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February 28, 2006

By Electronic Filing

The Honorable Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

**Re: Compliance Report of the New York Independent System Operator, Inc. in
Docket Nos. ER04-230-010, ER04-230-014 and ER04-230-019**

Dear Ms. Salas:

The New York Independent System Operator, Inc. ("NYISO") hereby respectfully submits its response to your January 26, 2006 letter on behalf of the Commission in the above captioned proceedings ("January 26 Letter").¹ The January 26 Letter directed the NYISO to either: (i) meet certain deadlines for integrating demand side resources ("DSRs") into its real-time ancillary services and energy markets; or (ii) provide an explanation of the reasons for any necessary delay, along with an alternative plan for moving forward.

After carefully exploring all available options, the NYISO is respectfully requesting that the Commission allow it to implement a DSR real-time market integration project in the third quarter next year. By making a maximum effort, the NYISO expects that it can complete the

¹ The NYISO filed a motion requesting a one-day extension of time to file this compliance report yesterday. That motion erroneously stated that the NYISO had shared a draft of this filing with the Multiple Intervenors yesterday. In fact, the NYISO discussed the content of a draft version of this filing yesterday but did not actually share a draft until today.

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software work necessary to allow DSR participation in all real-time markets on the same terms as generators by that time. Under the NYISO's plan, the necessary software modifications would be put in place as part of the first set of updates to the NYISO's settlement system replacement ("SSR") project, the first phase of which is scheduled to be implemented in the second quarter of 2007.

As will be described more fully below, the SSR project will replace the NYISO's current settlement software with a more robust and flexible system. SSR is a top organizational priority that enjoys widespread stakeholder support, but it is also a major undertaking. Implementing it will require that the NYISO's existing settlement code be "frozen" (*i.e.*, that no other coding changes be allowed) beginning early this summer. Any other market or software design change, including DSR integration projects, must either be made prior to the code freeze or subsequent to SSR deployment. The NYISO does not believe that it would be practical to try to complete a DSR project before the code freeze. Nor would it be efficient or cost-effective to delay SSR and introduce DSR integration first. The best option is therefore to introduce DSR integration as soon as possible after SSR deployment.

Because the NYISO's proposal would allow DSRs to participate in the real-time markets on the same terms as generators, it would not give them the option to provide ancillary services without also making themselves available for energy. The NYISO has determined that implementing an "ancillary-services only" bidding option for DSRs would entail a fundamental market design change, would take substantially longer to develop than the NYISO's proposal, and would require the NYISO to set aside other major project priorities. The NYISO also believes that implementing such an option would reduce the efficiency of its co-optimized security-constrained economic dispatch, and thus of its markets. The NYISO believes that most of its stakeholders support this conclusion.

The Commission should also be aware that it is not just the NYISO's software that must change before greater DSR integration can be achieved. Certain reliability rules that are not under the control of the NYISO currently prohibit DSR participation in certain ancillary services product markets. In recent discussions with the Multiple Intervenors, the entities that have urged the Commission to accelerate DSR integration in this proceeding, the NYISO has indicated that it would seek modifications to eliminate barriers that currently prevent DSRs from supplying Ten-Minute Synchronized Reserves ("TMSR")² and Regulation Service.

² Capitalized terms that are not otherwise defined herein shall have the meaning set forth in Article Two of the NYISO's Market Administration and Control Area Services Tariff.

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I. Background

As the NYISO has previously explained,³ the Real-Time Scheduling (“RTS”) software that was implemented with the Commission’s approval in early 2005⁴ has posed a challenge for some DSRs that wish to sell ancillary services in New York. The primary design objective of RTS was to fully integrate all of the day-ahead and real-time energy and ancillary services administered by the NYISO under a single, fully co-optimized security-constrained economic dispatch. This approach has brought significant market and pricing efficiencies but is dependent on suppliers making themselves available to provide energy and/or ancillary services when they are selected by the commitment and dispatch software. This has not been an issue for generators. It has, however, been a concern for DSRs that have wanted to provide ancillary services without the prospect of being called on to provide energy. This has not been an issue for other ISOs and RTOs because their energy and ancillary services markets are not as tightly integrated as the NYISO’s.

The NYISO recognizes the benefits that greater DSR participation could bring to its markets and appreciates that the Commission and Congress both want these benefits to be realized quickly. The NYISO has worked assiduously to find a solution that meets DSRs’ needs without undoing the benefits of having a single, co-optimized economic dispatch for all energy and ancillary services products. The Commission has endorsed this approach, emphasizing that the NYISO should strive “to accommodate the special aspects of DSR without violating the fundamental design principles of RTS.”⁵

The NYISO and its stakeholders have found that there is no quick or easy way to reconcile these goals. There is no stakeholder support for “solving” the DSR issue by reducing or undoing the market integration that RTS makes possible. The NYISO has not been able to identify any way to segregate DSRs from other resources, or to create a separate DSR “bid stack,” without having a major adverse impact on the overall efficiency and integration of the NYISO’s markets. Other options were rejected by both the NYISO and its stakeholders because

³ See, e.g., NYISO’s November 26, 2003 Filing Letter in Docket No. ER04-230-000; *Compliance Filing* in Docket No. ER04-230-000 (June 1, 2005); *Response to Deficiency Letter* in Docket No. ER04-230-010 (August 12, 2005).

⁴ *New York Independent System Operator, Inc.*, 106 FERC ¶ 61,111 at P 66 (2004) (“RTS Order”). Note that the NYISO’s RTS system is sometimes referred to as “SMD 2.0.”

⁵ RTS Order at P 66.

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they would require the NYISO to create new “manual” implementation systems that would be cumbersome and that might not coordinate well, if at all, with other NYISO software.

The NYISO has worked closely with its stakeholders to try to find the best possible solution for better integrating DSR into its real-time markets. The NYISO’s most recent report to the Commission on this subject⁶ indicated that the NYISO was exploring DSR mechanisms that worked within the RTS framework as well as possible options that would operate outside of it. Since that time, the NYISO’s Price Responsive Load Working Group (“PRLWG”) has met three times. It has carefully reviewed the functional requirements for both a RTS-based program and a possible non-RTS-based system that would allow DSRs to participate in a 30-minute program patterned after the NYISO’s Installed Capacity (“ICAP”) Special Case Resources program. Stakeholders at the January 30 PRLWG meeting did not support the further development of a non-RTS-based program and the NYISO has concluded that it should no longer pursue that approach. The NYISO would prefer, and the NYISO believes that its stakeholders support, a new Demand Side Ancillary Services Program (“DSASP”). The NYISO is now proposing to focus its DSR-related efforts solely on this RTS-based initiative.

Under the DSASP, DSRs could participate in the NYISO’s real-time energy and ancillary services markets in the same way that generators do today. The NYISO believes that DSRs will be able to structure their supply offers in a way that does not expose them to an unacceptable risk of being required to make unwanted real-time energy reductions. The NYISO’s most recent discussions with DSRs indicate that many have become more comfortable with this approach than they were in the past. By contrast, the NYISO does not believe that it would be practical in the near term, or compatible with core RTS market design principles, to create mechanisms that would allow DSRs to offer their output exclusively into ancillary services markets.

In compliance with the Commission’s directive that the role of DSRs in the NYISO-administered markets be expanded as quickly as possible, the NYISO is proposing to integrate development and release of DSASP with the staged implementation of SSR. SSR is currently the NYISO’s highest priority project. The NYISO’s proposal is described in greater detail below.

⁶ *Report on Stakeholder Process and Cost-Benefit Analysis* in Docket No. ER04-230-010 (October 3, 2005).

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II. The NYISO's Compliance Proposal

The January 26 Letter directed the NYISO to either comply with the DSR integration timetable that was originally proposed by the Multiple Intervenors in November or put forward an acceptable alternative. Multiple Intervenors' suggested deadlines would require the NYISO to first "implement the necessary modification of its RTS software by June 30, 2006 to allow DSR participation by those DSRs prepared to bid into NYISO's RTS ancillary services markets under the NYISO's existing tariffs"⁷ This would allow "RTS-ready" DSRs, *i.e.*, those that are willing to reduce their demand to provide energy if required to do so, to sell into the NYISO's ancillary services markets. Second, the NYISO would have to "open all of its RTS markets to DSR participation by June 30, 2007."⁸

The NYISO has evaluated its ability to meet these deadlines and has concluded that it will not be practical to make the software changes required to allow RTS-ready DSRs into its real-time markets by June 30, 2006. The NYISO's assessment of the effort required indicates that it will require approximately sixteen person-months to fully integrate RTS-ready DSRs into the markets.⁹ The effort can be generally broken into three areas:

- Front-end metering, communication, calculation, and display: three months;
- Settlements, billing simulator, decision support system: five months; and
- IT operations product design, integration, quality assurance testing: sixteen months

The NYISO does not have sufficient technical resources to devote sixteen person-months to new DSR-related software changes prior to the SSR code freeze. Among other things:

- Resources in the settlements and market operations products areas are fully committed to work that is scheduled for deployment over the next few months, including the SSR project and other major initiatives.

⁷ January 26 Letter at P 9.

⁸ *Id.*

⁹ These estimates do not account for each individual DSR's need to have sufficient metering equipment and the ability to receive and respond to NYISO dispatch signals before it can participate in the NYISO-administered markets.

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- Quality Assurance (“QA”) testing is a critical component of any new software release and this effort cannot be accomplished in parallel with software changes. QA requires four to six weeks to ensure that the changes are functioning properly and that there are no unintended consequences to other NYISO processes.

In addition, if the NYISO were to implement any kind of DSR integration program prior to SSR deployment it would need to immediately re-do much of the work after SSR goes into effect to make it compatible with the new billing and settlement regime. For example, the NYISO estimates that approximately one-third of the coding and testing effort associated with DSASP will be related to settlement issues. The NYISO does not believe that it would be cost-effective or wise to do this work twice. It is therefore asking that it only be required to work on DSR settlements coding once, after SSR is in place.

The NYISO is pursuing the SSR project in order to have a more robust and effective settlement system that will accommodate other market rule changes more easily, allow the NYISO to more accurately test the effects of proposed system changes, and eventually allow the NYISO to adopt a shorter settlement cycle. The NYISO has been directed to make the project a top priority by its independent Board of Directors and is it strongly supported by NYISO stakeholders. The Commission has also previously urged the NYISO to improve its settlement systems.¹⁰ The initial phase of SSR implementation is slated for the fourth quarter of 2006.

The NYISO asks that it be permitted to schedule DSASP implementation as part of the first set of enhancements/revisions to the SSR effort. This would result in the delivery of a fully-functioning product in the third quarter of 2007. Through the NYISO’s Project Prioritization Team, stakeholders will be kept current on the SSR/DSASP schedule, including exact deployment dates as the work progresses. By linking the DSASP and SSR development efforts, the NYISO would deliver a fully integrated package to DSRs in a time frame that is consistent with its overall market design and software improvement efforts and that makes optimal use of NYISO resources at the lowest possible cost.

It would not be practicable to implement DSASP and SSR at the same time because SSR is a major undertaking whose completion is a necessary pre-requisite to the efficient introduction of DSR integration. Trying to complete the two projects at once would add immense risk,

¹⁰ See, e.g., *Policy Statement on Credit-Related Issues for Electric OATT Transmission Providers, Independent System Operators and Regional Transmission Organizations*, 109 FERC ¶ 61,186 at P 23 (2004) (urging ISOs and RTOs to shorten their billing and settlement cycles).

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complexity, and difficulty. This would likely result in both projects taking longer, and encountering more implementation problems, than they would if they were implemented sequentially.

The NYISO has made a corporate commitment to implement DSASP as soon as possible after SSR is in place. The NYISO's best estimate is that this work can be complete by the third quarter of 2007. The NYISO believes that this proposal will meet the needs of DSRs that are interested in participating in the NYISO's real-time markets while at the same time recognizing the need for the SSR enhancements and making optimal use of NYISO resources.

The NYISO is not proposing to introduce a program at this time that would allow DSRs that are not willing to participate on the same terms as generators into its real-time markets. To the extent that the January 26 Letter's June 30, 2007 deadline is meant to require this functionality the NYISO respectfully asks that it not be required to adopt it. The NYISO has not been able to identify a way to make such an accommodation for DSRs without making fundamental changes to the RTS market design that the Commission approved in 2004.¹¹ As was noted above, RTS is predicated on the full scale integration of all suppliers into a single co-optimized dispatch system. RTS was developed after years of stakeholder discussions and coding work, and cost millions of dollars to put into effect. Making a major modification would require an effort on the same scale. The NYISO believes that most of its stakeholders would not want it to commit the resources, or postpone work on other projects, in order to pursue such a program. Allowing DSRs to bid into the NYISO markets without subjecting them to the integrated dispatch would also necessarily undermine the benefits of integration. The more DSRs that participated in the program the greater the impact would be. At the same time, the NYISO does not believe that it is necessary to allow DSRs to bid outside of the co-optimized RTS dispatch. This is because the NYISO already provides bidding options that are sufficiently flexible to allow them to minimize the risk of being selected to provide energy when they do not want to be.

¹¹ This is not to say that the NYISO will not be accommodating the special characteristics of DSRs under the DSASP. Among other things, the NYISO will make DSR-specific modeling accommodations to represent DSR as both loads and generators in the real-time market software.

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III. The NYISO Will Work to Modify Reliability Rules that Limit DSR Participation in its Markets

Modifications to NYISO's software alone will not suffice to open the NYISO's ancillary services markets to full DSR participation. Under the Reliability Rules established by the New York State Reliability Council ("NYSRC") all loads, including DSR, are ineligible to provide TMSR or Regulation Service in the NYISO-administered markets. The Northeast Power Coordinating Council ("NPCC") also has reliability criteria that put similar limits on DSR participation in ancillary services markets. As part of its discussion with Multiple Intervenors, the NYISO has agreed to do everything it can to try to persuade the NYSRC and the NPCC to change their rules so that DSR may provide TMSR and Regulation Service in the NYISO-administered markets.¹²

IV. Conclusion

In conclusion, for the reasons specified above, the New York Independent System Operator, Inc., respectfully asks that the Commission accept the DSR integration implementation plan described above and not require it to meet the deadlines specified in the January 26 Letter.

Respectfully submitted,

Ted J. Murphy

cc: Shelton M. Cannon
 Anna Cochrane
 Cheri Yochelson
 Michael A. Bardee
 Kathleen E. Nieman
 Dean Wight

February 28, 2006

¹² Indeed, this topic has been discussed at a recent NPCC task force meeting. While the NYISO will make every effort to facilitate a timely rule change, any such change must be approved through the NYSRC and NPCC governance processes which are not under the NYISO's control.

CERTIFICATE OF SERVICE

I hereby certify that I have on this day served the foregoing document on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, DC this 28th day of February 2006.

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