

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

**Wholesale Competition in Regions with
Organized Electric Markets**

)
)

**Docket Nos. RM07-19-000
AD07-7-000**

COMMENTS OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

In response to the Commission's June 22, 2007 *Advance Notice of Proposed Rulemaking* ("ANOPR") in the above-captioned proceeding,¹ the New York Independent System Operator, Inc. ("NYISO") hereby respectfully submits its comments. The NYISO supports the ANOPR's goals and has demonstrated success in each of the major policy areas that the ANOPR addresses, namely, responsiveness to stakeholders, market monitoring, integrating demand side resources ("DSRs"), and encouraging long-term contracts. If the Commission decides to issue a new Notice of Proposed Rulemaking ("NOPR") on any or all of these issues, it should avoid imposing uniform compliance requirements on all Independent System Operators and Regional Transmission Organizations ("ISOs/RTOs"). Instead, it should allow individual ISOs/RTOs to comply with any new requirements in ways that best suit regional differences and experience. An inflexible approach will likely result in unnecessary disruptions to existing ISO/RTO structures and practices, fewer benefits, and higher costs for consumers.

¹ *Wholesale Competition in Regions with Organized Electric Markets*, 119 FERC ¶ 61,306 (2007).

I. COMMUNICATIONS AND CORRESPONDENCE

Communications regarding this proceeding should be addressed to:

Robert E. Fernandez, General Counsel and Secretary
*Carl F. Patka, Senior Attorney
Elaine D. Robinson, Director of Regulatory Affairs
New York Independent System Operator, Inc.
10 Krey Boulevard
Rensselaer, N.Y. 12144
Tel: (518) 356-6000
Fax: (518) 356-4702
rfernandez@nyiso.com
cpatka@nyiso.com
erobinson@nyiso.com

*Ted J. Murphy
Michael E. Haddad
Hunton & Williams LLP
1900 K Street, NW
Suite 1200
Washington, D.C. 20006-1109
Tel: (202) 955-1500
Fax: (202) 778-2201
tmurphy@hunton.com
mhaddad@hunton.com

* - Persons designated to receive service.

II. ATTACHMENTS

1. Notice for the July 10, 2007 meeting of the NYISO's Board-Management Committee Liaison Subcommittee ("Attachment I");
2. NYISO Presentation to the Budget and Priorities Working Group Summarizing the Results of the 2006 Customer Satisfaction Survey (February 6, 2007) ("Attachment II");
3. July 24, 2003 NYISO staff presentation to the Management Committee describing the NYISO budget process ("Attachment III");
4. NYISO Budget Standards and Performance Subcommittee, *Guidelines for NYISO Budget Preparation/Financing and for Project Monitoring* (July 23, 2003) ("Attachment IV");
5. *Prepared Remarks of Mark S. Lynch, President and Chief Executive Officer on Market Monitoring's Role with Respect to ISOs/RTOs*, Docket No. AD07-8 (April 4, 2007) ("Attachment V");
6. *Prepared Remarks of Dr. Nicole Bouchez, Manager Market Monitoring and Performance on Market Monitoring's Role with Respect to the Federal Energy Regulatory Commission*, Docket No. AD07-8 (April 4, 2007) ("Attachment VI");
7. Presentation describing the NYISO's Demand Side Ancillary Services Program ("DSASP") (August 17, 2007) ("Attachment VII");

8. Comments of Mark S. Lynch, President and CEO, *FERC Technical Conference on Demand Response in Wholesale Markets*, Docket No. AD07-11 (April 23, 2007) (“Attachment VIII”); and
9. The NYISO’s *Responses* and *Reply Comments* in the New York Public Service Commission’s proceeding on long-term contracts and related issues, Case 06-M-1017 (June 25, 2007) (“Attachment IX”).

III. COMMENTS

A. Any Commission Initiative Should Retain the ANOPR’s Focus on Incremental Reforms and Avoid Inflexible “One Size Fits All” Mandates

The ANOPR correctly concludes that there is no need to “fundamentally redesign organized markets”² administered by ISOs/RTOs because those markets are working and are benefiting consumers.³ That is not to say that ISOs/RTOs should be complacent about the status quo. There is, and will presumably always be, room for improvement. Moreover, certain stakeholders have recently expressed concerns about the performance of the organized markets. Their arguments are often based on misplaced anger over fuel price increases that affect ISO/RTO and non-ISO/RTO regions alike and fundamental misunderstandings about markets. Nevertheless, it is appropriate for the Commission to address stakeholder concerns when it concludes that they are legitimate.

The ANOPR properly focuses on making “incremental improvements to the operation of organized markets without undoing or upsetting the significant efforts that have already been made in providing demonstrable benefits to wholesale customers.”⁴ The NYISO strongly

² ANOPR at P 3.

³ The ANOPR describes a number of the benefits that the implementation of ISOs/RTOs has created at PP 18-20 (identifying improved reliability, more coordinated and efficient dispatch, the elimination of pancaked rates, the establishment of spot markets, increased merchant generation investment, better generator capacity factors, and new opportunities for renewable resources and DSRs as advantages of ISOs/RTOs.)

⁴ *Id.*

supports this objective. The Commission should continue to focus on incremental improvements and reject the radical proposals that some may offer in an effort to undermine the organized markets.

The Commission has often emphasized that “[b]ecause the United States does not have a national electric power market,” its approach to “implementing competition has been to recognize and foster the development of regional markets.”⁵ As the ANOPR observes, the Commission has tried to “respect these differences in market structure and other differences across the various regions.”⁶

The Commission has also acknowledged that there are important differences not just between “organized” markets and “bilateral” markets but among the various organized markets. For example, as is noted below, the NYISO has: (i) a “shared governance” system; (ii) a “hybrid” market-monitoring system, and (iii) a market design that fully co-optimizes energy and ancillary services in both the day-ahead and real-time dispatch. All three of these features differ significantly from the arrangements that exist in some other ISO/RTO regions, and two are unique to New York.

Consequently, if the Commission decides to issue a NOPR in this proceeding, it should not propose one size fits all solutions. Even when it concludes that organized markets face common issues, it should allow individual ISOs/RTOs to address them in ways that work best for them and their stakeholders. It only makes sense to accommodate regional variations given that there is no single wholesale electricity market, no standard market design, and no universal ISO/RTO governance or market monitoring model that could satisfy all parties given the diverse electric system market conditions across the United States. The ANOPR appears to be open to

⁵ ANOPR at P 8.

⁶ ANOPR at P 9.

the possibility of allowing different regions to find different solutions,⁷ but also suggests, in a few instances, that uniform standards might be developed.⁸ The NYISO respectfully submits that, while collaborative efforts and an exchange of best practices are desirable, a flexible approach is, in practice, much more likely to result in greater consumer benefits at lower cost.

B. The NYISO Supports the Commission's Goal of Ensuring that ISOs/RTOs are Responsive to Stakeholders

1. The Commission Should Adopt the ANOPR's Flexible Approach to Ensuring that ISOs/RTOs Provide Stakeholders with Adequate Board Access

The NYISO supports the Commission's objective of ensuring that ISOs/RTOs are responsive to stakeholders without compromising their independence. The ANOPR rightly observes that ISO/RTO Boards must address a host of complex and contentious issues. They cannot possibly satisfy all stakeholders all of the time.⁹ Unquestionably, there exists what the ANOPR describes as a "natural tension"¹⁰ between their independence and responsiveness. This tension is highlighted when ISO/RTO Boards make impartial and good faith decisions on difficult questions only to be accused of ignoring concerns by stakeholders who did not prevail.¹¹

The NYISO agrees with the ANOPR's preliminary conclusion that direct stakeholder access to ISO/RTO directors is essential to successfully balancing independence and responsiveness. Indeed, the NYISO has provided its stakeholders with multiple opportunities to have direct access to its Board since its inception. The ANOPR was also right to propose allowing each ISO/RTO an opportunity to provide for direct access in the manner that is most

⁷ ANOPR at P 11.

⁸ *See, e.g.*, ANOPR at PP 61, 93, 120, 124, 131.

⁹ ANOPR at PP 12, 22, 135.

¹⁰ *Id.*

¹¹ *Id.* at P 135.

appropriate for it.¹² Each ISO/RTO currently has its own distinctive structure. The extent and nature of stakeholder access to the Board differs in each one. Consequently, requiring each ISO/RTO to provide such access in exactly the same way is unnecessary, and would not be reasonable.

The ANOPR offered two examples of direct access mechanisms that ISOs/RTOs might adopt; hybrid boards and advisory committees.¹³ Any future NOPR should reaffirm that these are just representative examples and that other alternatives are potentially acceptable. In particular, a future NOPR should indicate that the NYISO's established shared governance system addresses the Commission's concerns about direct access and responsiveness. The Commission should, at a minimum, permit the NYISO to demonstrate that shared governance satisfies its policy requirements in a future compliance filing.

The NYISO submits that its shared governance model already captures the benefits that hybrid boards are meant to bring without threatening the independence of its Board, creating an unwieldy system, or causing any of the other difficulties that Commissioner Kelly accurately described in her partial dissent to the ANOPR.¹⁴ Simply stated, in New York, stakeholders are empowered not by sitting on the Board but by sharing power with it.

Under the shared governance model, the Board is independent of stakeholders but does not have unilateral authority to implement major changes. Both the Board and a super-majority

¹² ANOPR at P 148, 150.

¹³ ANOPR at P 148.

¹⁴ Indeed, the NYISO shares Commissioner Kelly's concern that hybrid boards are inherently unworkable and would jeopardize ISO/RTO independence. The NYISO has no objection to the Commission allowing regions to voluntarily experiment with hybrid board structures but would strongly oppose any mandate. In any event, moving to a hybrid board is unnecessary in New York because the shared governance system more effectively balances independence and responsiveness.

of the NYISO's stakeholder Management Committee must agree before the NYISO may propose tariff revisions under Section 205 of the Federal Power Act.¹⁵ Because the NYISO's market rules are included in its tariffs, that the NYISO's stakeholders and Board are partners in shaping the market design. All stakeholders, including state agencies, environmental entities, demand response providers, municipal electric systems and public interest groups, have a real voice in the NYISO's governance. At the same time, the Board is a truly independent and effective body. Its decisions are not directly controlled by stakeholders, but it cannot, as a practical matter, launch major initiatives that do not enjoy considerable stakeholder support.

Shared governance has encouraged consensus-building among market participants and fosters collaboration and communication between the Board and stakeholders. To facilitate this, the NYISO established a Board-Management Committee Liaison Subcommittee in 1999. The Liaison Subcommittee meets every month, immediately after the regular Board meeting. It provides a path for direct communications between stakeholders and directors without "filtering" by NYISO management.¹⁶ Attachment I to these comments is the notice for the most recent Liaison Subcommittee meeting. As the notice indicates, the Liaison Subcommittee is normally comprised of three representatives from each of the five stakeholder sectors, as well as the Chair and Vice-Chair of the Management Committee, and the Chair of the Liaison Subcommittee. Any other stakeholder may listen to Liaison Subcommittee meetings over the phone.

¹⁵ The only exception to this rule is that the NYISO Board may make unilateral Section 205 filings in "exigent circumstances," but changes implemented through this procedure will only have a temporary duration, unless they are subsequently ratified by the Management Committee. Like any stakeholder, the Board can also unilaterally propose tariff revisions under Section 206 of the Federal Power Act.

¹⁶ For additional information on the Liaison Committee's responsibilities and work, see <http://www.nyiso.com/public/committees/documents.jsp?com=mc_ls>.

As a complement to the regular Liaison Subcommittee meetings, the NYISO holds an annual joint Board/Management Committee meeting and retreat that is open to all stakeholders. This event gives stakeholders extensive opportunities to provide the Board with formal and informal input.¹⁷ Just as importantly, it allows the NYISO's directors to ask questions of the stakeholders in a face-to-face setting. Senior members of the Commission Staff have often attended these annual meetings and have witnessed how freely information is exchanged. The NYISO's senior management also conducts semi-annual meetings with each of its stakeholder sectors to obtain further input, which is then relayed to the Board and provides significant input to the NYISO's strategic and business planning processes.

Minority positions are protected under the shared governance system through the ability of any individual stakeholder that disagrees with a Management Committee decision to submit a written appeal directly to the Board requesting that it not concur with the stakeholder majority. Other stakeholders may submit briefs opposing such appeals and the Board may, and frequently has, heard oral arguments prior to taking final action.¹⁸ Such a direct appeal mechanism can only work when directors are independent, impartial and have no vested interest in the result. Stakeholder directors sitting on a hybrid Board could not reasonably be expected to impartially review appeals that were contrary to the economic interests of their own stakeholder sector (or employer).

¹⁷ For additional information on the most recent (June 11, 2007) joint meeting and retreat, see <http://www.nyiso.com/public/committees/documents.jsp?com=mc&directory=2007-06-11&cols=5&rows=5&start=1&maxDisplay=999>.

¹⁸ The NYISO Board has discretion to refuse oral arguments, but its normal practice is to hear them.

Shared governance also gives stakeholders a role in filling vacancies on the NYISO Board. The NYISO's Management Committee has a Board Selection Subcommittee ("BSSC") that activates whenever there is a Board Vacancy. The BSSC is comprised of two representatives of each stakeholder sector, or ten members in total. It collaborates with the Board on the search for candidates and makes recommendations to the Management Committee and the Board on which candidates should be selected.¹⁹

On the whole, the NYISO believes that shared governance has been satisfactory to its stakeholders and ensures that its Board will not become isolated, or solely dependent on management for information. Indeed, when the ANOPR's governance proposals were discussed at the NYISO's July 10, 2007 Liaison Committee meeting, there was consensus support for preserving the existing model.

The NYISO also conducts regular customer satisfaction surveys which have yielded positive results. Attachment II to these comments is a copy of a NYISO presentation to its stakeholders summarizing the findings of its most recent survey. These surveys are examples of the kinds of objective tools that can be used to assess success at responding to stakeholder concerns and that the Commission should encourage all ISOs/RTOs to employ.²⁰

Shared governance has successfully eased the "natural tension" between independence and responsiveness without any of the disadvantages of a hybrid board. Shared governance is also superior to the ANOPR's "advisory committee" option. The latter model would provide certain stakeholders with direct Board access, but it would not give them the opportunity that

¹⁹ See *ISO Agreement*, Section 5.02, *By-Laws of the Management Committee*, Section 9.02. Both of these documents are posted at <http://www.nyiso.com/public/committees/documents.jsp?sort=none&order=ascending&maxDisplay=19&com=mc>. In addition, the BSSC has its own web page at http://www.nyiso.com/public/committees/documents.jsp?com=mc_bss.

²⁰ See ANOPR at P 155.

shared governance provides to vote on measures that affect their interests and to appeal unfavorable decisions. If the Commission takes additional action to address “responsiveness” in this proceeding, it should be clear that shared governance systems are an acceptable alternative to the hybrid board and advisory committee models.²¹ Should the Commission ultimately issue a final rule on responsiveness it should allow the NYISO to make a compliance filing demonstrating that its shared governance arrangements satisfy the rule’s requirements.

2. The Commission Should Encourage ISO/RTO Boards to Ensure that Executives are Responsive to Stakeholders But Should Not Directly Regulate Executive Performance

The ANOPR includes several proposals related to “Executive Management Practices.”²² It is the NYISO’s understanding that each ISO/RTO Board has established a management incentive plan to encourage and reward employee excellence. For its part, the NYISO has already implemented many of the measures that the ANOPR identifies as possible reforms, *e.g.*, it addresses responsiveness in its strategic plans, measures stakeholder satisfaction through periodic surveys, has formal procedures for gathering and evaluating recommendations for improving services to its stakeholders, and sets performance criteria for executives and managers based in part on their responsiveness to stakeholders. The NYISO’s corporate goals and project priorities are discussed with stakeholders at the Budget and Priorities Working Group (“BPWG”). After stakeholder review and comment they are approved by the NYISO Board.

²¹ Because the proper balance between independence and responsiveness cannot be found without accounting for differing regional characteristics, the NYISO would oppose requiring other ISOs/RTOs to adopt shared governance. Moreover, the United States Court of Appeals for the District of Columbia Circuit has concluded that the Commission may not impose particular governance structures on public utilities, including ISOs/RTOs. *See, California Independent System Operator Corp. v. FERC*, 372 F.3d 395 (D.C. Cir. 2004).

²² ANOPR at P 159.

More generally, there is no need for the Commission to impose specific requirements on ISO/RTO executives once it is satisfied that stakeholders have adequate access to responsive ISO/RTO Boards. The Commission should trust accessible and responsive Boards to establish compensation policies and standards for their executives. It would be appropriate for the Commission to make it clear that it expects Boards to ensure that executives are responsive to stakeholders and otherwise perform at a high level. To go further, for example, by dictating specific management or compensation policies, would undermine Boards by depriving them of tools they need to be effective. There is every reason to believe that ISO/RTO Boards will follow the Commission's guidance and adopt appropriate executive management practices. For example, as was noted above, in the NYISO, executive compensation is already tied to meeting corporate goals that are established collaboratively by the Board and stakeholders.

Moreover, stakeholders should not have direct influence over executive compensation, because such sway would subvert executives' independence by coloring their decisions according to the interests of stakeholders rather than objective implementation of the NYISO's tariffs and agreements. Subjecting executive compensation to the outcome of stakeholder votes would also be likely to make it harder for ISOs/RTOs to recruit and retain the high caliber officers that they need to attract and keep.

3. The NYISO's Existing Stakeholder Processes Are Fairly Balanced and Work Well

The ANOPR seeks comment on how well ISO/RTO stakeholder processes are working and how their effectiveness might be improved.²³ The NYISO believes that its own stakeholder process is an example of a successful system. Earlier in this proceeding, the NYISO explained how all stakeholders, including end-users, demand response providers, and distributed

²³ ANOPR at P 161.

generation, are fairly represented in its process and refuted allegations of bias in favor of suppliers, or against DSRs.²⁴ Voting rights in the NYISO are distributed among its stakeholders in a manner that was carefully designed, after years of negotiation, to ensure balance and to prevent any one or two sectors from dominating the process. There is simply no evidence of bias, or of inadequate protections for minority interests, in New York.

Consequently, it is not necessary for the Commission to mandate major changes to the NYISO's stakeholder process. More generally, the NYISO expects that the record in this proceeding will show that it will not be necessary for the Commission to take steps to improve ISO/RTO stakeholder processes in general, especially once any concerns regarding access to ISO/RTO Boards and Board responsiveness have been addressed. It would not be inappropriate, however, for the Commission to require ISOs/RTOs to submit periodic reports, perhaps every two years in connection with the independence audit reports that RTOs already submit, assessing voting patterns and identifying any problems that have arisen in their stakeholder processes. This would provide a systematic way for the Commission to monitor developments and assure itself that stakeholder processes continue to operate fairly.

The ANOPR also seeks comment on how an ISO/RTO should "respond when it must make a decision, such as deciding how to comply with a Commission regulation, and a stakeholder consensus cannot be reached."²⁵ As an initial matter, the NYISO notes that it routinely solicits stakeholder input on significant compliance filings in order to have the benefit of stakeholder perspectives and to avoid disputes. Nevertheless, in the case of a Commission-imposed compliance obligation that divides stakeholders, the ultimate answer must be that the

²⁴ See *Request for Leave to Submit Comments and Comments of the New York Independent System Operator, Inc.*, Docket No. AD07-7-000 (June 7, 2007) at 5-8.

²⁵ ANOPR at P 161.

ISO/RTO will decide on its own. Commission precedent is clear that ISO/RTO stakeholders may not veto ISO/RTO compliance with Commission orders.²⁶ It naturally follows that a deadlocked stakeholder process likewise must not be allowed to impede compliance. Outside of this kind of scenario, ISOs/RTOs should ordinarily try to avoid taking major actions that do not enjoy significant stakeholder support. Restricting ISOs/RTOs' ability to act without "consensus" support would, however, go too far and undermine the ability of NYISO's to take actions needed to maintain reliability and effective markets in compliance with Commission directives.²⁷ There may be circumstances when unilateral action, even in the face of stakeholder opposition would be a necessary and appropriate exercise of independent ISO/RTO authority. The Commission can reasonably expect such unilateral actions to be rare but should not adopt formal restrictions in an attempt to limit them.

4. The NYISO's Existing Budgeting Processes Already Satisfy the Commission's Proposed Requirements

Finally, the ANOPR expresses concern that ISOs/RTOs that recover their costs through formula rates, such as the NYISO, might not provide stakeholders with adequate opportunities to review or influence budget decisions.²⁸ The Commission can be assured that this is not the case with the NYISO.

The NYISO's shared governance system directly involves stakeholders in overseeing the NYISO's costs and performance. Each year, the NYISO's operating and capital budgets are

²⁶ See, e.g., Order No. 890 at P 159 (ISO/RTO stakeholders may not "veto" ISO/RTO compliance obligations); *Niagara Mohawk Power Corp. v. FERC*, 452 F. 3d 822 (D.C. Cir. 2006) (affirming that NYISO stakeholders may not block NYISO compliance filings).

²⁷ By contrast, under the NYISO's governance system, the NYISO cannot make a Section 205 filing without 58% or greater support in the stakeholder Management Committee. Other ISOs/RTOs must secure similar levels of stakeholder support before taking certain actions.

²⁸ ANOPR at P 162.

established by NYISO staff, in consultation with stakeholders, and subject to Board review and approval. The NYISO's annual project priorities, corporate goals, and employee incentive programs are developed with stakeholders through the Management Committee's BPWG.²⁹ The BPWG also participates in the development of five year budget targets. The NYISO provides the BPWG with regular reports comparing actual project costs to budget expectations as well as the benefits and costs associated with completed projects.

In addition, if the NYISO management concludes that an unanticipated project should be undertaken before the start of the next budget cycle, it must normally seek a Management Committee vote before starting work if the expected cost will be \$500,000 or more.³⁰ Similarly, the NYISO staff provides stakeholders with periodic status reports on project schedules, milestones, expenditures and resource requirements. If a project is expected to exceed budget by the lesser of 50% or \$500,000 the NYISO staff must inform the BPWG as soon as possible. Attachments III and IV to these comments include more detailed information about these procedures, which were approved by the Management Committee.

The NYISO budget process has generally worked well and, to date, has not resulted in conflicts between the NYISO's Board and stakeholders.³¹ Indeed, the NYISO's Board has approved the budget exactly as stakeholders recommended for at least the last five years.

²⁹ The BPWG was formed in 2007. Its functions were previously performed by two NYISO stakeholder bodies, the NYISO's Budget Standards and Performance Subcommittee and the Project Prioritization Team. For additional information on the BPWG's responsibilities and work, see <http://www.nyiso.com/public/committees/documents.jsp?com=mc_bpwg>.

³⁰ There is an exception for emergency projects to correct problems that adversely affect reliability or markets and another for intra-year projects that can be accommodate under the annual budget without adversely affecting other projects.

³¹ In the event that there was such a dispute in these areas, the NYISO's Board would have the final say. Given, however, the extent of stakeholder authority under the shared governance system the Board has every incentive to work collaboratively with stakeholders.

Established NYISO procedures already incorporate many of the reforms discussed in the ANOPR. For example, the NYISO periodically reviews “its cost accountability processes with its customers and other stakeholders” and considers how to improve them, presents “budget information to customers with adequate detail, transparency, and cost support,” provides “customers a timely opportunity to review budget proposals, ask budget questions, and comment before major expenditures are finally decided.”³²

The NYISO’s budget review process fully satisfies the Commission’s policy goals. Additional requirements, such as informational budget filings or the use of the Commission’s rate filing format to present budget data to stakeholders, would be unnecessary and unduly burdensome, especially for smaller entities such as end-users and demand response providers. A filing requirement would be especially disruptive in the context of the NYISO’s collaborative budget-setting procedures, because it would provide a single aggrieved stakeholder with inappropriate leverage to frustrate the will of stakeholder majorities, *e.g.*, by threatening to file challenges with the Commission unless its individual concerns were addressed. Using the Commission’s rate filing format for stakeholder budget presentations would likewise not be helpful in New York because there is no evidence that stakeholders are dissatisfied with the information they currently receive from the NYISO. Attempting to fit NYISO budget data into a format designed for traditional utility rate cases would only complicate presentations to stakeholders.

If the Commission decides to issue a NOPR on budget issues, it should propose to evaluate the transparency and effectiveness of ISO/RTO budget processes individually. ISOs/RTOs that demonstrate that they already have successful systems in place should not be

³² ANOPR at P 163.

subject to new requirements. Any improvements that an individual ISO/RTO must make could then be addressed on an individual ISO/RTO basis.

Additional information on the NYISO's budget procedures is provided in Attachments III and IV to these comments.

C. The NYISO Supports the Commission's Goal of Strengthening Market Monitoring

1. The NYISO Supports the ANOPR's Proposals to Ensure that Market Monitors Have Adequate Resources and to Increase Transparency

The NYISO strongly supports the Commission's goal of strengthening market monitoring. The NYISO has no objection to a Commission requirement that ISO/RTO tariffs be revised to expressly require market monitors to have access to market data, resources, and personnel sufficient to fulfill their responsibilities and to bring issues to the Commission's attention.³³ The NYISO's existing Market Monitoring Plan already requires the NYISO's Chief Executive Officer to ensure that the internal Market Monitoring and Performance Unit has "adequate employees, funding and other resources, access to required information and the cooperation of [NYISO] staff" necessary to ensure its effectiveness.³⁴

The NYISO would not object to preparing quarterly market monitoring reports, although such reporting would be unduly burdensome if quarterly reports had to be as extensive and detailed as the annual reports that are prepared today.³⁵ The Commission should specify the information it requires on a quarterly basis and not impose requirements that would make quarterly reports as comprehensive or as labor-intensive as annual reports.

³³ ANOPR at P 111.

³⁴ NYISO Market Monitoring Plan at Section 3.3(b).

³⁵ ANOPR at P 125.

The NYISO would support a requirement that bid and offer data be posted, without revealing the identity of the bidders, on ISO/RTO websites after a three-month delay.³⁶ The NYISO's tariffs currently require it to wait six months before posting such information, but the NYISO believes a three-month delay would be sufficient to protect commercially sensitive data and limit opportunities for abuse.

The NYISO likewise has no objection to the ANOPR's proposals to require ISOs/RTOs to consolidate all of their market monitoring rules in their tariffs,³⁷ and to include ethical rules for market monitors in the tariffs.³⁸ Although it would be appropriate for the Commission to provide guidance on the kinds of ethical requirements that it expects market monitors to satisfy, the NYISO does not believe that the Commission should adopt a standardized code of ethics. As the ANOPR noted, different ISOs/RTOs have different market monitoring arrangements and different market power mitigation systems. ISOs/RTOs will therefore naturally need to have ethics rules that differ in some particulars. It would be better to allow ISOs/RTOs to ensure that their existing tariff rules governing the conduct of their employees adequately cover any specific new concerns that the Commission has with respect to market monitoring, instead of adopting entirely separate rules that only apply to market monitoring personnel. The NYISO already has a strict Code of Conduct, set forth in Attachment F of its OATT, that applies to all of its employees. Attachment F also establishes conflict of interest rules applicable to outside consultants and contractors, including the NYISO's Independent Market Advisor ("IMA").

³⁶ ANOPR at P 127.

³⁷ ANOPR at P 121. The NYISO assumes that the Commission would not intend for this requirement to override its established "rule of reason" approach, recently reaffirmed in Order No. 890 at P 1649, to distinguishing between market-monitoring related rules and practices that are so significant that they must be included in tariffs and technical information that is so detailed that it should be included in manuals (and posted on ISO/RTO websites.)

³⁸ ANOPR at P 120.

For the same reason, if the Commission decides to develop *pro forma* market monitoring tariff provisions it should follow the approach described by the ANOPR and allow each ISO/RTO leeway to propose modifications that “suit its particular needs.”³⁹ Significant deviations from any *pro forma* language will likely be necessary to accommodate differences in the structure of market monitoring units and market power mitigation mechanisms.

The Commission should not attempt to develop *pro forma* tariff provisions on market power mitigation. ISOs/RTOs have different market power mitigation systems for valid reasons having to do with distinctions between their market structures and regional market conditions. In the NYISO’s case, the existing market power mitigation policy was developed by the NYISO’s IMA, with NYISO staff and stakeholder input, and with New York specific concerns in mind. Given that the Commission has declined to impose a single standard market design on ISOs/RTOs, it would be unreasonable to require each ISO/RTO to take an identical approach to market power mitigation. Just as Order No. 890 established principles for open and coordinated regional transmission planning, but left it to individual regions to work out the details,⁴⁰ the Commission should allow different ISOs/RTOs to continue to have mitigation rules that follow certain principles but reflect legitimate differences among regional markets.

The NYISO has no objection to the ANOPR’s proposal that independent market monitors share their recommendations regarding possible tariff changes, which currently go to ISO/RTO Boards, with the Commission and other “interested entities,” including state regulators and

³⁹ ANOPR at P 131.

⁴⁰ *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 72 FR 12266 (March 15, 2007), FERC Stats. & Regs. ¶ 31,241 (2007) (Order No. 890), *reh’g pending*.

market participants.⁴¹ The Commission should clarify, however, that an independent monitor should share drafts with the ISO/RTO and consider its input before circulating recommendations more widely.⁴² The NYISO believes the requirement to include ISO/RTO comments will provide the Commission with better information that it can use to evaluate an independent market monitor's recommendations.

2. The NYISO Supports the ANOPR's Proposals to Ensure that States Have Access to Information Concerning Organized Markets But the Commission Should Not Require ISO/RTO Market Monitors to Conduct Additional Analyses On Behalf of State Regulators

The NYISO has no objection to any of the ANOPR's proposals regarding states' access to market information. When a state requests access to otherwise confidential information, any rules governing an ISO/RTO's disclosure of that information, including requirements to notify the market participant that owns the information being sought should continue to apply. The NYISO's Commission-approved Code of Conduct includes a notice requirement that the NYISO must satisfy prior to disclosing confidential information to any entity other than the Commission.

The NYISO already makes a great deal of market and market monitoring information, available to the New York Public Service Commission ("NYPSC"). Under an arrangement between the NYISO and NYPSC that has been in place since 2000, certain authorized members of the NYPSC Staff have direct access to bid data, and other confidential information, while they

⁴¹ ANOPR at P 115. The NYISO does not understand the Commission's proposal that market monitoring units advise the Commission and other "interested entities," as well as ISO/RTO Boards, of their recommendations for rule or tariff changes to imply that MMUs would be given independent authority to file tariff revisions. Such a proposal would raise a host of legal and practical problems that need not be addressed here given the NYISO's interpretation of the ANOPR.

⁴² See *Southwest Power Pool, Inc.*, 115 FERC ¶ 61,051 at P 44.

are physically at the NYISO's offices.⁴³ This access enables the NYPSC Staff to conduct its own market analyses and prepare its own reports. While the NYISO cooperates with the NYPSC's efforts, and gathers the data that the NYPSC Staff requests, it is not ordinarily required to prepare analyses or reports for the NYPSC.

Any final rule that is issued in this proceeding should respect existing arrangements between ISOs/RTOs and state regulators, such as the arrangement that exists in New York. There should be no need for the Commission to generically require ISO/RTO market monitors to prepare reports at the request of state regulators,⁴⁴ so long as state regulators have adequate access to market data themselves. Mandating that ISO/RTO market monitors prepare analyses on demand would be unreasonable because permitting state regulators to dictate what a market monitor studies could undermine its independence and delay the completion of analyses that the market monitor has identified as a higher priority. Market monitoring analysis staff time is a valuable and limited commodity. To the extent that market monitors are required to engage their limited analytical resources preparing requested by a state regulator, it will either supplant other work that the market monitor is required to perform, or require ISOs/RTOs to expand their market monitoring staffs (assuming qualified personnel are available), which will directly increase the regulatory expense associated with the market monitoring function.

More generally, the NYISO believes that the Commission struck the right policy balance in its earlier orders involving the PJM Interconnection, LLC ("PJM").⁴⁵ Those orders held that

⁴³ See *The Provision by the New York Independent System Operator, Inc., of Information and Data to Department Staff*, Case 00-E-1380, New York Public Service Commission, 200 N.Y. PUC LEXIS 1380 (August 14, 2000); 2000 N.Y. PUC LEXIS 1159 (August 23, 2000).

⁴⁴ ANOPR at PP 122-129.

⁴⁵ See, e.g., *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,263 (2006).

because PJM's internal market monitor was accountable only to the PJM Board and, ultimately, to the Commission that it should not be required, without authorization from those entities, to prepare special reports for state regulators. There is no reason for the Commission to depart from this precedent in this proceeding. Again, so long as states have adequate access to ISO/RTO market data there should be no need to compel ISO/RTO monitors to analyze the data for them.

In the alternative, if the Commission determines that ISO/RTO market monitors should be required to satisfy "tailored requests" for analysis or reports by states, then the Commission must (i) ensure that all such requests are truly narrowly tailored, and (ii) be prepared to accept substantial increases in ISO/RTO market monitoring staffs and budgets to permit them to perform these additional duties.

3. If the Commission Addresses Market Monitoring Structures and Functions in a Future NOPR it Should Support the Continued Use of "Hybrid" Market Monitoring Arrangements

The NYISO appreciates the Commission's recognition that there need not be any "appreciable difference" between the performance of internal and external market monitors that perform the same functions and supports its refusal to take a one size fits all approach to structural questions.⁴⁶ Any NOPR that addresses the structure of market monitoring units should retain this flexibility. It should also clearly state that "hybrid" market monitoring structures, under which an ISO/RTO has both an internal market monitoring unit that is under the authority of ISO/RTO management and an external independent market advisor that is answerable only to the Board and the Commission, is an acceptable option.

⁴⁶

ANOPR at P 110.

The NYISO currently has a hybrid market monitoring structure and believes that it offers important advantages that are not available under other arrangements. The NYISO's internal Market Monitoring and Performance unit ("MMP") is part of the NYISO's management and works closely with the rest of the company's staff. It therefore has greater opportunities to review real-time market operations and access to real-time market information than would be possible for an external monitor. Daily, informal, intra-staff contacts allow the MMP to identify potential problems and address them before they emerge. The MMP also collaborates on the design and development of new market rules, beginning with the conceptual stage, as well as the implementation of operational and financial practices. The effect of this coordination is to reduce design flaws and unintended implementation issues. The NYISO's internal MMP frequently identifies and resolves issues well before they could have been detected by an external monitor. Although the MMP is part of NYISO staff it also frequently interacts with stakeholders, the NYISO Board, and the Commission's Staff (to which it is obliged to report potential violations of the NYISO's tariffs or the Commission's regulations by market participants).

The NYISO's external IMA serves at the pleasure of the Board and reports directly to the NYISO Board's Market Performance Committee. The IMA is physically located in a different location than MMP staff and functions independently from NYISO management.⁴⁷ The IMA and MMP collaborate extensively, however, on various matters, such as preparing the annual "State of the Market" report, which is primarily the responsibility of the IMA, and on the

⁴⁷ Section 4.1 of the NYISO's Market Monitoring Plan currently provides that the IMA is "accountable" to the NYISO's CEO. In practice, the NYISO's CEO has been responsible for ensuring that the IMA complies with its contractual and tariff obligations, not for managing the IMA or revising its analysis or recommendations. Section 4.1 makes it clear that the IMA serves at the pleasure of the Board, rather than any NYISO officer.

implementation of market power mitigation measures, which is primarily the work of the MMP, but which requires MMP to consult with the IMA at key times.⁴⁸

Additional information on the MMP, the IMA, their respective functions, and the collaboration between them is set forth in Attachments V and VI to these comments.

If the Commission issues a NOPR that addresses market monitoring structures, it should clarify that any new rules requiring that “market monitors” be independent from management, or to report possible tariff violations by ISOs/RTOs to the Commission,⁴⁹ can be satisfied by the independent, external component of a hybrid market monitoring structure. Stated differently, the Commission should clarify that an ISO/RTO will be in compliance with the Commission’s requirements if it has an independent, external advisor (such as the NYISO’s IMA), even if its internal market monitoring staff (such as the NYISO’s MMP) does not have its own authority to bring concerns directly to the NYISO Board or to the Commission in all circumstances. Granting this clarification would allow the ISOs/RTOs to comply with a future Commission requirement without losing the benefits of internal market monitoring expertise and collaborative interactions between market monitoring and other staff.

4. The ANOPR’s Concern that a Market Monitor’s Involvement in “Tariff Support” Functions Might Compromise Its Independence Is Misplaced

The Commission should also clarify that its concern that a market monitor’s independence might be compromised if it were involved in “tariff support” functions, including the implementation of market mitigation measures,⁵⁰ does not apply when those functions are performed by internal monitoring staff that is an integrated part of an ISO/RTO. As a practical

⁴⁸ See NYISO Market Monitoring Plan at 3.2.2 and 3.3.

⁴⁹ See ANOPR at PP 113, 115.

⁵⁰ ANOPR at PP 118, 119.

matter, implementation of the market power mitigation measures set forth in the NYISO's tariffs requires a broad range of expertise that is distributed across its trained MMP staff. If one part of the MMP staff were to work on mitigation in isolation, the overall mitigation program would suffer from the absence of other perspectives and talents.

More generally, the ANOPR's concerns about market monitors performing tariff support functions are not well founded. There is no reason to fear that a market monitor would hesitate to report market power problems or potential market abuses just because it was involved in implementing mitigation measures in that market.⁵¹ If market power problems were detected despite the application of the mitigation measures it would not reflect badly on the monitor. It would simply suggest that the mitigation measures might need to be changed. The monitor may even be lauded for its diligence in identifying a novel market issue. The NYISO respectfully submits that the Commission should not prohibit independent market monitors from participating in tariff support activities. At the very least, independent market monitors should be permitted to advise ISO/RTO staff, including internal monitoring experts, when they perform such functions. The risk of diminished independence is too slight to justify sacrificing the benefits of collaboration.

5. While it is Appropriate for Market Monitors to Monitor ISO/RTO Performance the Commission Should Ensure that Market Monitors Themselves Have Appropriate Incentives and are Accountable for Any Failures

The ANOPR discusses a number of initiatives that would clarify or expand the role that market monitors play in overseeing ISO/RTO performance. If the Commission decides to

⁵¹ The NYISO has not hesitated to report to the Commission when it identified problems with its implementation of the market monitoring provisions of its Tariffs. *See, e.g.,* the NYISO's November 8, 2005, *Report of Tariff Implementation Errors and Request for Limited Tariff Waivers* in Docket No. ER06-185.

require market monitors to report “suspected” tariff violations by ISOs/RTOs to the Commission and others,⁵² it should clarify that suspected offenses should not be reported unless the market monitor has reasonable cause to believe that a violation has occurred. To the extent that market monitors are empowered to report alleged violations directly to the Commission, and are placed outside of ISO/RTO management, the Commission itself should take responsibility for ensuring that monitors are accountable for their performance. If the Commission requires market monitors to identify potential problems, but does not require them to verify that a violation exists to some reasonable degree of certainty it will promote over-reporting. Conversely, if the Commission imposes reasonable checks that hold monitors accountable, it will minimize wasted effort by both the Commission and ISO/RTO Staffs and permit the Commission to focus on actual violations.

In addition, the ANOPR proposes to expand market monitors’ existing obligation to report on tariff violations and violations of the market manipulation rules so that they will also report on suspected violations of the Commission’s Codes of Conduct, Standards of Conduct, and other rules and regulations. The Commission should clarify the kinds of violations that it expects market monitors to look for in the case of ISOs/RTOs. The NYISO believes that the only area that could reasonably be overseen by market monitors is ISO/RTO compliance with, and implementation of, the market rules included in ISO/RTO tariffs. ISOs/RTOs are not subject to the Commission’s Standards of Conduct, which only apply to utilities with transmission and merchant functions, or to the Code of Conduct, which covers sellers with market-based rate authority. The Commission should not expect market monitors to take on traditional auditing functions that are likely to be beyond their expertise and which existing ISO/RTO compliance

⁵² ANOPR at P 115.

officers are better equipped to handle. It should, likewise, not ask market monitors to be responsible for ensuring that sellers have market-based rate authority, have filed required reports with the Commission, or have complied with the Order No. 652 “Change in Status” reporting rules. Those matters are more properly reviewed by Commission Staff.

The Commission should not require that ISO/RTO market monitoring personnel, or outside advisors, report directly to the Commission without accountability to the ISO/RTO Board. Such a requirement would effectively convert ISO/RTO employees (or consultants) into *de facto* Commission Staff hired at the expense of ISO/RTO stakeholders.⁵³ The NYISO does not believe that there is any need for the Commission to seek to replace existing market monitors and advisors with its own Staff. Indeed, as the NYISO has noted, there are advantages to having internal employees play a market monitoring role. Nevertheless, if the Commission were to decide to take over the ISO/RTO market monitoring function it should do so openly and make its own Staff clearly responsible for tasks currently performed by ISO/RTO market monitors. Short of this, any market monitoring employee or consultant hired or retained by an ISO/RTO should ultimately be accountable to the ISO/RTO Board, because it is the Board that is ultimately accountable for their actions.

The Commission should also be careful not to incentivize market monitors in a way that causes them to focus on internal enforcement to the detriment of other important objectives. ISOs/RTOs are not-for-profit institutions performing a public service function. Their employees and officers are subject to strict codes of conduct that oblige them to have no stake in the markets and no incentive to discriminate in favor of any market participant. While it is appropriate for

⁵³ *Electric Power Supply Ass’n. v. FERC.*, 391 F. 3d 1255 (D.C. Cir. 2004) establishes that ISO/RTO market monitoring employees and consultants are not, and may not be deemed to be, part of the Commission’s Staff.

ISOs/RTOs' implementation of their markets to be monitored, it should be understood that the incentive to commit violations, and thus the likelihood of violations, will be lower within an ISO/RTO. Abuses are far more likely to occur in the markets that ISOs/RTOs administer. Market monitors should, in short, normally be expected to devote most of their attention and resources to monitoring the markets for abuses, rather than policing ISO/RTO compliance.

In the NYISO's specific case, turning the internal MMP into a "watchdog" over the rest of the organization, with no accountability to senior management, would impede the MMP's ability to work collaboratively with other NYISO departments and impair its effectiveness. As the NYISO explained above, the benefits that come from interaction between the MMP and other NYISO staff in developing market improvements, and identifying potential problems, are among the most important reasons for having an internal MMP. NYISO staff would naturally be less willing to discuss issues with colleagues whose principal purpose is to identify violations for possible punishment by the Commission. At worst, suspicions and disputes could give rise to an "us against them mentality." Non-MMP staff might try to avoid interactions with an internal monitor, respond only to direct requests for information from it, and even feel a need to consult counsel before complying with requests. Creating an adversarial dynamic would lead to inefficiency, wasted resources, and a reduction in the MMP's effectiveness.

Finally, making the MMP the "watchdog" is unnecessary in New York because the NYISO has both internal and external auditors reviewing its staff's and management's compliance with its tariffs.

D. The NYISO Supports Greater Integration of Demand Side Resources Into Organized Markets and the Adoption of Effective Shortage Pricing Mechanisms

1. The NYISO Supports Permitting Demand Side Resources to Bid in the Organized Markets on the Same Terms as Generators

The ANOPR states that the Commission is:

considering a proposal to require each [ISO/RTO] to purchase [DSRs] in its markets for certain ancillary services similar to any other resources, if the resources meet the necessary technical requirements and the resources submit a bid under the generally-applicable bidding rules at or below the market-clearing price, unless the seller is not permitted to do so by state retail laws or regulations.⁵⁴

The NYISO wishes to clarify that it does not “purchase” products but instead administers centralized markets through which capacity, energy and ancillary services are bought and sold. The NYISO assumes that the ANOPR’s proposal was not intended to revolutionize this fundamental design feature of organized markets but was instead meant to require ISOs/RTOs to allow DSRs to sell ancillary services. With this understanding, the NYISO supports the Commission’s proposal and believes that it will be in full compliance with it once it implements its new “Demand Side Ancillary Services Program” (“DSASP”).

As the NYISO has previously explained,⁵⁵ it supports the Commission’s policy that DSRs be integrated into the organized markets to the greatest extent practicable. The NYISO has supported DSR participation in its day-ahead energy market since 2001 and has already done a great deal to include DSRs in the markets it administers. In particular, the NYISO offers two demand response programs to support the reliability of the bulk power system: the Emergency Demand Response Program (“EDRP”) and the Installed Capacity-Special Case Resource

⁵⁴ ANOPR at P 59.

⁵⁵ See, e.g., *Request for Leave to Submit Comments and Comments of the New York Independent System Operator, Inc.*, Docket No. AD07-7-000 (June 7, 2007) at 8-11, and Attachment VII hereto.

Program (“ICAP/SCR”). In addition, the NYISO offers the Day-Ahead Demand Response Program (“DADRP”), an economic program that permits interruptible load resources to schedule load reductions in the day-ahead energy market.

The EDRP provides resources an opportunity to earn the greater of \$500/MWh or the prevailing locational-based marginal price for curtailments provided when the NYISO calls on them. There are no consequences for enrolled participants that fail to curtail. The ICAP/SCR program allows customers that can meet certification requirements to offer unforced capacity to Load Serving Entities. Special Case Resources can participate in the ICAP Market just like any other ICAP Resource. Resources are obligated to curtail when called upon to do so with two or more hours’ notice, provided that they were notified in the day ahead of the possibility of such a call. ICAP/SCR resources are compensated in the ICAP program at the auction clearing prices and in the energy markets at the greater of their strike price or the prevailing LBMP. Resources that fail to curtail are subject to financial penalties in the ICAP Program. Both of these programs provide valuable service in managing the critical peak load periods. These high load periods of time also correspond to high emission periods as all available generating resources are called upon.

The DADRP provides retail customers with an opportunity to bid their load curtailment capability into the day-ahead market as energy resources. Customers submit bids by 5:00 a.m. the day before the operating day specifying the hours and amount of load curtailment they are offering for the next day, and the price at which they are willing to curtail. Bids are structured like those of generation resources. Accepted resources receive the greater of the prevailing LBMP for the curtailments provided or the production costs represented in their bids for the

scheduled periods. Resources that fail to keep a curtailment commitment are subject to financial penalties.

Additional information on the NYISO's existing DSR programs, and the success they have had, is provided in Attachment VII to these comments.

Presently, the NYISO is working with its stakeholders to develop the DSASP so that DSRs may participate fully, to the extent that they are technically able to do so, in the NYISO's ancillary services markets. Under the DSASP, DSRs would be modeled in the same manner as pumped storage hydro-electric generation facilities, which sometimes absorb energy (by pumping water during off-peak energy consumption periods) and sometimes produce it (by generating during peak periods or during system major emergency conditions). DSRs would be subject to the same bidding requirements and dispatch procedures as generators. Consistent with the ANOPR's expectations, DSRs would also have to satisfy reasonable technical requirements. They would be paid for providing ancillary services but not for avoided energy costs.

The DSASP would implement already effective NYISO tariff provisions that allow DSRs to participate, on the same terms as generators, in the real-time energy and ancillary services markets contingent on the development of necessary software changes. The NYISO expects these coding changes to be in place in 2008. The NYISO would also introduce substantial new tariff revisions necessary to integrate DSASP features with the rest of the NYISO market design and complete DSASP implementation.

The implementation of the DSASP is contingent on the New York State Reliability Council ("NYSRC") approving changes to the NYSRC Reliability Rules that currently prevent DSRs from supplying synchronous (known as "spinning") operating reserves in New York. The NYISO has been working with members of the Reliability Rules Subcommittee of the NYSRC

on the necessary rule changes. NYSRC approval may come as soon as the next few months, although the outcome is ultimately outside of the NYISO's control.

Moreover, the ANOPR states that the Commission is considering requiring ISOs/RTOs to revise their market rules to allow aggregators to submit demand reduction bids on behalf of retail customers directly into the markets.⁵⁶ The ANOPR notes that the NYISO currently does not support such aggregator bids in its Day-Ahead and Real-Time Markets, but does allow aggregators to participate in the ICAP SCR and EDRP.⁵⁷ The NYISO wishes to clarify that it in fact supports aggregation of retail customers under its DADRP, EDRP, and ICAP SCR. The NYISO has no objection in principle to accepting DSR aggregators' bids into its markets if they meet appropriate communication, validation, verification and minimum bid size requirements (*i.e.*, one megawatt or larger).⁵⁸

Attachment VIII to these comments is a recent NYISO staff presentation that describes the DSASP initiative as well as some of the design issues, and reliability requirements, that the NYISO and its stakeholders have been considering.

The NYISO is also supporting the expansion of market-based demand side response programs in a NYPSC proceeding in which the NYPSC is considering how to achieve a statewide goal of reducing net energy consumption by 15 percent by the year 2015.⁵⁹ The NYPSC is evaluating a number of programs to achieve that goal, from traditional utility demand

⁵⁶ ANOPR at P 69.

⁵⁷ ANOPR at n. 61.

⁵⁸ The NYISO is not proposing to accept aggregator bids as part of the first phase of its DSASP initiative because it does not appear that such bids would comply with applicable reliability rules. The NYISO is open in principle to the inclusion of aggregator bids in the future.

⁵⁹ NYPSC Case 07-M-0548, *Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard, Order Instituting Proceeding* (May 16, 2007).

side management (“DSM”) programs, to enhanced building codes. In the proceeding, the NYISO is advocating expanding participation in market-based demand side response programs through such measures as implementation of advanced metering and exposing more residential customer classes to energy market clearing prices. The NYISO’s comments in that proceeding are attached hereto as Attachment IX.

2. The Commission Should Not Require ISOs/RTOs to Treat DSRs More Favorably Than Generators

Although the NYISO strongly supports treating DSRs and generators alike whenever technical and reliability considerations allow,⁶⁰ the NYISO does not believe that DSRs should be treated more favorably than generators. The NYISO therefore asks that the Commission reconsider the ANOPR’s proposal to “modify ISO/RTO tariffs to provide that [DSRs] must be allowed to provide spinning and supplemental reserves without also being required to sell into the energy market.”⁶¹ This change would not be efficient in New York because the NYISO’s market design fully co-optimizes energy and ancillary services through an integrated dispatch process. Generators in New York must make themselves available to supply energy in order to be eligible to supply ancillary services. The NYISO could not treat DSRs differently without making fundamental changes to its market design and software that would lead to inefficient scheduling outcomes of the available resources. Such changes would undermine the benefits of full co-optimization that led the Commission to approve its introduction in 2004.

This issue was the subject of a recent series of Commission orders. Last year, the Commission concluded that giving DSRs a special right to bid in the ancillary services markets

⁶⁰ For example, the Northeast Power Coordinating Council has operating reserves criteria, which apply to the NYISO-administered markets, that impose “sustainability” requirements that DSRs would currently have to meet in order to qualify as operating reserves suppliers.

⁶¹ ANOPR at P 60.

without being available to supply energy was not worth compromising the benefits of full co-optimization.⁶² It noted that the NYISO's existing bidding procedures were sufficiently flexible to permit DSRs to structure their bids in a manner that would virtually eliminate the possibility that they might be selected to provide energy involuntarily. DSRs will continue to have this ability after the DSASP is implemented. The NYISO could also develop new bidding parameters that would enable DSRs to specify that they: (i) could not be called on for more than an hour or a certain maximum number of times per day; or (ii) would be subject to energy management limits. These kinds of new parameters would allow DSRs to reflect their underlying limitations on frequency and duration of activation without undermining the co-optimization system. In would, instead, utilize the benefits of a co-optimized system to determine the most applicable time frame for the activation.

Nothing has changed, or is likely to change in the near future, that would enable the NYISO to support "selective bidding" by DSRs without compromising the benefits of full co-optimization. Because the NYISO's current, and potential, bidding tools greatly reduce the risk that DSRs will have to provide energy involuntarily, and thus greatly diminish their disincentive to participate in the ancillary services markets, there is no reason for the Commission to reverse its precedent. Given the NYISO's circumstances, any NOPR issued in this proceeding should not propose to require the NYISO to allow DSRs, unlike generators, to bid into the ancillary services markets without also making themselves available to provide energy.

⁶² See *New York Independent System Operator, Inc.*, 116 FERC ¶ 61,043 at P 24 (2006).

3. The NYISO Has No Objection to the ANOPR's Proposals Regarding Deviation Charges

The ANOPR seeks comment on whether ISO/RTO tariffs should be revised to eliminate, during system emergencies, special uplift charges applicable to buyers that take less energy in an ISO/RTO's real-time market than they purchased day-ahead.⁶³ The Commission believes that these charges can discourage DSR participation in the markets. The NYISO takes no position on this proposal because it does not have special uplift charges that would apply to DSRs.⁶⁴

4. The NYISO Supports the ANOPR's Flexible Approach to Shortage Pricing

The ANOPR seeks comment on four possible ways that ISO/RTO market rules might be revised during shortage conditions in order to stimulate DSR participation.⁶⁵ The four methods are: (i) increasing bid and price caps during emergencies; (ii) raising bid caps only for demand bids; (iii) requiring the use of operating reserves demand curves; and (iv) setting the market clearing price at the level of the payments made to participants in emergency demand response programs. The ANOPR also asks whether any of these methods should be used, whether any one, or some specific combination of them, should be favored, or, "given the differences in market design among the RTOs and ISOs," whether it should provide general guidance and direct each RTO and ISO to develop its own compliance mechanism.⁶⁶

The NYISO's preliminary view is that each of the four methods discussed in the ANOPR could be a reasonable way to promote accurate scarcity pricing and stimulate DSR responses

⁶³ ANOPR at P 62.

⁶⁴ The NYISO does have special uplift charges applicable to virtual traders that could apply to DSRs that engage in virtual trading. The NYISO does not interpret the ANOPR as referring to these rules, which would only apply to DSRs engaged in virtual trading in their capacity as virtual traders.

⁶⁵ ANOPR at PP 75-80.

⁶⁶ ANOPR at P 81.

during shortages. It is difficult to identify any single method, or combination of methods, as “the best” given the differing circumstances and market design within each ISO/RTO. The NYISO therefore recommends that the Commission take a flexible approach and allow each ISO/RTO to determine which of the methods, if any, is right for its market and its stakeholders.

For its part, the NYISO already successfully uses operating reserve demand curves, in conjunction with administrative scarcity pricing rules. Any NOPR issued by the Commission should allow the NYISO to retain these systems. Furthermore, the NYISO does not believe that it should be required to adopt additional rules that would require it to increase bid caps during emergency conditions. Because of the interaction between market bids and the NYISO’s demand curves, it would be necessary to make significant and complex adjustments to ensure that the demand curves continued to yield results that complied with reliability rules at times when emergency conditions triggered bid cap increases. The NYISO does not believe that there would be any benefit to adopting new rules that would justify the additional complexity.

When considering these design issues, the Commission should always remember the difference between allowing market prices to rise due to the interplay of supply and demand and allowing the exercise of market power. While it may be appropriate to consider raising bid and price caps in some scarcity situations, those caps are not true market power mitigation measures. They were originally adopted to address the lack of demand elasticity in electricity markets.⁶⁷ By contrast, true anti-market power mitigation safeguards, such as the NYISO’s conduct and impact screens, should never be relaxed. It is every bit as objectionable for consumers to be subject to market power abuses during scarcity conditions as it is at any other time.

⁶⁷ See, e.g., *New York Independent System Operator, Inc., et al.*, 92 FERC ¶ 61,073 (2000).

5. Other DSR Issues

The ANOPR asks whether it should allow ISOs/RTOs to have their own minimum requirements, *e.g.*, with respect to minimum bid size, measurement, and telemetry, or specify standards in a final rule.⁶⁸ Because the Commission has decided not to impose a standard market design it will almost certainly not be feasible to have standard rules for DSRs. Different ISOs/RTOS will need to have different rules, including with respect to minimum bid size, to reflect differences in their markets. Moreover, because the Commission has not proposed to develop a single set of standards for generators, but has proposed to require that DSRs and generators be treated comparably, it follows that different ISOs/RTOs will need to have different rules for DSRs to match the differences in the rules they apply to generators.

The ANOPR proposes to require ISOs/RTOs to report on how they plan to work together to “explore best practices, common issues, and market rules for the direct participation of [DSRs] in their markets,” but would not require standardization.⁶⁹ The NYISO strongly supports coordination but sees no need for a reporting requirement. ISOs/RTOs, along with other stakeholders, are already collaborating extensively in this area. The NYISO is currently participating in North American Electric Reliability Council, North American Energy Standards Board (“NAESB”), and ISO/RTO Council initiatives that address DSR market integration.

The ANOPR also seeks comment “on whether aggregation of retail customers allows inappropriate compensation when a retail customer is paid for wholesale demand reduction and also saves in its retail bill from the same demand reduction.”⁷⁰ The NYISO does not believe that there is a single answer to this question. “Double compensation” may be appropriate in some

⁶⁸ ANOPR at 61.

⁶⁹ ANOPR at P 71.

⁷⁰ ANOPR at PP 73-74.

circumstances but not others. For example, the NYISO's current DSASP proposal would not entitle DSRs to real-time energy payments above and beyond their ancillary services payments, but the NYISO has not yet concluded that "double compensation" could never be appropriate in other settings. Rather than attempting to create a universally applicable rule on this issue, the Commission should instead consider it within the framework of regional market designs.

Finally, the ANOPR asks whether ISOs/RTOs should be required to quantify the cost-effectiveness of DSR in their markets.⁷¹ The NYISO sees no reason for such a requirement, assuming that ISOs/RTOs are going to be required to integrate DSRs into their markets to the greatest extent practicable. The Commission appears to have already reached the reasonable conclusion that DSR integration is beneficial, so it is unclear why additional analyses of the benefits would be helpful. It would be better to allow ISOs/RTOs to focus on achieving DSR integration instead of studying the consequences of doing so.

E. The NYISO Supports Efforts to Facilitate Long-Term Power Contracting in Organized Markets

The ANOPR offered a number of proposals that were intended to facilitate opportunities for long-term power contracting in organized markets.⁷² As a general matter, long-term power contracts offer important advantages, such as hedging against price fluctuations, easing investment, and helping to mitigate market power. Neither Commission policy nor ISO/RTO market rules should discourage their formation.

At the same time, organized markets, including the NYISO-administered markets, already accommodate both short and long-term bilateral contracts. To the extent that the Commission believes that there is currently a sub-optimal level of long-term contracting, there is

⁷¹ ANOPR at P 82.

⁷² ANOPR at P 93.

considerable record evidence indicating that differences between buyers' and sellers' assessments of long-term risks, not the structure (or the existence) of organized markets, is the primary reason why long-term contracts are not more common.⁷³

As it has acknowledged in the ANOPR, the Commission has relatively little ability to regulate buyers' purchasing practices or to compel the formation of long-term contracts.⁷⁴ It is appropriate for the Commission to do what it can within its jurisdiction to facilitate long-term contracting, but it should recognize that fundamental changes to organized markets will not promote this end. The Commission should also avoid creating regulatory incentives for long-term contracts that would stimulate inefficient investments and ultimately burden consumers. Making long-term power contracts artificially attractive could distort markets, lead to uneconomic investments, and have severe unforeseen consequences. Fortunately, it does not appear that any of the proposals contemplated in the ANOPR would have these undesirable qualities.

Turning specifically to the Commission's proposals,⁷⁵ the NYISO would have no objection to periodically posting information on long-term contract prices and quantities, or long-term projections of congestion patterns and costs.⁷⁶ The Commission should be aware, however, that the NYISO does not currently have access to contract price or quantity information and does not expect parties to share it absent a Commission mandate. Similarly, the NYISO

⁷³ See, e.g., *Conference on Competition in Wholesale Power Markets*, Docket No. AD07-7-000, Tr. at 103-105, 132-34 (May 8, 2007).

⁷⁴ See ANOPR at P 92 (noting that the Commission is "mindful of the limits of its jurisdiction" in these areas").

⁷⁵ ANOPR at P 93.

⁷⁶ The NYISO does not currently post such projections but anticipates that it will do so in the future as part of its compliance with Order No. 890's "economic planning" requirements.

could make a dedicated portion of its website available for posting voluntary offers to enter into long-term contracts, although this is not a service that stakeholders have previously requested and thus may not be of much value to them. Consequently, there is no reason for the Commission to mandate such postings.

The NYISO is also participating in a NYPSC proceeding that is examining whether and how state policies could be modified to encourage entry into long term contracts to provide needed electric system infrastructure.⁷⁷ In that proceeding, the NYISO agreed that economic long term contracts can produce a useful hedge against price volatility, a future revenue stream for financing opportunities, and can mitigate market power. The NYISO expressed its concern, however, that uneconomic long term contracts, supported by regulatory cost recovery, could undermine private investment and, as a result, adversely impact reliability. Finally, the NYISO agreed with other filers that the NYPSC should avoid adopting policies concerning long-term contracts that, by design or by default, could serve to manipulate the state's markets for installed capacity in an attempt to reduce electricity prices. Contracts that are not market driven, the NYISO suggested, should be used, if at all, to pursue electricity supply characteristic or desired energy or environmental public policy outcomes that are not priced in the NYISO's markets. In response to the Commission's inquiry, the NYISO respectfully suggests that the preferred means of implementing infrastructure enhancements to meet reliability needs or to satisfy economic opportunities in the electric industry should be the market mechanisms established by the Commission rather than mandatory or heavily incentivized long-term contracts.

⁷⁷ PSC Case 06-M-1017, Proceeding on Motion of the Commission as to the Policies, Practices and Procedures for Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers, *Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios, and Instituting a Phase II to Address Longer-Term Issues* (April 19, 2007).

Finally, the NYISO supports the development of new standardized forward products, insofar as market participants desire them, but does not think that ISOs/RTOs should lead an effort to create them. Establishing standardized products on a national scale would likely be beyond the expertise of any individual ISO/RTO. It may also be, as the ANOPR suggests, that developing such products would result in ISOs/RTOs playing an overly commercial role. If the Commission thinks that it is necessary to stimulate the development of new standardized products it would be better to give the NAESB primary responsibility. ISOs/RTOs could participate in the process, along with other NAESB stakeholders, to create new standardized products that are compatible with organized markets.⁷⁸

F. The Commission Should Avoid Setting Generic Implementation Timetables

Finally, the ANOPR seeks comments on how long it will take for ISOs/RTOs to implement reforms that may be adopted in this proceeding, specifically, “how much time -- including time for stakeholder processes -- might be needed for technical development of compliance filings.”⁷⁹ The possible reforms discussed in the ANOPR are so diverse that it is not practicable to provide precise answers to the ANOPR’s question. The NYISO would recommend, however, that the Commission take a flexible approach to each requirement that may ultimately be part of a final rule. It should invite comments on how much time will be required to complete each such reform. It should also take a realistic view of ISO/RTO capabilities in light of the other projects that compete for their attention and resources, including projects undertaken in compliance with other Commission-imposed requirements.

⁷⁸ The NYISO is in the process, however, of exploring the addition of a longer-term forward capacity component to its capacity market design. The development of new market design elements is properly the responsibility of ISOs/RTOs and their stakeholders, not NAESB.

⁷⁹ ANOPR at P 165.

IV. CONCLUSION

WHEREFORE, for the foregoing reasons, the NYISO respectfully asks that the Commission consider these comments as it formulates further proposals in this proceeding.

Respectfully submitted,

/s/ Ted J. Murphy

Counsel for the
New York Independent System Operator, Inc.

September 14, 2007