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November 8, 2002

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

Re: ISO New England, Inc.
New York Independent System Operator, Inc.
Docket No. RT02-3-000

Dear Secretary Salas:

For filing please find the Notice of Intervention and Comments of the Public Service Commission of New York in the above-entitled proceeding. Should you have any questions, please feel free to contact me at (518) 474-1585.

Very truly yours,

Penny Rubin
Managing Attorney

Enclosure

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

ISO NEW ENGLAND, INC.)
NEW YORK INDEPENDENT)
SYSTEM OPERATOR, INC.)

DOCKET NO. RT02-3-000

**NOTICE OF INTERVENTION AND COMMENTS OF THE
PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK**

Pursuant to the Notice of Filing, issued August 28, 2002, and Rule 214 of the Federal Energy Regulatory Commission's (Commission) Rules of Practice and Procedure, the Public Service Commission of the State of New York (NYPSC) respectfully submits this Notice of Intervention and Comments in opposition to the Joint Petition of ISO New England Inc. (ISO-NE) and the New York Independent System Operator, Inc. (NYISO) (collectively, Petitioners) for a declaratory order stating that their proposed new Northeastern Regional Transmission Organization (NERTO) would qualify as a Regional Transmission Organization (RTO). Copies of all documents and correspondence should be sent to:

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Ronald Liberty
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In our judgment, the benefits claimed for the NERTO can be realized, with far less cost, by adoption of the Standard Market Design (SMD) that the Commission is considering in a separate proceeding.¹ Considering the broader context of the Commission's efforts to date and

¹ Docket No. RM01-12-000, Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design, Notice of Proposed Rulemaking (July 31, 2002) (the SMD NOPR).

its anticipated future efforts to develop effective, competitive markets for electricity, adoption of the rate design feature of the SMD would make far more sense than pursuit of the NERTO plan. NYDPS would support a regional combination which met the Commission's test for the scope of a natural wholesale market and whose organization was both responsive to constituent groups and equipped to handle market power issues.² Accordingly, we recommend that the Commission reject the Petition and proceed, free of this distraction, in the direction of the SMD.

I. THE COMMISSION CONTEMPLATED AN RTO COMPRISING NEW ENGLAND, NEW YORK, AND PJM; NERTO GROWS OUT OF THE FAILURE TO ACHIEVE THAT GOAL.

In its Order No. 2000,³ the Commission set the standards applicable to the organization of RTOs as the then-favored means of advancing the development of competitive electricity markets. Among other things, it determined that an RTO must serve an appropriate region, that is, a region of sufficient scope and configuration to permit the RTO to effectively perform its required functions and to support the efficient and non-discriminatory operation of power markets.⁴

The Commission addressed itself to the proper size of a Northeast RTO in a series of orders issued July 12, 2001. Noting its ongoing efforts "to facilitate the development of large, regional transmission organizations reflecting natural markets," the Commission found that "at a minimum, the Northeast United States [comprising New England, New York, and the Pennsylvania-New Jersey-Maryland Interconnection (PJM)] constitutes a single region that

² New York continues to support a PJM, New York, New England RTO as the natural wholesale market in the Northeast.

³ See, Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (January 6, 2000) (hereinafter Order No. 2000).

⁴ Id.

should not be divided up into multiple RTOs.⁵ It initiated a mediation looking toward "formation of [that] single RTO for the Northeastern United States."⁶ At the conclusion of that process, the mediator offered the Commission a detailed "blueprint" for an RTO encompassing New England, New York, and PJM.⁷

Despite the progress represented by the mediator's report and a considerable degree of stakeholder involvement, the Northeastern ISOs have been unwilling or unable to press forward with the three-way merger and the Commission has not compelled them to do so. Instead, PJM has gone ahead with a number of alliances, while NYISO and ISO-NE have pursued the merger here proposed. It appears highly unlikely that a three-way merger will be accomplished in the foreseeable future; among other things, disagreements over RTO governance have proven a stumbling block.

Meanwhile, the Commission has embarked on a salutary new course--the SMD NOPR--that makes ISO mergers less immediately significant. The SMD provides a mechanism for gaining the benefits of larger markets, circumventing the resistance of some ISOs and stakeholders to the establishment of RTOs. As detailed in the next sections, the goals of the SMD are substantially the same as those of RTOs; the benefits offered by NERTO are largely available through the SMD; and achieving those benefits through the SMD rather than through NERTO avoids significant, disruptive problems. Accordingly, the two-way merger here proposed is not a smaller step in the right direction, toward a larger RTO. On the contrary, it

⁵ New York Independent System Operator, Inc., et al., 96 FERC ¶ 61,059, at 61,184 (2000), (rejecting the NYISO's proposal to constitute itself an RTO unto itself).

⁶ Regional Transmission Organizations, 96 FERC ¶ 61,065 at 61,282 (2001).

⁷ Docket No. RT01-99-000, Regional Transmission Organizations, Administrative Law Judge Mediator's Report to the Commission (issued September 17, 2001).

would be a costly diversion producing few if any benefits that could not be realized at much lower cost through elimination of barriers to economic transactions provided for in the SMD; and it would likely prove unsuccessful in view of the overwhelming opposition to it on the part of states and market participants.

II. THE GOALS OF THE SMD ARE SUBSTANTIALLY THE SAME AS THOSE OF AN RTO.

Order No. 2000 identified the aims of an RTO as to "(1) improve efficiencies in transmission grid management; (2) improve grid reliability; (3) remove remaining opportunities for discriminatory transmission practices; (4) improve market performance; and (5) facilitate lighter handed regulation."⁸ In that Order, the Commission went on to state its expectation that RTOs would be voluntarily formed, but it noted that "[i]f the industry fails to form RTOs under this approach, the Commission will reconsider what further regulatory steps are in the public interest."⁹

The goals sought to be advanced by the SMD are strikingly similar to those identified for RTOs; they can be summed up as efficient, reliable markets. The SMD NOPR states, for example, that

The Commission's objectives in this [proceeding], therefore, are to remedy remaining undue discrimination and establish a standardized transmission service and wholesale electric market design that will provide a level playing field of all entities that seek to participate in wholesale electric markets. The Commission proposes to provide new choices through a flexible transmission service, and an open and transparent spot Market design that provides the right pricing signals for investment in transmission and generation facilities, as well as investment in demand reduction.

⁸ Order No. 2000, at p. 5 (footnote omitted).

⁹ Order No. 2000, at p. 6.

...We seek in this rulemaking to put in place sufficient regulatory backstops to protect customers against the exercise of market power when structures do not support a competitive market. Market monitoring at all times, and market power mitigation when needed, are critical pieces of this initiative.¹⁰

Later, the Commission declares its purposes to be "to remedy undue discrimination, enhance competition, remove economic inefficiencies and ensure just and reasonable rates, terms and conditions [for the] transmission of electric energy."¹¹

Thus, the SMD goes so far in the direction of an efficient, seamless market as to obviate immediate RTO development; indeed, the SMD can be regarded as the "further regulatory step...in the public interest" that the Commission contemplated taking if the RTO initiative failed to bear fruit. The Commission, as noted, called for formation of a Northeast RTO that includes PJM, but that initiative was not pursued.¹² Under current circumstances, the rate design features of the SMD offer a more efficient means of achieving the Commission's goals for the power markets.

III. THE PETITION FAILS TO IDENTIFY SUBSTANTIAL ECONOMIC BENEFITS THAT COULD BE ACHIEVED ONLY THROUGH NERTO

In their economic study, Petitioners present the following base case summary of the incremental savings in wholesale power costs expected to be achieved through NERTO in 2005 and 2010¹³:

¹⁰ SMD NOPR ¶¶ 3-4 (footnote omitted).

¹¹ Id., ¶6.

¹² Petitioner's use of the term "Northeast" is striking, given the Commission's use of the term, noted above, to include PJM as well as New York and New England. Petition, p. 19

¹³ Petition, Attachment X, p. 33.

	2005/\$Million	2010/\$Million
(1) Market Standardization	61	13
(2) Eliminate Export Fees	142	68
(3) Single Dispatch	7	33
(4) Organizational Savings	10	35
Total	<u>220</u>	<u>150</u> (rounded)

The SMD provides for market standardization, eliminates seams, and eliminates export fees. Accordingly, the savings from market standardization and elimination of export fees on lines (1) and (2) of the table--amounting to 92% of the total savings in 2005 and far smaller savings in 2010--can be achieved through the SMD, without requiring establishment of the RTO.

IV. THE NERTO PROPOSAL LACKS WIDESPREAD SUPPORT, SUGGESTING A DIFFICULT, COMPLEX AND POTENTIALLY COSTLY IMPLEMENTATION PROCESS

The NERTO fails to meet the “minimum” standard set forth by FERC in defining a natural market region for the Northeast, noted earlier, because it excludes a major trading partner of New York, PJM. Further, any merger of two or more ISOs into a new RTO raises a host of issues related to the merger process, the governance and operation of the new RTO, reliability, and related matters (It also entails, at least in New York, the need to secure state regulatory approval for the associated transfer of assets.¹⁴). In assessing those issues and the likelihood that they will be successfully resolved, we cannot lose sight of the overwhelming opposition to NERTO on the part of the expected market participants.

The Petition describes what it characterizes as "an extensive stakeholder process" through which the proposal was developed, suggesting it enjoys wide support. In fact, the contrary is

¹⁴ See New York Public Service Law §70.

true. The ISOs invited parties to numerous, lengthy committee meetings to share their views on significant NERTO issues. Unfortunately, the management of both ISOs paid little attention to the ideas and suggestions of participants. That, in large part, explains why the NERTO is not supported by most of the interested parties. At the June 13, 2002 meeting of the NYISO Management Committee, a motion to support the filing of the Petition was soundly defeated, with 80% of the votes opposed. In New England, a resolution that the New England Power Pool Participants Committee support the filing of the Petition was defeated, with nearly 90% of the votes opposing it.

This powerful opposition to NERTO bodes ill for its successful implementation. Effective operation of an RTO requires that the players be committed to the process and eager to cooperate in making it work. Parties opposed to its formation are unlikely to share that commitment. Moreover, in the absence of general support, problems could arise in connection with the need to secure state regulatory approval for necessary transfers of assets. In addition, without stakeholder support for the proposal, there might well be challenges to the Commission's authority to require formation of NERTO.

V. THE PROPOSED GOVERNANCE STRUCTURE IS FLAWED.

The broad concerns, discussed above, obviate extensive comment here on the specifics of the NERTO proposal, many of which we find troublesome.¹⁵ However, both because of its inherent significance and because of its bearing on the obstacles to successful implementation already noted, the governance proposal bears comment. The NERTO Board, comprising five board members from each merging ISO and only two outside members, would be unduly insular

¹⁵ RTOs provide the benefit of single dispatch, but the management of ISO-NE appears to resist single dispatch, calling into question whether that benefit could be secured through NERTO.

and self-perpetuating, providing little opportunity for the introduction of new perspectives. The SMD NOPR strikes a better balance: an equal number of directors from each of the constituent ISO's and from the outside. In the Commission's words, "this type of composition will provide the new merged [entity] with the expertise, knowledge and experience during start-up while new board members would bring fresh ideas and perspective."¹⁶

While the PSC does not support the NERTO as proposed, we would welcome a regional organization that includes the New England and PJM states. Such an organization must have a leadership that is both responsive to its constituent groups and equipped to handle market power issues raised in the Commission's SMD NOPR.

VI. CONCLUSION: APPROVAL OF NERTO NOW WOULD BE ILL-ADVISED

For the reasons explained above, most of the benefits that the Commission hopes to realize through RTOs can be achieved through the provisions of the SMD. Meanwhile, NERTO falls short of encompassing the minimum Northeast RTO territory envisioned by the Commission; it lacks widespread support and is therefore unlikely to secure the degree of cooperation needed to make it work; and it raises issues that distract interested parties from pursuing the advantages promised by the SMD. We therefore urge the Commission to deny the Petition, disapprove the NERTO, and pursue the marketing opening features of SMD.

Respectfully submitted,

Lawrence G. Malone, General Counsel
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Public Service Commission
of the State of New York
Three Empire State Plaza
Albany, New York 12223-1350

Dated: November 7, 2002

¹⁶ SMD NOPR ¶573.

CERTIFICATE OF SERVICE

I, Karen Houle, do hereby certify that I will serve on November 8, 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.

Karen Houle

Date: November 8, 2002
Albany, New York