and 3) access charges are paid only by customers that can be offered Transmission Rights or the allocation of revenues from the sale of Transmission Rights.

If the Commission is going to standardize access charges, we recommend that it impose access charges on the customers taking power off the grid (Option 2). This approach, as currently utilized by the New York Independent System Operator, Inc. (NYISO), places the access charges upon end-use consumers who receive significant benefits from the transmission system. Moreover, consumers have historically paid this charge and therefore Option 2 will not cause major disruptions.

On the other hand, Option 1, which applies access charges to anyone scheduling deliveries within the transmission provider's system, would impose multiple charges on intermediate transactions, thereby creating a disincentive for trading in the energy markets or scheduling multiple transactions. To illustrate, market participants wishing to avoid such charges could opt out of the energy market and trade offline, only using the energy market to settle their net positions.

Because Option 3 links the payment of access charges to the receipt of Transmission Rights, (i.e., Transmission Congestion Contracts (TCCs)) or auction revenues from those rights, it would allow some customers to inequitably avoid access charges.

For example, under Option 3, customers in low price areas that do not need Transmission Rights would not have to pay access charges but would receive the benefits of the transmission system.

B. Access Charges Should Not Apply to Exports and Wheel Throughs But There Should Be An Annual Revenue Adjustment

The four options for applying access charges to exports and wheel throughs are: 1) the access charge applies to exports and wheel throughs; 2) the access charge does not apply to exports and wheel throughs; 3) the access charge would not apply to individual transactions but there would be an annual revenue adjustment; and 4) a lower access charge would apply to exports and wheel throughs than for deliveries within the transmission providers' system.

In choosing an option, the Commission must balance the impacts of the desire to eliminate rate pancaking and to use the transmission system most efficiently, against inequitable cost shifting. Allocating access charges for exports and wheel throughs based on the aggregate transactions between regions for the year (Option 3) strikes the proper balance. Option 3 allows for the recovery of embedded costs from those receiving the greatest benefits by determining each region's net annual contribution to such transactions. This option eliminates

access charges on individual transactions (i.e., pancaking) from the cost of energy thereby allowing for more efficient trading, commitment and dispatch. To the contrary, Options 1 and 4, which impose charges on individual transactions, interfere with economic dispatch. Although Option 2, which does not apply access charges to export and wheel through transactions, would incent the most efficient dispatch, it may lead to significant cost shifting, which Option 3 could mitigate.

C. Access Charges Should Be Billed
Based on Peak Load

The three options for billing access charges are:

1) using monthly peak load for billing the access charge; 2) using annual peak load for billing the access charge; and 3) billing the access charge for each MWh used.

As a guiding principle, those that receive the greatest benefits of the transmission system should pay the greatest costs. Customers that use the transmission system during peak or near-peak loads, when the value of reducing congestion costs is highest, receive the greatest benefits of the system. Accordingly, those customers should pay for the greatest costs. One way to do so is to base the access charge on peak load (Options 1 or 2). However, it is preferable to use a monthly peak load (Option 1), which captures seasonal variations, rather

than an annual peak load (Option 2), which may allocate a disproportionately large amount of the costs to those that use the transmission system for relatively short time frames. Option 3, which would bill the access charge for each MWh used, treats the value of the transmission system as the same for all hours, regardless of congestion costs, and therefore produces inequitable results and economic inefficiencies. Consequently, Option 1 is the most efficient choice.

II. Transition of Customers Under Existing Contracts to SMD

Customers With Existing Wholesale Contracts Should Be Accommodated Under the Revised Pro Forma Tariff

The Options Paper also addresses the issue of how customers under existing wholesale contracts and customers taking bundled retail service should be switched to transmission service under the revised pro forma tariff.¹ The three options for resolving this issue are: 1) all service occurs under an open access transmission tariff at the time SMD is implemented; 2) convert all customers taking bundled retail service upon implementation of SMD and provide strong incentives for customers under existing contracts to convert; and 3) allow regional variations if there will be an RTO in place when SMD is implemented.

¹ The issue of retail unbundling presented in the Options Paper is not an issue for New York.

At the start-up of the NYISO, widespread support for establishing competitive markets was made possible because parties with existing contracts were allowed to retain the benefits of their bargained-for positions. The Commission should consider the impact of Option 1, which would convert customers under existing contracts to service under the pro forma tariff at the time SMD is implemented. Abrogating such existing contracts may result in significant financial harm to consumers and/or suppliers. The Commission's goals could better be accomplished by either providing strong incentives for customers under existing contracts to convert (Option 2) or allowing regional variations (Option 3).

III. Allocation of Transmission Rights

A. Initial Transmission Rights Should Be Allocated Based on Existing Customers' Usage

The options for resolving whether existing customers should get the initial Transmission Rights include: 1) converting existing customers' usage to the initial Transmission Rights; and 2) giving all customers that pay access charges the same rights to Transmission Rights.

The Commission should utilize the same approach employed by the NYISO, which permitted existing customers to convert

their usage to the initial Transmission Rights (Option 1).² This approach recognizes that it is the native load that funded the transmission system and therefore should also receive the initial benefits associated with that funding. Moving to other formulae, such as in Option 2, which gives all customers that pay access charges the same rights to transmission rights, may cause significant cost-shifting, including increased costs to end-use consumers.

B. Transmission Rights Should Be
Auctioned For Short-Terms

The Commission identifies four options for allocating Transmission Rights if existing customers are given the initial conversion rights. Specifically, these options include:

1) assigning rights based on existing contract rights and existing customers' usage; 2) auctioning Transmission Rights and assign the auction revenues based on existing contract rights (real and implicit); 3) a partial allocation and auction; and 4) allowing regional variation where an RTO will be in place when the SMD is implemented.

Option 2 is preferable because it will allow the market to establish the value of Transmission Rights through an auction.

² Under the NYISO's approach, Transmission Rights are allocated based on the ownership of transmission facilities, and therefore the benefits ultimately accrue to the customers of the Transmission Owners.

However, any auction should be for short periods (i.e., 6 months or 1 year TCC auctions). Auctions covering long periods are extremely risky and are likely to yield low auction revenues. For example, in September 2000, the NYISO conducted auctions for five-year terms and two-year terms. The five-year transmission rights sold for approximately the same price as two-year transmission rights, which suggests that the rights for years three through five of the five-year auction were sold for almost nothing.³ As a result, customers may end up paying for the shortfall between the auction value and the actual cost of congestion. Moreover, because the designs of Transmission Rights and auctions are still evolving, short-term auction periods make it easier to adjust markets in the future, whereas auctioning off long-term rights may hinder implementation of improvements.

In the alternative, any partial auction (Option 3) should be commensurate with the demand for long-term transmission rights.

³ Specifically, transmission rights for five years (2000-2005) from the reference bus in western New York to the Indian point 2 bus yielded an average of \$164,308 in revenues across four auctions, while the same rights for two years (2000-2002) yielded an average of \$158,854 in revenues across three auctions. As such, the rights for years three through five effectively sold for just \$5,454. The results on an annual average basis show that the five-year auction yielded \$32,862/year while the two-year auction yielded \$79,427/year.

Although Option 1 does not have the disadvantage of long term transmission rights auctions, it has the disadvantage of not allowing the market to establish the value of Transmission Rights through auctions. Option 4, which allows regional variation, is also disadvantageous because it could interfere with establishing cross-RTO Transmission Rights and contribute to seams issues.

IV. Long-Term Generation Adequacy

Capacity Obligations Are Necessary To Ensure Adequate Long-Term Generation

The five options for ensuring long-term generation adequacy are as follows: 1) rely on energy prices and information on projected supply/demand situation; 2) require a regional supply obligation; 3) require a regional capacity obligation; 4) impose a supply obligation on LSEs only if projected reserves fall below a trigger level; and 5) capacity obligations for operating reserves only.⁴

As we move toward competitive wholesale markets, it is necessary to have capacity obligations in place to ensure long-term generation adequacy until sufficient supplies exist in

⁴ While Option 5 may be advantageous, it is not clear how this option would operate and we request that the Commission provide further clarification.

constrained areas (Option 3).⁵ New York City and Long Island are two regions in New York where such an obligation is needed to meet capacity needs and ensure reliability in the interim. New York's installed capacity (ICAP) market currently does so by providing generators a source of revenue in exchange for a commitment to offer their capacity on a day-ahead basis and as a resource that can be called upon in-day to meet emergency conditions. For example, the ICAP market allows several peaking units in New York City, which are necessary for reliability purposes, but do not operate often enough to recover their fixed costs, to recover these costs. The ICAP market is not only valuable to maintaining existing generation, but it also provides an incentive for construction of new generation.⁶

The other Options present serious drawbacks. For instance, Option 1, which relies on energy prices and information on the projected supply/demand situation, cannot be easily implemented. This implementation problem is due to a lack of adequate infrastructure including meters and circuit breakers that prevents load shedding targeted to specific LSEs that do not

⁵ It may be inefficient to set one region-wide capacity obligation based on local capacity, load and constraints.

⁶ We are working on approaches with market participants at the NYISO to improve the design and operation of the ICAP market by providing more stability to ICAP prices. Reducing the volatility of the ICAP market should improve the effectiveness of the ICAP market in encouraging new generation.

have adequate supplies. Moreover, Option 1 could lead to lower generation capacity, especially in New York City, resulting in decreased reliability and an excessive number of energy price spikes.

Option 2, which would require a regional supply obligation, is also objectionable because it restricts the flexibility of the market participants and would hinder the development of an efficient wholesale energy market. Similar to Option 1, a lack of infrastructure prohibits LSEs from being curtailed, as envisioned in Option 2. Furthermore, Option 2 may be very expensive to implement.

Finally, Option 4, which imposes supply obligations on LSEs if inadequate supplies exist to meet projected future demand with an appropriate reserve margin (e.g., 15%-18%), fails to consider that substantially higher reserves might be required to ensure a competitive market.

CONCLUSION

The Commission should balance competing interests given that the various options described in the Options Paper have the ability to significantly impact efficiency, revenues and rates.

Respectfully submitted,

Lawrence G. Malone
General Counsel
By: David G. Drexler
Assistant Counsel

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of the State of New York
3 Empire State Plaza
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Dated: May 10, 2002
Albany, New York

CERTIFICATE OF SERVICE

I, Naomi Tague, do hereby certify that I will serve on May 10, 2002 the foregoing 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: May 10, 2002
Albany, New York

Naomi Tague