UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

| | | |
|---|---|---|
| **Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid** | ) ) ) | **Docket No. PL03-1-000** |

**COMMENTS OF
THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.
ON PROPOSED TRANSMISSION PRICING POLICY**

The New York Independent System Operator, Inc. ("NYISO") submits these comments on the Commission's proposed pricing policy in the above-captioned proceeding ("Pricing Proposal").[1]

## EXECUTIVE SUMMARY

The NYISO fully supports the Commission's goal of achieving a robust infrastructure for the future by providing incentives for traditional transmission owning utilities ("TOs") to turn over operational control of their transmission facilities to independent operators. However, because the Commission proposes to offer such incentives retroactively to TOs that have already turned over operational control of their facilities to an independent operator, the NYISO urges the Commission to modify its proposal to include TOs that have previously joined Commission-approved Independent System Operators ("ISOs"). In addition, the NYISO believes that the proposed incentive for divesting assets to an ITC is disproportionate to the incentive for participating in a Regional Transmission Organization ("RTO").

As the Pricing Proposal recognizes, the development of the "nation's infrastructure has not kept pace with load growth or with the increased demands brought about by industry restructuring." *See* Pricing Proposal at P 19. One result of the present impasse in transmission expansion is that increased congestion costs amounting to hundreds of million dollars a year in New York State alone fall on customers. Construction of new transmission facilities could, in some instances, result in substantial savings at moderate costs. A recent study conducted by the NYISO identified several transmission upgrades that could produce sufficient congestion cost savings to cover their installed costs in one or two years. Yet such facilities are not being built. Incentives may spur new construction. TOs that have turned over their assets to the operational control of an independent entity should generally be amenable to funding new construction. In turn, as the Pricing Proposal recognizes, independent grid operators are in the best position to identify system needs on a non-discriminatory basis and to evaluate the appropriateness of proposed innovative transmission technologies.

In support of the Commission's proposal, the NYISO offers the following specific observations and recommendations.

## I. Incentives For Turning Over Operational Control Over Transmission Assets Should Be Available To Transmission Owners Participating In Commission-Approved ISOs As Well As RTOs

In proposing incentives for TOs that join RTOs or divest their assets to Independent Transmission Companies ("ITCs"), the Pricing Proposal appears to overlook the fact that the same justifications for offering these incentives apply to TOs that are already members of Commission-approved ISOs. There is little or no practical difference between the level of independence enjoyed by existing ISOs and the level that the Commission has required for RTOs, or even ITCs. In fact, the Commission's independence requirements under Orders 888

---

[1] *Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid*, 102 FERC ¶ 61,032 (2003).

and 2000 are nearly identical.[2] The NYISO urges the Commission to modify its proposed incentive pricing policy to encompass approved ISOs.[3]

## II. Incentives For Forming An ITC Should Be Proportional To The Market Benefits That ITCs Will Bring

The NYISO believes that the benefits of additional independence, recognized by the Pricing Proposal and prior Commission orders, justify offering incentives for the formation of ITCs. The NYISO also understands that the incentive included in the Pricing Proposal would make the Return on Equity ("ROE") for ITCs comparable to that for natural gas pipelines, which are arguably more similar to ITCs than traditional vertically integrated electric utilities.

However, offering an incentive that is three times the incentive offered for turning operational control over to an RTO is not proportional to the wholesale market benefits that ITCs bring. Because the benefits of forming an RTO or ISO that is able to manage congestion efficiently and conduct transparent spot markets are likely far greater than the benefits that flow from forming an ITC, the Commission should, at a minimum, consider establishing both incentives at 100 basis points.

---

2 *Compare Promoting Wholesale Competition Through Open-Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,730-31 (1996) *with Regional Transmission Organizations,* Order No. 2000, FERC Stats. & Regs. ¶ 31,089 at 31,071-72, 31,073-74 (1999).

3 Furthermore, although the Pricing Proposal implies that larger RTOs may be better able to administer efficient electricity markers, *See* Pricing Proposal at P 14, recent Commission orders establish that smaller entities can create seamless markets through close cooperation and coordination. *See, e.g., PJM Interconnection, L.L.C.,* 101 FERC ¶ 61,345 at P 11 (2002) (explaining that the Northeastern ISOs could create a seamless Northeastern energy market through collaborative efforts).

## III. ISO And RTO Planning Processes Can Include The Evaluation Of Innovative Transmission Technologies

The Pricing Proposal expresses concern that innovative transmission technologies may not be considered in an ISO or RTO planning process and seeks comment on how to encourage the development of such technologies. *See* Pricing Proposal at P 31. There is no reason to think that ISO and RTO planning processes will fail to assess new technologies or "foreclose" their use. Conversely, making new technological proposals subject to an ISO or RTO planning process would ensure that are independently and objectively assessed. With guidance from the Commission on the criteria to apply in determining when a proposed investment should receive the incentive, ISO and RTO planning staffs can fulfill this role.

## IV. ISOs And RTOs Should Determine The Eligibility Of Innovative Operating Practices For Incentives

For similar reasons, ISOs and RTOs will be in the best position to determine whether innovative operating practices should receive other incentives. ISOs and RTOs can evaluate the two primary criteria that should apply in establishing the eligibility of such practices for incentives. First, the alternative practice must be consistent with applicable reliability requirements. Second, the practice must achieve the Commission's goal of finding "timely and cost-effective ways to meet demand for additional grid capacity." *See* Pricing Proposal at P 32. Only ISOs and RTOs will have the information needed to determine the market benefits that result from the implementation of such measures.

## V. ISOs And RTOs Should Establish Criteria For The Measurement Of Improved Transmission Grid Performance

ISOs and RTOs are also the appropriate entities to establish the criteria by which to measure improvements in grid performance. *See* Pricing Proposal at P 33. These criteria must first ensure that all applicable reliability requirements are observed. Such measurement criteria could include increased thermal line ratings (*e.g.*, through application of dynamic ratings), improvement in the transfer capability of an interface (*e.g.*, through the use of Flexible AC Transmission Systems ("FACTS") devices) or reduced levels of congestion (*e.g.*, through improved maintenance scheduling). ISOs and RTOs should also establish measurement procedures for quantifying performance improvements as satisfying such procedures seems likely to be a prerequisite for receiving incentives.

## VI. The Commission's Proposed Incentives For New Investment Are Appropriate

Due to the barriers to investment and the substantial market benefits of new transmission capacity that are recognized in the Pricing Proposal, it would be appropriate to increase the ROE for new transmission investments. The Commission has correctly concluded that investors must have an adequate incentives to commit significant capital to new transmission investments. To further this objective, the Commission should also consider accelerated depreciation provisions for new investment in the transmission infrastructure.

## VII. The Commission Should Provide Additional Guidance On How The Incentives Proposed In the Pricing Policy Should Be Integrated With Other Incentives For New Investment

Under the Commission's proposed standardized market design, the issuance of Congestion Revenue Rights ("CRRs") to entities that invest in new transmission facilities in amounts corresponding to the amount of new capacity created will be a critical incentive. In particular, modest incremental investments to address specific transmission limits that create significant quantities of new transmission capability would often be much more profitable under the market-based approach than the ROE incentives offered by the Commission. The NYISO continues to support this kind of market-based compensation for new investments.

One issue that the Commission should in a final transmission pricing rule is how market-based compensation should be combined with regulatory incentives. Generally, a third-party, *i.e.*, non-regulated, investor seeking regulated rate treatment for a new transmission investment that is found to be eligible for Commission-approved rate incentive should not also receive CRRs since that would constitute double recovery.[4] There may, however, be cases where it is appropriate for an investor to receive a portion of the CRRs corresponding to the portion of the transmission investment on which it is willing to take the market risk, along with regulatory rate incentives.[5]

Lastly, to the extent that the Commission increases its reliance on regulatory incentives to support new investment in transmission, it is important that the Commission establish eligibility provisions that ensure that these incentives do not crowd out more efficient investments in new generation or demand response, or artificially over-stimulate transmission investments.

---

[4] This assumes a structure similar to that which currently exists under the NYISO Tariff is in place under which all CRR auction revenues received by the TOs are credited to a Transmission Service Charge, thereby benefiting all transmission customers. This requirement does not apply, however, in the case of non-TO investors.

[5] ISOs and RTOs can establish procedures for identifying circumstances when "double recovery" might be appropriate in their regions.

Thoughtful guidance by the Commission on these issues should ensure that regulatory incentives provide are part of a balanced and coherent regulatory framework that will encourage efficient new transmission investments.

Respectfully Submitted,

*/s/ Ted J. Murphy*
Ted J. Murphy
Counsel for New York Independent
System Operator, Inc.

Arnold H. Quint
Ted J. Murphy
Hunton & Williams
1900 K Street, NW
Washington, DC 20006-1109

Robert E. Fernandez, General Counsel
Elizabeth Grisaru, Senior Attorney
New York Independent System Operator, Inc.
3890 Carman Road
Schenectady, NY 12303

Of Counsel

March 13, 2003

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned proceeding in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 385.2010 (2002).

Dated at Washington, D.C. this 13th day of March 2003.

*/s/ Ted J. Murphy*
Ted J. Murphy
Hunton & Williams
1900 K Street, NW
Washington, DC 20036