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November 15, 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 - Remedying Undue
Discrimination Through Open Access Transmission
Service and Standard Electric Market Design

Dear Secretary Salas:

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

Very truly yours,

David G. Drexler
Assistant Counsel

Attachments

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

Remedying Undue Discrimination Through)
Open Access Transmission Service and) Docket No. RM01-12-000
Standard Electric Market Design)

**COMMENTS OF THE NEW YORK STATE
PUBLIC SERVICE COMMISSION ON
THE STANDARD MARKET DESIGN
PROPOSED RULEMAKING**

On July 31, 2002, the Federal Energy Regulatory Commission (FERC or Commission) issued a Notice of Proposed Rulemaking (NOPR) that would establish a national Standard Market Design (SMD). The SMD NOPR seeks to "remedy remaining undue discrimination and establish a standardized transmission service and wholesale electric market design."¹ Pursuant to the SMD NOPR and the October 2, 2002 "Notice of Conferences and Revisions to Public Comment Schedule" (Notice), the New York State Public Service Commission (NYPSC) submits these Comments. In accordance with the Notice, we will file our comments in January on those sections of the NOPR regarding Long-Term Resource Adequacy, State Participation in Regional State Advisory Committees, and Transmission Planning.

¹ NOPR at ¶13.

OVERVIEW AND EXECUTIVE SUMMARY

The NYPSC supports FERC's objective to "create 'seamless' wholesale power markets that allow sellers to transact easily across transmission grid boundaries and that allow customers to receive the benefits of lower-cost and more reliable electric supply."² With a standard transmission service and a single market design, some of the "seams issues" that have hampered trade in the Northeast should be eliminated. While we anticipate that implementation of SMD will eliminate several of the existing seams problems, the Commission should accommodate regional variations, provided those variations do not significantly impede the efficiency and reliability of interregional trade.

The SMD, as proposed, is a major step toward establishing larger markets, particularly since a Regional Transmission Organization (RTO) of sufficient size and scope is not moving forward in the Northeast. As we stated in our comments on the Northeast RTO (NERTO), "most of the benefits that the Commission hopes to realize through RTOs can be achieved through the provisions of the SMD," yet "with far less cost."³

² NOPR at ¶9.

³ NYPSC Notice of Intervention and Comments in Docket No. RT02-3-000 (dated November 8, 2002).

Most important in the SMD is the proposal to eliminate export and wheel-through fees. Eliminating these charges on individual transactions (known as "pancaking") will remove disincentives to trading and allow for more economic transactions. We anticipate that this will translate into significant savings for consumers. Therefore, we urge the Commission to eliminate these charges immediately for the Northeast (i.e., ISO-NE, NYISO, and PJM). In the event the Commission is unable to rule immediately on the SMD, the Commission should convene a separate proceeding to address the rate design associated with the elimination of pancaked rates for the Northeast (i.e., ISO-NE, NYISO, and PJM).

The NYPSC concurs with most of the proposed market rules. These rules have proven to be effective in New York. In particular, we support the SMD's use of locational-based marginal pricing as the mechanism for managing congestion, and agree that price signals should support efficient decisions about consumption and new investment. The day-ahead, real-time, and ancillary services markets ensure efficient commitment and dispatch at least cost, while ensuring price transparency.

Effective market monitoring and mitigation are essential to prevent the exercise of market power and inspire confidence in the markets during the transition to competitive wholesale markets. The NOPR recognizes that safety-net bid caps and

automated mitigation procedures, such as those approved for the NYISO, provide an effective way to mitigate market power during the transition, while allowing for scarcity pricing during periods of true scarcity.

Moreover, the NYPSC generally endorses the SMD's approach to governance. The proposed stakeholder committee structure will reflect all industry segments and ensure balanced representation among suppliers and loads. The proposed governance selection process will ensure that the board is independent and that its interests are aligned with the interests of the market as a whole, rather than particular classes of market participants.

Although we concur with the vast majority of the SMD's proposals, a limited number could be improved. In particular, while we agree that Congestion Revenue Rights (CRRs) are important as a hedging mechanism, tying CRRs with physical rights and then using physical rights as the basis for load shedding (curtailment) might jeopardize public health and safety. We would suggest the Commission instead allow the ITP to consider the effects upon public health and safety when curtailing load.

We also recommend that "license plate" rates be maintained so that those who receive the benefits of the transmission system also pay their fair share of the costs. In addition,

transmission losses should be recovered on the basis of the marginal cost of losses to ensure proper price signals necessary for the efficient operation of the system. Moreover, allowing fixed block generators to set prices in the day-ahead market should minimize price distortions and cost-shifting.

Lastly, market mitigation will only be effective if the Commission establishes a formula and process for setting cost-based reference levels in those instances where a generator does not have a sufficient history of bidding and the Independent Transmission Provider (ITP) must estimate whether a bid is reasonable.

DISCUSSION

I. The New Transmission Service (SMD § IV.C.)

We support the New Transmission Service's reliance on day-ahead and real-time spot markets for energy and ancillary services, including operating reserves, regulation, frequency response, and energy imbalance. These services can be provided efficiently and reliably by using a bid-based, security-constrained dispatch that determines the locational-marginal price, while managing congestion and meeting consumers' needs in real time.

**The ITP Should Consider The Effects On Public Health
And Safety When Load Shedding Is Required (SMD § IV.C.9.)**

The SMD NOPR proposes that "when system conditions require curtailment (in real time) that cannot be resolved through the congestion management system, the Independent Transmission Provider should curtail the customers whose transactions contribute to the constraint on a pro rata basis... [T]o the extent the [ITP] is unable to schedule all requests for service made through the day-ahead scheduling process, those customers with [CRRs] for their requested receipt point-delivery point combinations should be scheduled first."⁴

The proposed system for shedding load could undermine public health and safety by resolving constraints without consideration of the public impacts. The system would also be administratively cumbersome because the ITP would be required to track all CRR holders. Further, such curtailments would be impractical because a program based on physical rights would require a load-serving entity to curtail service to specific customers in large multi-unit buildings, such as apartment and office complexes, if they lacked physical rights. This approach would not work in states that have adopted retail access, since energy services company (ESCO) customers are scattered

⁴ SMD NOPR at ¶159.

throughout the system, making ESCO-specific curtailments impractical.

Currently, the NYISO uses CRRs (referred to as Transmission Congestion Charges (TCCs)) as a financial instrument to collect congestion rents, rather than to create physical rights. In the event the NYISO needs to physically curtail load, the NYISO selects those areas that best resolve the constraint with the least harm to the public, and directs the appropriate transmission owners to implement physical curtailment. Facilities dependent on energy services for health and safety, such as hospitals and police, are curtailed only as a last resort. Consequently, the impracticality of the physical rights approach to curtailment, coupled with the advantages of a financial rights system for congestion, strongly argues against the Commission adopting a "one size fits all" requirement for curtailment.

II. Transmission Pricing (SMD § IV.D.)

The SMD seeks to resolve a significant barrier to interregional transfers of energy by eliminating the payment of multiple access charges. This step will allow for more efficient use of the transmission system while still allowing for the recovery of the system's embedded costs. In addition, we support a regional approach to transmission expansion that includes our participation as part of a regional group.

A. Pancaked Rates Should Be Eliminated Immediately
(SMD § IV.D.1.)

The SMD proposes to "eliminate rate pancaking both within an [ITP's] service area and between service areas."⁵ As described in the SMD, TOs will "recover embedded costs through an access charge assessed mainly to load-serving entities [(LSEs)], based on their respective shares of the system's peak load, i.e., their load ratio shares."⁶

The elimination of rate pancaking is the most important regulatory change the Commission can make to facilitate efficient energy markets. These rates (i.e., "through-and-out charges," "export charges" or "wheel-through charges") are among the most significant barriers to interregional transactions.⁷ More efficient trading, commitment, and dispatch will follow from their elimination.

We support the SMD's mechanism for recovering the embedded costs of the transmission system, under which "the interregional transfers will be netted across RTOs and the load-serving entities on the net importing RTO will pay a load ratio share of

⁵ SMD NOPR at ¶170.

⁶ SMD NOPR at ¶169.

⁷ See, DOUGLAS A. IRWIN, FREE TRADE UNDER FIRE, 58-62 (2002) (wherein the author demonstrates the significant societal costs of tariffs and other trade barriers).

the embedded costs of the exporting RTO.”⁸ The proposed methodology provides for a partial payment of embedded costs by those regions that receive the greatest benefits of the transmission system (i.e., net importers) based on their proportion of energy consumption compared to the total consumption in the exporting region. However, the SMD should provide that all exporting RTOs, including those that are only passed-through, should be allowed to recover their embedded costs. Moreover, clarification is needed to explain how the load ratio share would be calculated.⁹

In the event the Commission is unable to rule immediately on the SMD , the Commission should bifurcate the elimination of pancaked rates for the Northeast (i.e., ISO-NE, NYISO, and PJM), from the SMD rulemaking. Bifurcation may be accomplished in a manner similar to that followed by the Commission when it initiated a Federal Power Act §206 investigation with regard to the rates for through-and-out service under the Midwest ISO and PJM tariffs, and with respect to the protocols relating to the distribution of revenues associated with through-and-out service

⁸ SMD at Appendix F, p. 11.

⁹ We suggest that the load ratio share may be based on the proportion of the importing region’s energy receipts compared to the total load in the exporting region. We also propose that an ITP’s load ratio share be calculated individually with respect to each ITP that it borders.

in the PJM, PJM West, and Midwest ISO Transmission Owners Agreements.¹⁰

B. "License Plate" Rates Should Not Be Eliminated
(SMD § IV.D.1.)

The Commission solicits comment on "whether [it] should retain license plate ratemaking only for a transitional period and at some later date, require that all regions have postage stamp rates."¹¹ According to the SMD, a postage stamp rate means that all customers would pay the same for use of the utility's grid. A license plate scheme, in contrast, means that customers would pay different charges, based on the revenue requirement for the zone where the transaction terminates.¹²

New York's current system of license plate rates allocates the costs of facilities to those that receive the benefits of the system. Moving to postage stamp rates might cause taxes and other carrying charges of companies in some regions to be subsidized by customers from other regions, and require some customers to pay for upgrades and associated benefits that they do not receive. License plate rates are more efficient because they accurately reflect delivery costs and properly place such

¹⁰ Alliance Companies, et al., 100 FERC ¶61,137 at ¶50 (2002).

¹¹ SMD NOPR at ¶174.

¹² Id. at ¶168.

costs on those that receive the benefits. We see no economic or reliability reasons to require a different approach.

III. Day-Ahead And Real-Time Market Services (SMD § IV.F.)

The Commission's approach to the day-ahead and real-time markets for energy, ancillary services, and transmission services reflects, for the most part, the market design in New York. This approach works well and continues to be redesigned to promote efficient commitment and dispatch at the least cost, while also ensuring price transparency. We urge the Commission to approve the proposal in the SMD.

A. Transmission Losses Should Be Recovered On The Basis Of The Marginal Cost Of Losses (SMD § IV.F.1.b.)

The Commission seeks comment on "whether transmission losses should be recovered on the basis of the marginal cost of losses or if they should be recovered on the average cost of losses."¹³

The NYISO's calculation of marginal line losses¹⁴ equals the additional costs associated with transmitting an additional MWh and therefore sends a more efficient price signal than using average cost of losses. Surplus revenues, if any, are not a

¹³ SMD NOPR at ¶267.

¹⁴ The NYISO's Market Administration and Control Area Services Tariff defines marginal losses as "[t]he NYS Transmission System Real Power Losses associated with each additional MWh of consumption by Load, or each additional MWh transmitted under a Bilateral Transaction as measured at the Points of Withdrawal."

concern because they are refunded to load via an offset to uplift payments. If average losses are used, market participants would receive price signals that do not reflect the additional costs imposed on the system by their actions. Because the use of average losses would reduce efficiency and increase costs, the use of marginal losses is preferable.

B. "Lumpy" Generators Should Be Allowed To Set Prices In The Day-Ahead Market¹⁵ (SMD § IV.F.3.a.)

The SMD proposes to "allow generators whose output is adjustable in increments greater than 1 MW, to be eligible to set the energy price in the Real-Time Market if...the generator's output [is] needed to meet load in the hour...[and, the generator is not operating because of] a minimum run time constraint."¹⁶ However, the Commission seeks comment "on whether such lumpy generators should [also] be eligible to set the energy price in the day-ahead market."¹⁷

"Lumpy" generators should be allowed to set prices in the day-ahead market, especially in constrained markets such as New York City. These generators may be needed to meet load and unless they are permitted to set energy prices, the costs associated with these units will be collected in state-wide

¹⁵ "Lumpy" generators are also referred to as fixed block generators in New York (e.g., gas turbines).

¹⁶ SMD NOPR at ¶318.

¹⁷ SMD NOPR at ¶319.

uplift payments, severely distorting the pricing signals in the energy market. The Commission has already determined that "precluding fixed block generation from setting day-ahead prices will have adverse effects on [the NYISO's] markets at this juncture."¹⁸ As the Commission found,

[such a preclusion] would distort price signals because day-ahead prices would be artificially low if fixed block generators are needed to meet load, but their bids cannot set the price... There would be significant cost-shifting among New York consumers as the higher bid prices of fixed block generators would be recovered state-wide as uplift costs rather than through [locational-based marginal pricing (LBMP)]... [M]arket participants' bidding incentives would be impacted because, if the market-clearing price is below that used for settlements (where a fixed block unit is paid a price higher than the market-clearing price through uplift payments), then some participants may bid at the expected clearing price rather than at their marginal costs.¹⁹

¹⁸ 100 FERC ¶61,182, Docket Nos. ER00-3591-011, et seq., (August 9, 2002), at ¶8.

¹⁹ Id. at ¶5. We agree with the ISO's arguments that the rule would distort price signals because day-ahead prices would be artificially low if fixed block generators were needed to meet load, but their bids could not set the price; that market participants' bidding incentives would be impacted because, if the market-clearing price were below that used for settlements (where a fixed block unit was paid a price higher than the market-clearing price through uplift payments), then some participants might bid at the expected clearing price rather than at their marginal costs; that the rule would require substantial alterations to its mitigation measures because of the changed bidding incentives and because fixed block generation would be effectively exempted from them if their bids did not trigger the impact test of the Automated Mitigation Measures; and that there would be significant cost-shifting among New York consumers as the higher bid prices of fixed block generators would be recovered state-wide as uplift costs rather than through LBMP.

The Commission rightly decided the matter for the NYISO, and should adopt that same policy in the SMD rule.

IV. Other Changes To Improve The Efficiency Of The Markets Under Standard Market Design (SMD § IV.G.)

We support the Commission's proposal to conduct transmission planning and expansion on a regional basis. A regional approach is best suited to finding the most efficient and optimal solution at the least cost. We look forward to commenting in January on the broader planning issues facing the Commission and state regulators.

The Commission Should Not Adopt A Bright-Line Voltage Test For Determining What Transmission Facilities Must Be Under The Control of an Independent Transmission Provider (SMD § IV.G.5.c.)

The SMD asks "whether, either in addition to or in lieu of the seven factor test,²⁰ the Commission should use a bright line voltage test (e.g., 69 kV) to determine which facilities are placed under the control of the [ITP]."²¹ This test would be used to determine which facilities fall under the operational control of an ITP, and which facilities remain the responsibility of the utility/line owner.

A bright-line voltage test is too simplistic, failing to distinguish between lines that may be serving different

²⁰ This test is used to determine what facilities are transmission and which are local distribution.

²¹ SMD NOPR at ¶369 (footnote added).

functions. For example, several 138 kV lines in New York City are used solely to distribute power in a load pocket, and never reverse flow or move power between markets. At the same time, there are 115 kV lines that serve as the backbone of the bulk power system in upstate New York. The latter lines, though lower in voltage, serve a transmission function. Thus, a bright-line test, while easy to administer, will fail to accurately assign responsibility for a line.

Instead, the Commission should adopt a standard that looks to the function of the line, similar to the seven factor test in Order 888. In general, a line which normally moves power between markets, is capable of reverse flows under normal conditions, and is used in a manner having regional impacts, should be subject to the operational control of the ITP. If, however, the line flows toward load within the same market, it should be considered a distribution line and treated accordingly.

V. **Market Power Mitigation And Monitoring In Markets Operated by The Independent Transmission Provider (SMD § IV.I.)**

We applaud the Commission's initiative to establish effective market monitoring and mitigation measures through the SMD. As the Commission properly noted, "[e]ffective market monitoring and market power mitigation are critical...to create

and sustain competitive regional bulk power markets.”²²

Currently, New York’s markets suffer from various structural flaws, including a lack of sufficient price-responsive load and the presence of transmission-constrained load pockets which prevent effective competition under certain conditions. The Commission’s approach under SMD recognizes these flaws and should facilitate the transition to competitive markets. Moreover, we look forward to working with FERC to establish protocols for the sharing of confidential market data.

A. A \$1000 Per MWh Safety-Net Bid Cap Is Appropriate
(SMD § IV.I.4.)

The Commission proposes that ITPs have safety-net bid caps as part of their market power mitigation plan and seeks comment on “how to determine an appropriate value for such a cap.”²³

Safety-net bid caps are currently in place, and we recommend that the \$1,000 per MWh bid cap be maintained.²⁴ The \$1,000 value has worked well to provide protection against the potentially-extreme impact of market power, while allowing for scarcity price signals. At this juncture, there is an insufficient amount of real-time demand response available to

²² SMD NOPR at ¶392.

²³ SMD NOPR at ¶ 414

²⁴ See, New York Independent System Operator, Inc., 97 FERC ¶61,095 (2001)

restrain price spikes and market power during extreme peak hours. To the extent that the bid cap may contribute to a shortfall in necessary revenues for generators, including peakers, there are other sufficient sources of revenue including revenues from the capacity and ancillary services markets.

B. The Commission Should Establish A Formula And Process For Setting Bid Caps/Reference Levels (SMD § IV.I.6.)

The Commission seeks comment on what process should be used for determining the bid caps for individual units.²⁵ It is critical that FERC establish an effective process for estimating and reviewing generator-specific bid caps ("reference levels" in New York).²⁶ Under non-competitive conditions, bid caps (reference levels) act as a surrogate for competitive bids, and must yield "just and reasonable" prices. Valid and up-to-date reference levels are thus necessary to ensure effective detection and mitigation of market power if recently accepted bids do not exist.

Our experience has shown that estimates of reference levels may vary significantly, depending on the methods and data used

²⁵ SMD NOPR at ¶427.

²⁶ Reference levels are used to represent the marginal costs of specific generating units. Ideally, the NYISO uses a generator's accepted bids over the previous 90 days and adjusts for changes in fuel prices to determine an appropriate reference level. However, if data on the unit's bidding and dispatch cannot be used, an appropriate level is determined by the NYSIO in consultation with the affected generator.

to estimate generator-specific marginal costs. Specifically, any method needs to consider: the historical data that should be used (one year, ten years, or some other duration); whether replacement costs associated with catastrophic failure should be included and, if so, how; how to measure fuel prices; and whether there should be additional compensation for the high-end operation of a unit to reflect the extreme stress when operated in that range and, if so, how much. To ensure that reference levels are consistently applied to individual companies and across regions, the Commission should establish the specific components and the data to be used. Moreover, since the ISO/RTO's expertise is in running markets, rather than reviewing costs, the Commission's direction is necessary to ensure that rates are "just and reasonable" in those instances where sufficient competition does not exist, such as in load pockets.

Further, the Commission should take an active role in reviewing generator-specific bid caps (reference levels). The ISO/RTOs review generator-specific information in secrecy because of confidentiality constraints. Consequently, the ISO/RTOs hear generators' arguments for setting a higher reference level, but do not hear the counter-arguments for a lower level. As a result, the Commission must play a central role in ensuring that the results are reasonable. To do that,

the Commission should review the reference prices of those plants that are in the best position to exert market power. Considering the workload required, the Commission could ask the Outside Market Monitor, as discussed below, to review the reasonableness of reference levels on behalf of the Commission.

C. Reference Levels Should Not Include An Adjustment For Opportunity Costs (SMD § IV.I.6.)

The current trading of power between markets generally yields prices that reflect the marginal costs in adjacent markets. While seams issues now render imperfect the transfer of market impacts between markets, 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. Moreover, once seams issues are resolved, so that they no longer hamper the free transfer of power across geographic regions, the market price in a region will reflect prices in adjacent markets, making the geographic opportunity cost adjustment redundant.²⁷

Furthermore, relying on markets to reflect opportunity costs is a more accurate and efficient solution than any

²⁷ In contrast, permitting the use of a temporal opportunity cost component, which for the most part applies only to hydro facilities, is appropriate 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.

administrative process could hope to bring. While we agree with the theory that generators should be permitted to bid up to the marginal cost of a unit, including opportunity costs, there are practical reasons why attempts to incorporate opportunities in different geographic markets make the process of doing so a very difficult one to implement. Every day, the generation owner and the ITP would be required to predict 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 that reflect these forecasts, while the RTO would establish reference values for each generator that reflect the RTO's own forecast of market prices in other geographic areas. The RTO would then have to 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 prices of all nearby geographic markets and would have to be prepared to rapidly 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 likely take place. Thus, the market itself should be relied

upon to reflect opportunity costs, rather than relying on an administrative process that is impractical.

D. Under Most Circumstances, Scarcity Premiums For Peaking Units Would Not Be "Just and Reasonable" (SMD § IV.I.6.)

The SMD suggests that it may be appropriate to allow a scarcity premium above the marginal cost-based bid caps of peaking units "that fail to recover fixed costs" in order to "compensate for the lack of price-responsive demand that would otherwise set the price when these units were dispatched."²⁸

A scarcity premium for peaking units is unnecessary in New York because the current capacity market is specifically designed to allow such units to recover their fixed costs. In addition, efforts to create a more stable capacity payment in the Northeast to replace the current capacity market should provide ample opportunity for recovery of fixed costs. Further, peaking units can recover a portion of their fixed costs in the energy market, which occasionally clears at levels well above the marginal costs of such units. Moreover, the NYISO has

²⁸ SMD NOPR at ¶421.

established a price-responsive load program that would set the market-clearing price during hours in which scarcity exists.²⁹

Over time, as demand response matures, the resource mix that is available to the system to meet peak demand will adjust accordingly. In other words, a significant number of peaking generating facilities will be replaced by demand response capability. Under those circumstances, demand response will set the clearing price at a very high level during the highest load hours of the year (e.g. \$200, \$400, \$600 per MWh). Today, such hours typically clear at the lower prices associated with the energy bids of peaking units (e.g., \$100/MWh) except for a very few hours per year.³⁰ Thus, in its mature state, there will be a much larger number of hours in which peaking units will run and get paid an energy market price that is well above their bids, even if their bids equal marginal costs without a scarcity adder. The energy market will then provide a substantially

²⁹ The NYISO's Management Committee has approved a tariff filing, subject to ISO Board and Commission approval, whereby the Emergency Demand Response Program and the Special Case Resources in the ICAP market will reflect scarcity pricing. It may be necessary where demand response programs do not exist to permit prices to rise to \$1,000 during true scarcity conditions in a region or load pocket. This can be accomplished by allowing a few \$1,000 reference levels (i.e., bid caps) in each geographic market.

³⁰ While demand response will tend to employ higher energy market bids than peaking facilities, the total annual cost of the demand response alternative is less expensive than peakers, given the higher annual fixed cost of the latter.

larger revenue stream for generators that may well obviate the need for either a scarcity adder to bids or a capacity market. However, until adequate demand response exists, the capacity market should be relied upon for reimbursing peaking units for their fixed costs.

In the event that the SMD results in the elimination of capacity market revenues, it may be necessary to include scarcity premiums in reference levels. In that event, the Commission should establish a mechanism to ensure that the additional premium reflects only the unrecovered costs and is not used to unfairly inflate earnings.

E. Market Monitoring Functions Should Be Divided Between Separate Entities (SMD § IV.I.8.)

As the NOPR indicates, the market monitoring unit would be "autonomous of the [ITP's] management and market participants," and "may be located within the offices of the [ITP], to permit easy access to the market data and operations personnel, or it may be physically located elsewhere."³¹

Because there are distinct and separate market monitoring functions, the Commission should consider requiring two separate market monitoring units. For example, the market monitoring function includes daily monitoring of market power and implementation of mitigation rules in real-time; providing

³¹ SMD NOPR at ¶429.

reports and analyses on the functioning of the markets; and proposing rule changes and new mitigation measures to address perceived problems.

Day-to-day monitoring and mitigation should be done from within the ITP, which should have real-time access to data and operations personnel. The market monitoring unit should report to the ITP Board of Directors. This unit's function would be to implement the policies and rules proposed by the Outside Market Monitor and the Commission.

However, analyses of the functioning of the market, the conduct of individual market participants, and market mitigation recommendations, including, but not limited to, reviewing reference prices and proposing remedies for economic and physical withholding, should be conducted by an Outside Market Monitor (OMM).³² To ensure complete independence, the OMM should report directly to the Commission (and make all information available to the ITP and the state(s)). The OMM should be hired by the Commission and although its scope of work should be determined in consultation with the ITP and the state(s), it should be accountable only to the Commission. The Commission

³² In addition, we agree that the final rules should include the list of responsibilities contained in the SMD NOPR at ¶433.

would need to make absolutely clear that the ITP is entitled to real-time access to all ITP data and personnel.

Under this approach, the monitor would be truly independent and the market participants would be confident that its findings and recommendations were not subject to undue influence and were fair. The Commission would therefore be assured that rates were "just and reasonable" under the Federal Power Act.

In contrast, an OMM hired by the ITP Board or the Chief Executive Officer (CEO) would suffer from the infirmity that it would be charged to oversee those who have the power to hire and fire and control its budget. This obvious conflict of interest would not inspire the same level of confidence as would a fully-independent OMM.

Recognizing that the Commission may be unable to take on these responsibilities in the first instance, we recommend that if the model suggested in the SMD is adopted, any hiring or firing decisions of the ITP be made in consultation with the Commission and the state(s) and that the OMM budget be subject to Commission and state approval to ensure that the OMM has the tools necessary to monitor the market and make recommendations. This second-best approach would provide protection against compromising the OMM's independence.

**VI. Governance for Independent Transmission Providers
(SMD § IV.L.)**

The NYPSC agrees with the NOPR that the method and criteria for selection of the members of the board of directors (board) is critical to ensuring that the ITP/RTO is independent and that its interests are aligned with the interests of the market as a whole, rather than with particular market participants or classes of market participants.³³ We also agree that the board must be fully independent of market participants so that it can satisfy its responsibilities and that applying a code of conduct for board members would be consistent with the objective of creating an independent board that focuses broadly on the health of the entire market.³⁴ Accordingly, we support the proposal that the stakeholder committees provide advice to the board, but that the board would have full independent authority to make FPA Section 205 filings.³⁵

**A. The Proposed Stakeholder Committee Structure Reasonably Reflects All Industry Segments
(SMD § IV.L.2.)**

For the markets to evolve and improve consumer confidence, it is critical that the composition of the market participant

³³ SMD NOPR at ¶¶ 556-574.

³⁴ See, SMD NOPR at ¶ 564.

³⁵ See, SMD NOPR at ¶ 560.

committees represents all segments of the industry. The SMD correctly recognizes that the current composition of the sectors in New York and other ISOs may not accomplish that objective.

We agree with the NOPR, therefore, that each ITP/RTO must reflect the interests of: (1) generators, (2) marketers; (3) transmission owners; (4) transmission-dependent utilities such as municipalities or other LSEs that do not own or control transmission facilities; (5) public interest organizations such as consumer advocates (both governmental and non-governmental), environmental groups, and citizens; (6) alternative energy providers, such as distributed generation, demand response technologies, and renewable energy; and (7) end-users and retail energy providers.

Although we recommend that the particular configuration of the sectors be left up to each ITP/RTO, this general approach would allow for a meaningful voice at the table for a wider spectrum of stakeholders than is currently the case in the NYISO (e.g., alternative energy) and may reset sectors in a way that better aligns interests.³⁶

The NOPR seeks comment on whether or under what circumstances stakeholder classes should be able to directly

³⁶ While the NOPR does not address the issue, we assume that the Commission intends that each sector will have equal voting rights. It is extremely important that there is balanced representation among suppliers and loads.

take an issue to the board. In the NYISO, any individual or group of market participants may appeal a decision of a market participant committee either to a higher committee, or through a formal process, to the board. This approach has worked efficiently so far and should be continued to ensure that the board hears all opinions. It is particularly important that non-voting stakeholders have access to the board to ensure that the board's decision-making takes into account the views of interested stakeholders.

B. Boards Should Be Designed To Ensure Stability While Encouraging Continuous Infusion Of New Ideas
(SMD § IV. L.3.)

The SMD addresses the process by which: (1) initial board members would be selected, (2) vacancies would be filled, and (3) the composition of a merged board would be determined following merger of two ITP/RTOs.³⁷ Regarding initial selection of the board, we generally agree that a nominating committee composed of two members from each of the six sectors would review a list of candidates presented by a nationally-recognized search firm.³⁸ We suggest that the nominating committee recommend a slate of candidates, rather than individuals, that market participants would consider. We recommend the slate approach because it was the experience of the search firm that

³⁷ SMD NOPR at ¶¶ 562-574.

³⁸ See SMD NOPR at ¶¶ 566, 567.

was used to interview and recommend board members for the NYISO that qualified professionals would be leery of engaging in a competitive individual election process.

The NOPR proposes that board members have staggered terms "to maintain a degree of continuity of board membership to ensure stability and consistency in decision-making, while at the same time ensuring that the board does change membership over time to allow the introduction of new viewpoints and encourage innovation."³⁹ We support the concept, but suggest that the SMD's proposal that half of the board members' terms expire at the same time (every third and fourth years after inception) would be too disruptive given the complicated nature of the industry, and would undermine the goals of consistency and stability. A one-third turnover would accomplish the goal of encouraging innovation without sacrificing much-needed stability.

The NYPSC agrees with the SMD that boards should not be self-perpetuating.⁴⁰ Vacancies, both mid-term and at the end of a term, should be filled in the manner the NOPR generally suggests, namely, identification of candidates that satisfy the

³⁹ SMD NOPR at ¶ 569.

⁴⁰ If the Commission deems the NYISO to be a single state RTO or ITP, we would expect the existing board to continue in the new organization for no more than one additional term. SMD NOPR at ¶¶ 571, 572.

relevant criteria, by a nationally recognized search firm, with a recommendation by a nominating committee composed of market participants.

Regarding mergers, the Commission's proposal that board members serve two terms should be clarified. Board members from the existing ISOs who are chosen to serve on a merged board should only be permitted to serve no more than one term, or four years, on that merged board to ensure that new ideas are brought to the board and to prevent parochialism.⁴¹

We disagree with the SMD's proposal that the nominating committee for a merged board should include two board members from each of the respective merging organizations and "the Chairs of two committees representing market operations, reliability and/or management."⁴² Existing board members should not serve on the nominating committee because of their inherent interest in self-perpetuation. In contrast, we recommend that the nominating committee consist of only market participants, and that market participants then vote on a recommended slate,

⁴¹ Furthermore, the board must, at all times, be viewed as an independent entity. Consequently, the Commission should seriously consider prohibiting the chief executive office from being a non-voting member of the board. See, SMD NOPR at ¶ 567.

⁴² We request clarification as to what groups this description refers and whether it suggests two committees from each of the merged organizations.

but only with a nominating committee that represents all the sectors as described above.

CONCLUSION

The Commission's SMD, if adopted, will further competitive markets within and among neighboring regions. Although the NYISO and market participants have implemented many of the principles identified in the SMD, greater efficiencies can be achieved within an SMD framework.

Respectfully submitted,

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Dated: November 15, 2002
Albany, New York

CERTIFICATE OF SERVICE

I, Jacquelynn Nash, do hereby certify that I will serve on November 15, 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: November 15, 2002
Albany, New York

Jacquelynn Nash