New York State Independent System Operator

Incentive Compensation Plan Design

Overview

Incentive Compensation is a component of an effective Compensation policy for most organizations today. Most compensation plans currently in effective have three components:

Base Compensation-usually based on comparable salary within the specific industry giving effect for regional cost of living differences.

Short term Incentive- based on specific goals that can be achieved in one year.

Long term Incentive- based on the long term vision or goals that cover a period of three to five years.

These elements of compensation should align the employees' and organization's vision and long term operating results. In addition, executive compensation should attract, motivate and reasonably reward individuals.

The tier nature of incentive compensation plans are designed so that each of the elements creates a natural tension among the components. It should require management to continually evaluate organizational goals so that they are balanced to achieve maximum benefits. For example, focusing only on the achievement of short-term goals may be detrimental to the accomplishment of long term goals. Similarly, focusing on only one element of operations such as customer service, may result in expenditures far in excess of the approved budget or value added.

Typically, incentive compensation plans are also split between organizational employees and executives. This bifurcated design reflects the amount of influence that can be brought to bear on corporate goals. In a “for-profit” organization, the incentive plans are split into operational goals, which may include budget expenditures, customer service and satisfaction measures, safety and specific divisional goals. The executive plan would include shareholder or profitability measures in the form of earnings per share or return on equity measures[1] and overall price of the product or service that the organization is providing.

A good plan design requires that plan participants focus and exercise the maximum effort in the achievement of the corporate goals, as well as, account for the division of corporate responsibility. Clearly, operational goals can have both short-term and long-term implications. It is also clear that operational employees can not directly effect the overall vision of the organization as to policy and direction. That responsibility rests with the senior executives of the organization[2].

Current NYISO Design

The NYISO Incentive Goals for 2002 has10 Goals. These goals were developed by a NYISO team that was comprised of two representatives each from Market Services, Operations & Reliability, Information Technology, Finance/Compliance and Strategic Initiatives; and one representative each from Government Affairs/Communication and General Counsel/Regulatory Affairs. This team received and considered suggestions by the Budget Standard and Performance Subcommittee (“BS&PS”) in the development of the Goals. The Goals were ultimately approved by the Management Committee and the NYISO Board. The 2002 goal program design is essentially the same as the previous year. There are two gateway goals (1) Reliability and (2) Market that must be met in order to have a payout on the operational goals.

The operational goals are as follows:

- Prepare Accurate Day-Ahead Zonal, Non-weather-adjusted Load Forecasts
- Comply with NERC/NAERO Standards CPS-1 and CPS-2
- Real-time Price Certainty and Accuracy
- Issue True-up Bills Within Three Months of Original Invoices
- Improve Customer Responsiveness with Timely and Satisfactory Resolution of Customer Inquiries
- Achieve Customer Satisfaction with NYISO Services-2002 Survey
- Improve Project Management Deliverables with On-time Completion of High Priority Items
- Conduct SAS 70 Review

The current design for the NYISO Incentive Compensation Plan is short-term and operational in nature. The current NYISO Annual Incentive compensation Plan is budgeted at approximately $2.2 million or 10% of base compensation.

The NYISO Incentive Compensation Plan did not have a long-term component nor was the plan differentiated between employees and executives until the Board modified the Plan in the 2001 plan year.

In the year 2001 the Board put in place a long term compensation plan for the Executive Officers of the ISO. FERC filings indicate that awards under the first three year cycle were made retroactive for the year 2000, as well as, awards for the year 2001. The plan has a three year cycle with payout to be made in the year following the completion of a three year performance cycle. Distributions are anticipated in the year 2003 and the accrued liability through December 31, 2001 amounts to $574,660[3]. The goals of the long term compensation plan have not been made available to market participants even though some Market Participants have requested that information. The NYISO Board will be provding a vehicle whereby Market Participants can have input into the development of long term goals that may be used for the program year beginning 2003.

[Still Awaiting description of plan and mechanics from NYISO; to be updated]

Possible Goals

The NYISO Incentive Compensation Plan has been modified to include goals for Executive Officers. It is unclear if the goals that are currently established provide a focus on cost control, providing a high level of service to market participants and providing a strategic vision over a 3-year planning horizon.

As indicated previously, a traditional executive compensation plan has a goal related to shareholder value in the form of earnings per share or return on equity. While the ISO is a "not-for-profit" organization and a shareholder goal may not be available in the traditional sense, a goal that can increase participants value in the market is available. This can be achieved by establishing a budget goal and other cost control goals that would reduce overall costs in the market such as up-lift or introduction of technologic improvements that would increase the effienciey of the market.

It has been argued that these types of goals are not appropriate for the ISO incentive compensation plan since it could provide conflicting signals to the ISO Staff. For example, in order to meet a budget goal, project expenditures that would reduce overall operating costs could be delayed or to meet a goal to reduce up-lift, operators may not schedule resources that would maintain system reliability. This may be a concern if all employees were subject to the same incentive compensation goals. This concern has been eliminated since the Compensation Plan has been bifurcated. The ISO Board has acknowledged the wisdom of this approach in by putting in place both a short-term and long-term compensation plan for the ISO Executive Officers. This change supports the philosophy that management should be responsible for not only the short-tem operational goals, but management should be responsible for costs that support these goals and the long-term vision of the organization. It is management that can ensure that cost control measures are free from operational conflicts to maximize market benefits.

A model that can be used under this concept can be as follows:

Executive Plan

	Weighting
Short Term	
ISO Operational Goals	100%
Long Term Incentive Compensation	
Cost Control	50%
Budget	
Up-Lift	
Long Term Goals	50%
Seams Issues	
Infrastructure Issues	(e.g. Cost of implementing RTS and Benefits to be derived)

Budget Goal

Objective: To ensure that overall operating plan for the NYISO for the Year XXXX is executed within the budget that underlies that plan.

Rationale: The cost of operating the NYISO is set by reference to needs of the market participants and supports the capital expenditures and operating costs of the organization. Management which controls the day to day operation of the ISO should be charged with the responsibility to ensure that the operational goals of the ISO are conducted in manner that is cost effective and reflects the changing priority of a dynamic organization.

Up- Lift Goal

Objective: To ensure that overall Up-Lift costs incurred by the NYISO for the Year XXXX is reduced in order to ensure that overall operating costs reflect the absolute minium administrative burden to market participants consistent with safe and reliable system operations.

Rationale: The cost of up-lift charged by the NYISO is comprised of many components each of which has operational and pricing implications. Management should be charged with the responsibility of managing these costs to ensure that cost of operating the energy market are minimized and that energy prices are properly reflected in the market.

Long Term Planning

Objective: To promote effective long term planning

Rationale: To ensure that the ISO management is proactive taking steps that will promote, enhance and expand the market that the NYISO administers.

The excel spreadsheet schedules that are being provided contains possible payout design

[The above cost control and long term goals are illustrative. There may be more appropriate or different goals that reflects the market participants needs]

[1]The return on equity goals typically are measured relative to company specific historic results, indexed to the results of comparable companies or a combination of both.

[2]This is not to suggest that operational employees do not have any input into long term organizational goals but it is the executives that have the ultimate responsibility for the short and long term vision of the organization.

[3]The long term compensation for the Year 2001 per the Tax Return for Executives as a group amounts to $512,351 the difference of $62,309 represents awards made to eligible non-officer employees.