

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.) Docket No. RM01-12-000

**COMMENTS OF THE
NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.**

In accordance with the Commission's March 25, 2002, *Notice of Extension of Time*¹ in the above-captioned docket, the New York Independent System Operator, Inc. ("NYISO") hereby respectfully submits the following comments on the Commission's "Working Paper on Standardized Transmission Service and Wholesale Electric Market Design" issued on March 15, 2002, in Docket RM01-12-000 ("SMD Working Paper"). The NYISO strongly supports the Commission's efforts and is pleased to submit comments in this matter.

I. Copies of Correspondence

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¹ *Notice of Extension of Time*, Docket No. RM01-12-000 (2002).

² The NYISO respectfully requests a waiver of the Commission's regulations (18 C.F.R. § 385.203) to allow the inclusion of more than two persons for service and communications.

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II. Summary

The NYISO strongly supports the overall policy direction of the SMD Working Paper. The NYISO's markets already include most, but not all, of the standard market design features discussed in the SMD Working Paper. However, the NYISO urges the Commission to consider certain suggested modifications to the SMD Working Paper, as discussed in these comments. The NYISO agrees that there are a number of areas where best practices cannot yet be readily discerned, and looks forward to working with the Commission on these issues. The NYISO also agrees with the Commission that finalizing and, in particular, implementing a new standard market design will require significant resources and time. For ease of reference, the NYISO's comments are organized to correspond with the outline of the SMD Working Paper.

III. Discussion

A. The Need for a Single Transmission Tariff

The NYISO generally supports the Commission's efforts to update the *pro forma* open access transmission tariff first promulgated in Order No. 888. Consistent transmission rules across control areas will protect customers and increase the benefits realized through competition. The NYISO agrees that the Commission's key challenge in updating the open access transmission tariff will be to balance the need for standardization to achieve a seamless transmission grid with the need to permit regional differences and market innovations to address local challenges. Ultimately, what may appear to be a "seam" problem or market design flaw from one side of an interface may be a valid market design innovation addressing physical limitations on the other side of the seam.

Adequate investment in transmission upgrades and real time metering at the customer level will help to overcome the physical limitations justifying residual seams. In the meantime,

the Commission should take a measured approach to market harmonization. The NYISO urges the Commission to strive for a balance between eliminating seams by adopting best practices, on the one hand, and avoiding “one size fits all” or “lowest common denominator” solutions on the other hand. The Commission must take care not to stifle innovation or impede regional best practices. The NYISO therefore supports the Commission’s approach to creating a new, flexible transmission service based on a new standard market design incorporating best practices with appropriate variations to reflect local conditions.

B. General Principles for Standard Market Design

The NYISO supports the Commission’s general principle guiding the development of a standard market design. Standardization of the market rules and business practices will reduce transaction costs and “seam issues” that restrict trading. The NYISO believes, however, that variations may sometimes be necessary to accommodate legitimate regional differences and should be allowed so long as they are shown to be consistent with or superior to the Commission’s standardized rules and compatible with the rules used in neighboring systems.

The NYISO agrees that demand resources and intermittent supply resources should be able to participate fully in energy, ancillary services, and capacity markets. The physical limitations and unique attributes of these entities, however, need to be considered and the use of special rules, such as those in effect in New York, may remain necessary. With respect to the application of these rules, the NYISO questions the suggestion in the SMD Working Paper that generation sources that are not intermittent or subject to environmental restrictions should be allowed to elect to participate as though they were intermittent or energy limited resources. The NYISO is concerned that offering additional scheduling options, or other specially-designed market rules to a generator that is not, in fact, energy limited or intermittent, and has no

comparable justification for such treatment, provides it with an unnecessary opportunity to engage in physical withholding from the market. Market harmonization and standardization should not be construed so widely as to allow any generator to elect to participate in any manner, regardless of whether it in fact qualifies for a particular status.

C. The New Transmission Service

The NYISO supports the Commission's analysis that identifies congestion charges as a market-based way to allocate the scarce transmission capacity in the day-ahead and real-time markets. The NYISO currently administers point-to-point, source-to-sink transmission rights in connection with its energy scheduling mechanisms. The NYISO believes that point-to-point transmission rights allow more opportunities for hedging than flow gate rights. While there may be some theoretical, long-term benefit to allowing flow gate rights to co-exist with financial rights, the NYISO does not believe this is immediately necessary and believes that it may ultimately not be possible to reconcile flow gate rights with financial rights. Therefore, the Commission should not include flow gate rights as part of a standard market design.

The NYISO generally supports moving toward a system that would accommodate transmission rights in the form of both obligations and options. The NYISO is amenable to offering option-based transmission rights if market participants express a desire for that option and subject to confirmation that the NYISO is able to implement such an option.

The NYISO agrees with the Commission's recognition of alternative mechanisms for allocating financial rights and auction revenues for transmission capacity. There is a distinction, however, between allocating the financial rights to transmission customers and assigning the revenues to the transmission owner for crediting against the embedded cost charges paid by the transmission customers. The better approach is to assign congestion revenues and congestion

rent surpluses to transmission owners for flow through to transmission customers as reduced embedded cost charges, as is currently the practice in New York. Allocating rights and revenues to transmission customers through transmission owners ensures that all transmission customers receive some benefit from these revenues and at the same time avoids cost shifting among customers of different transmission owners. If auction revenues were directly allocated to transmission customers, then there would be a potential that some customers would be compensated inequitably.

The NYISO also supports the Commission's statement that, in the event of construction of new transmission facilities that add transfer capability, the entity that funds the construction should receive the additional transmission rights associated with the new transfer capability. The NYISO currently applies a similar rule, but it recognizes that administering this concept can be complex in practice and that the issue deserves further investigation.

D. Energy Market Design

The NYISO supports the Commission's approach to handling imbalances using real-time markets for energy and agrees that both day-ahead and real-time markets should be based on voluntary, bid-based, security-constrained markets.

Implementing multi-part bids for buyers paying nodal prices based on real-time metering is a desirable market improvement that will enable consumers to better participate in both day-ahead and real-time markets. It is not clear from the SMD paper, however, whether the Commission's statements regarding multi-part buyer bids are intended to apply to real-time loads only or also to virtual loads bidding in the day-ahead market. In New York, virtual loads are currently able to arbitrage day-ahead and real-time prices through one-part bids. Allowing market participants to submit multi-part virtual load bids could, in theory, provide some benefits

in terms of improved arbitrage opportunities, but the NYISO is concerned that there is a potential performance impact on the day-ahead market if it were required to process a large number of multi-part virtual bids. The NYISO therefore requests that the Commission clarify that multi-part real time demand bidding should be included in the standard market design, at least in the short term, only for buyers who are actually purchasing energy to serve physical load.

The NYISO urges the Commission to leave open the option of allowing suppliers to submit multi-part bids in the real-time energy markets. The NYISO currently uses multi-part bids in its hour-ahead Balancing Market Evaluation and believes that this approach enhances economic efficiencies in a way that single-part bidding cannot.

The NYISO supports the Commission's conclusion that reliability authorities may establish locational requirements for operating reserves. The NYISO does not, however, agree that a need for locational reserves should translate into a requirement of reserving transmission capacity merely to allow the self scheduling of reserves.³ It would not generally be cost effective to reduce energy transactions across a constrained interface, such as Central East, in order to accommodate self-scheduled reserves unless the reserve price would exceed the energy

³ The NYISO believes that a system of physical self-scheduling of operating reserves would be very complex and difficult to use in markets with locational reserve constraints, such as currently exists in New York. The NYISO also notes that *financial* self-scheduling of reserves is already available in New York through the use of bilateral contracts with suppliers of reserves. Systems for reserving transmission to support delivery of self-scheduled reserves across transmission constraints to satisfy locational reserve requirements would entail significant implementation costs and appear more likely to enable the exercise of market power than to provide any real benefits to consumers or producers. This is because reservations for reserve deliverability could require that scarce transmission capacity be set aside for reserves instead of more valuable energy. Therefore, the NYISO believes that any *pro forma* rule providing for self-supply of operating reserves should not require transmission reservations to support delivery of reserves satisfying locational requirements. Such a reservation policy should be studied at length and implemented on an experimental basis before it is mandated as part of a standard market design.

price. Moreover, reservation of transfer capability to accommodate self-scheduled reserves would inflate energy prices on the constrained side of the interface. Enabling market participants to reserve transfer capability for uneconomic reserve imports would drive up energy prices and potentially raise difficult market power mitigation issues. The issue of self-scheduling of operating reserves should be reviewed carefully, particularly for areas where locational reserve requirements or significant transmission restraints exist.

The NYISO agrees that day-ahead regulation and operating reserve markets should clear simultaneously with day-ahead markets for energy and transmission services. The NYISO employs such a co-optimized, security-constrained unit commitment system for all its various markets in both the day-ahead and hour-head markets.

Generally, the price of energy exceeds the price of operating reserves, and the price of higher quality operating reserves does not go below the price of lower quality operating reserves. The NYISO is concerned, however, about the staff's conclusion that market rules should be structured so that the price of energy is *never* less than the price of reserves. In the NYISO's experience, there are instances where the price of energy, particularly at low load hours, can go below the price -- often significantly below the price -- of reserves for short periods. Creating a system where energy must always be more expensive than reserves would place either an artificial floor on the price of energy or an artificial ceiling on the price of reserves during certain hours.

F. Market Power Monitoring and Mitigation

The best way to avoid market power is to establish market designs that send appropriate price signals for the development of new generation, additional transmission, and demand-side response. Nevertheless, the NYISO recognizes that mitigation tools are necessary to address

market power issues that arise particularly where there are structural impediments to achieving these goals.

The NYISO supports many of the proposals the Commission has put forth regarding market power monitoring and mitigation. Many of the NYISO's current practices and rules already conform to the Commission's proposals. For example, the NYISO already administers a market power mitigation system that involves monitoring both economic and physical withholding and employs a bid cap, as the SMD paper contemplates. The NYISO's Automated Mitigation Procedure ("AMP") enacts the Commission's preferred approach, *ex ante* mitigation, rather than retroactive price changes. The NYISO's recent Comprehensive Mitigation⁴ filing also recognizes that particular market power conditions may exist in load pockets, and proposes behavioral mitigation for those circumstances, just as the Commission suggests is appropriate.

The NYISO does not disagree that many market monitoring functions may be vested in an entity that is independent of the market participants and the RTO management. It also may be appropriate to assign to an independent market monitoring unit ("IMMU"), responsible to the RTO Board, the task of evaluating market design and market rules, assessing the markets' competitiveness, and developing modifications to the market design. Indeed, many of these functions are currently carried out at the NYISO by an Independent Market Advisor. However, unlike the structure of the IMMU proposal set forth by FERC, with which the NYISO agrees, the NYISO disagrees with the proposals espoused by some market participants for a separate market monitoring entity with a separate board of directors and CEO. The NYISO believes that such an entity would create an unnecessary additional layer of bureaucracy and would dilute the

independence of the RTO Board itself. We believe that an IMMU can be structured as a distinct division of the RTO that is nonetheless insulated from improper influence by RTO staff and market participants.

The NYISO also believes that the approach to market monitoring ultimately adopted in a standard market design should recognize that the mitigation function is necessarily intertwined with the RTO's operations. Mitigation actions may have implications for system reliability, and for this reason the NYISO suggests that the implementation of a market mitigation program such as the AMP be entrusted to expert staff located within the RTO. In addition, the in-house administrator has access to real-time market data and a detailed understanding of real-time operating conditions, elements essential to ensure that the IMMU's recommendations are properly translated into the RTO's procedures. RTO monitoring staff would also provide support to RTO management and be available to respond on a routine basis to individual market participants.

The NYISO's present governing structure already reflects both elements: an independent Market Advisor advises the Board on market design issues, and an internal Market Monitoring Unit is responsible for monitoring market participant behavior. The NYISO fully agrees that the evaluation of market performance requires independence. However, the NYISO believes the Commission should not, in its concern for the independence and impartiality of the oversight function, overlook the necessity for integration of mitigation implementation functions with real time operations. If the Commission proceeds with the IMMU concept, it is important to recognize that these functions must remain the responsibility of the RTO.

⁴ *Compliance Filing of the New York Independent System Operator, Inc. Regarding Comprehensive Market Mitigation Measures and Request for Interim Extension of Existing*

K. Issues that Need Further Clarification

The Commission is right to “recognize that implementation of a new transmission tariff and standard market design on a nationwide basis may take some time” because “[s]tandard market design requires many institutional changes and software development.”⁵ The NYISO believes that it will likely be a matter of years, not months, before regions that do not already have LMP-based centralized energy markets can complete the transition to SMD. “Off-the-shelf” solutions will not be available because even the most advanced existing market designs lack many of the features that SMD will apparently require.⁶ Even regions that already have market designs that are very close to the SMD, *e.g.*, PJM and the NYISO, will need time to come into full SMD compliance as they continue to operate their existing markets reliably and efficiently.

The Commission should not attempt to set implementation deadlines without the benefit of industry input. Instead of prescribing arbitrary deadlines in the NOPR and placing the burden of persuasion on the industry to modify them, the Commission should use the NOPR to describe its SMD and tariff proposals in greater detail. It should only consider comments on appropriate implementation timeframes once it has thoroughly described what it is proposing.

Finally, when adopting a “phased” approach to SMD implementation the Commission should not proceed in a one-size fits all manner that forces comparatively advanced regions, such

Automated Mitigation Procedures, Docket Nos. ER01-1385-000, *et al.* (March 20, 2002).

⁵ SMD Working Paper at 25-26.

⁶ For example, although they currently exist in New York, even some very sophisticated market designs do not currently include co-optimization of energy and ancillary services or ex ante automated mitigation.

as the Northeast, to wait while other regions catch up. The NOPR should instead allow different regions to proceed at different speeds towards the same goal.

IV. Conclusion

WHEREFORE, the New York Independent System Operator, Inc. respectfully requests that the Commission consider these comments in this proceeding.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 2010 (1999).

Dated at Washington, D.C. this 10th day of April, 2002.

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