

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

ISO New England Inc.	)	
New York Independent System	)	Docket No. RT02-3-000
Operator, Inc.	)	
	)	

**COMMENTS AND REQUEST FOR CLARIFICATION OF  
THE NEW ENGLAND CONFERENCE OF PUBLIC UTILITIES  
COMMISSIONERS**

The New England Conference of Public Utilities Commissioners, Inc. (NECPUC) hereby submits its comments and request for clarification regarding the Petition for Declaratory Order (Petition) filed on August 23, 2002 by ISO New England, Inc. (ISO-NE) and the New York Independent System Operator, Inc. (NYISO). The Petition requests an order finding that the proposed Northeastern Regional Transmission Organization (NERTO) would qualify as a Regional Transmission Organization (RTO).

NECPUC is strongly in favor of reduced seams among regions and development of a more efficient and robust wholesale market for electricity. NECPUC strongly supports the adoption of Standard Market Design (SMD) for the ISO-NE region.

NECPUC has not, however, reached a position regarding the merits of a merger between ISO-NE and NYSIO. Individual states within New England have submitted or may submit comments regarding the NERTO proposal or any of the components within the proposal. The comments submitted herein are supplemental to the comments of individual states.

The sharing of costs and benefits of a reduction of seams, however achieved, is an important issue. Preliminary analyses indicate that seams reduction, through merger or SMD, will likely result in a savings in the short term to the New York region. Filing,

Economic and Reliability Assessment of a Northeastern RTO, Attachment X. Further, there will be a consequent rise in costs to users in the New England region. In an attempt to ensure parity among regions, New England market participants, New England regulators and ISO-NE created a working group to address mechanisms to ensure that the New England region is not harmed either through elimination of seams or through formation of NERTO or other northeastern RTO.

There is not agreement among the New England constituents on the degree of allocation that would be appropriate. All NECPUC members agree that New England entities must be at least no worse off than they were without the Seams Reduction. Some NECPUC members would go further, believing that New England entities must receive a share of the benefits from Seams Reduction. This issue is addressed in more detail in a separate document jointly filed with the New England Power Pool this date.

In the event that a merger between ISO-NE and NYISO is approved, whether as a result of this Petition or a petition filed at a future time, or in the event that a stand-alone New England RTO is formed, NECPUC advances principles on the following subjects to guide the Commission in its analysis:

1. Preservation of RTO Independence
2. Governance, including Board Selection, Retention and Obligation to Act in the Public Interest
3. Market Monitoring and Mitigation Functions
4. System and Resource Planning

#### **I. PRESERVATION OF RTO INDEPENDENCE**

The NERTO filing calls for reposing exclusive Section 205 filing rights in the RTO. However, it may also be noted that, as yet, there remain transmission-owning

utilities that have not agreed to cede their Section 205 rights to the proposed NERTO. Since the decision of the Circuit Court in Atlantic City Electric Company, et al. v. Federal Energy Regulatory Commission, Duquesne Light Company, et al., 353 U.S. App. D.C. 1 (July 12, 2002) some utilities have asserted that the issue of the conditions under which a utility's Section 205 rights may be limited by the Commission has become less clear. That decision is now on remand to the Commission and, pending a decision on remand and any possible appeals, the holding of the Court might encourage utilities to demand concessions as a condition of agreeing to giving the NERTO exclusive Section 205 filing rights. NECPUC urges the Commission to exercise caution in considering any provision in the NERTO filing or the filing of any utility that might be construed as a concession necessary to obtain the voluntary relinquishment of a utility's Section 205 rights. While this caution exists with regard to provisions that may be sought in the NERTO, it applies as well to other RTO formations, including the two separate ISOs now performing the RTO/ITP functions.

## **II. GOVERNANCE, INCLUDING BOARD SELECTION, RETENTION AND OBLIGATION TO ACT IN THE PUBLIC INTEREST**

NECPUC, with one condition, supports the governance structure proposed in the NERTO Petition. Consistent with Order No. 2000, the NERTO Petition would establish a fully independent RTO Board while providing a meaningful advisory role for market participants. NECPUC's support is contingent upon the Commission requiring NERTO (or any other RTO approved for New England) to have an explicit statement affirming

that the RTO Board has an obligation to act in the long term public interest.<sup>1</sup> This affirmation must be included in the RTO governing documents filed at the Commission.

The NERTO Proposal furthers the Commission’s intent of establishing an independent board and a meaningful advisory role for market participants, through the following provisions:

- the Board has the exclusive authority under section 205 of the FPA to propose market rules or propose amendments to market rules and to file its own formula tariff to fund its operation. However, except in “exigent” circumstances where expedited action is necessary, the NERTO will develop its section 205 filings “in a manner that allows for stakeholder input and review.” Filing at 28.
- the Board initially will consist of 10 members, five from the ISO-NE Board and five from the NYISO Board. Two additional members will be chosen by a six member nominating committee made up of two NERTO Board members originally from the ISO-NE Board, two Board members originally from the NYISO Board and the Chairs of the NYISO Management Committee and the NEPOOL Participants Committee.<sup>2</sup> Filing at 24-25.
- The nominating committee, with the aid of a search firm, will develop a slate of candidates that are presented to the market participants for approval. Importantly, however, the nominating committee is not bound by the vote of the market participants. If the slate is not approved by the market participants, the nominating committee may still present the slate to the Board, after informing the Board of the participants’ vote. Alternatively it may decide to modify the slate and resubmit it to the participants. The filing, at 26, states that “In the latter case, the nominating committee will report the entire process and may opt to do so more than once, *if necessary*.” (Emphasis added.)<sup>3</sup>

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<sup>1</sup> There are three elements to that obligation: 1) explicitly stating a responsibility to the long-term (not just short-term) public good; 2) assuring system reliability and operational efficiency; and 3) ensuring that the legitimate interests of both buyers and sellers are given appropriate weight.

<sup>2</sup> While NECPUC prefers a structure that does not include market participants on the nominating committee, it does not object to this provision because minority market participant representation on the nominating committee is unlikely to result in market participant control over Board selection.

<sup>3</sup> While NECPUC prefers a structure that does not put Board members to any sort of a vote of market participants, it can accept this provision *if* the Commission makes clear that the ultimate decision to appoint, reappoint or terminate a Board member rests with the Board and that it cannot be controlled, vetoed, deterred or delayed by a process of multiple iterations of market participant review. NECPUC notes, however, that the Petition, in essence, grants the market participants “three bites at the apple” since their views can be presented both through control of one-third of the nominating committee and, also, through the proposed formalized “vote and comment” process, as well as through comments to the Commission. Because of these multiple opportunities for market participants’ influence, the Commission

As a result of these provisions, the Petition asserts that “NERTO will not be subject to direction by any entity other than the Commission.” Filing at 23. NECPUC strongly endorses the principle that the RTO cannot retain its independence if it is subject to direction by market participants. Thus, market participants cannot be allowed to exercise authority over the RTO by selecting Board Members. By providing market participants with an *advisory* vote on the slate of directors, the NERTO proposal allows market participants to make their views known to the nominating committee and the Board; however, the Commission must make clear that the market participants’ opportunity to present an advisory comment in no way transfers decisional authority from the RTO to market participants and, in particular, that no more than one round of comment by market participants is required. The need for such a clarification is particularly important in light of the final clause of the text of the Petition on this point (quoted and italicized above). If read to imply that multiple rounds of comment by the market participants might be “necessary” until their agreement is achieved, it would clearly corrode the vital principle of independence. Such market participant intrusion into selection of market managers is not only undesirable but also unnecessary. If concern arises that Board selection of new Board members, or reappointment of existing Board members, is working to the detriment of the markets or resulting in unjust and unreasonable rates, an interested person can bring the record of the stakeholder advisory process, nomination process and Board decision before the Commission under section

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should clarify and emphasize the independence of any RTO and its Board. This is particularly important since the Commission, in authorizing market-based rates within an RTO footprint, will be relying on the RTO’s role as market manager, as the surrogate for the Commission’s own statutory obligation to ensure just and reasonable rates.

206 of the FPA. As the Commission has authority over the RTO, it ultimately must resolve any specific concerns about the functioning of the Board.<sup>4</sup>

Though NECPUC takes no position on the use of term limits for Board members, it supports the use of staggered terms as proposed, filing at 24, to ensure continuity and effective operation.

The NERTO filing notes that the development of a meaningful stakeholder process is an ongoing effort. In this regard, the Commission may wish to consider the proposal submitted by the IECG and supported by the Maine Public Utilities Commission, the Maine Public Advocate and others. *See*, Additional Comments of the Industrial Energy Consumer Group, the Maine Public Utilities Commission, the New Hampshire Office of Consumer Advocate, the Connecticut Office of Consumer Counsel, the Maine Office of the Public Advocate, the Vermont Department of Public Service, Texas Instruments, Poweroptions, the Energy Consortium and the Energy Council of Rhode Island, filed on July 19, 2002 in Docket No RM01-12-000 (and other dockets). The IECG proposal ensures that *in practice* stakeholders have a meaningful advisory role in any RTO.

NECPUC also notes that a meaningful role for state regulatory input into board selections is important. The Petition affirms a commitment to work with state regulators “through a formal advisory committee” but is otherwise silent. Filing at 30. The relationship between the NERTO and state regulators must be further developed.

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<sup>4</sup> See further discussion of why market participants should have only an advisory role in Attachment A, NECPUC Governance Principles and Proposal, developed for the NERTO process and posted May 28, 2002 on the NERTO website.

### **III. MARKET MONITORING AND MITIGATION**

NECPUC substantially supports the NERTO market monitoring and mitigation proposal. The NERTO proposal is consistent with NECPUC's long-held position that both the RTO Board and any market monitoring and mitigation unit must be independent of market participants. It is also consistent with NECPUC's view that the market monitoring unit must be independent of the ISO operations division.

#### **A. Internal Unit**

The NERTO proposal differs slightly from NECPUC's in that the NERTO proposal has an internal market monitoring unit appointed by and reporting directly to the NERTO's chief executive officer. NECPUC has proposed that the internal unit report directly to the Board. NECPUC has stated:

The RTO Board should have the responsibility of ensuring that markets operate efficiently and competitively. As long as the Board is truly independent and is imbued with this mission, it follows that a unit that has both the day-to-day and long-term mission to ensure that anticompetitive behavior does not affect the competitiveness of the market – i.e. the MMU – should report to the Board. The Board and the MMU have essentially the same mission; therefore, there is no conflict with having the Board oversee the MMU.

NECPUC Proposal for Market Monitoring and Mitigation, posted on NERTO website May 28, 2002 at 1.

While the NERTO filing presents a slightly different structure, it still contemplates that the internal unit “will have a regular reporting relationship with the Board.” Filing at 26. Whether the internal unit reports directly to the Board or to the Board and the CEO, the crucial factor is that it is independent of market participants (as will be the Board) and

of the operations division of the RTO. For this reason, NECPUC supports the NERTO formulation.<sup>5</sup>

NECPUC also concurs with the NERTO Petition's delineation of the duties of the internal unit:

- performing real time market monitoring for efficiency, competitiveness, anomalies, etc.;
- implementing Commission-approved market mitigation measures;
- providing the Commission with unfettered access to data and records; necessary for the Commission to perform its regulatory oversight function<sup>6</sup>
- consulting with the external market monitoring unit to ensure that the markets are operating and evolving appropriately; and
- developing rule changes as necessary and in consultation with the external monitor. Filing at 46.

B. External Monitor

As is currently the structure in the New York and New England control areas, NERTO will also have an external monitor appointed by the Board. Under the NERTO proposal, however, the NERTO Board must notify the Commission of the hiring of the external monitor and, in the case of termination, explain the reasons for that decision.

NECPUC concurs with the NERTO Petition's delineation of the duties of the external monitor:

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<sup>5</sup> Allocations for market monitoring functions in the current ISO-NE budget appear minimally adequate and may over time prove to be insufficient to perform the functions called for. Should the budget level prove to be too low, NECPUC would advocate for increased funding to ensure the internal market monitoring function is effective.

<sup>6</sup> As discussed herein, however, the internal unit also should provide state regulators with access to market data.



- monitoring the markets for efficiency, competitiveness, anomalies, etc., including identifying flaws in the design and application of the market rules and procedures;
- monitoring the NERTO's administration of the market rules and procedures;
- advising the internal market monitoring unit on market efficiency and market power issues;
- notifying the Commission if the NERTO's administration of the markets is improper or incorrect; and
- providing regular reports to the Commission, the NERTO Board, state regulators and market participants on the state of the market and its evolution. Filing at 47.

In addition, the filing provides that market participants will have direct access to the IMMU and may submit complaints or requests for investigation to the external monitor. Finally the external monitor will participate, presumably with the internal unit and the Board, in the development of a “detailed description of the functions of the internal unit and the IMMU.” Filing at 47.<sup>7</sup>

The external monitor will assess NERTO's administration of the market rules in the context of ensuring that the markets operate competitively. It will not, however, take on the role of operational auditor, as some market participants have urged. NECPUC concurs with NERTO's limitation: “Given the specific skill set necessary for the performance of these operational audits, these operational audits will not come within the purview of the market monitoring units.” Filing at 48.

NECPUC notes that the NERTO proposal is quite similar to the role of the market monitor set forth in the Commission's SMD NOPR:

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<sup>7</sup> Similarly, as in footnote 5, allocations for the external market monitoring function now appear to be minimally adequate and should be increased if they prove insufficient to effectively perform the external market monitoring functions.

The market monitor will be expected to report directly to the Commission, and the independent governing board of the Independent Transmission Provider. This will include reporting at regular intervals on the general performance of the markets in its region and reporting, on a timely basis, observed attempts at market manipulation or factors that impair the efficiency of the market. Although the market monitor will be accountable only to the Commission and the governing board, it should share its analyses and reports with the management of the Independent Transmission Provider and the Regional State Advisory Committee.

SMD NOPR ¶ 430.

Although the NERTO proposal contains significant measures to protect the external monitor from undue influence by the Board, NECPUC believes the proposal could do more to safeguard the external monitor's independence. We strongly disagree with those who assert that the answer is to put the external monitor under an entirely separate board (or under a subset of NERTO directors who would somehow be separate from the rest of the Board), as that approach would balkanize responsibility for the operation of the market and create what could in effect become a shadow government.<sup>8</sup> Rather, NECPUC proposes that the selection and removal of the monitor be subject to the approval of the Commission, possibly acting through the Commission's Office of Market Oversight and Investigations. This would not only protect the independence of the monitor, but would have the added benefit of enhancing the effectiveness of the Commission's oversight effort.

C. Market Data Availability to State Regulators

Neither the NERTO filing nor the SMD NOPR addresses whether market data collected by NERTO will be available to state regulators for the purpose of market

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<sup>8</sup> It is imperative to avoid the situation in which those unhappy with the actions or direction of the NERTO try to achieve change by appealing to some other regional board rather than by exercising their right to review by FERC. The creation of a separate board has the potential to inject into the new market the types of problems that have resulted from NEPOOL's labyrinthine structure.

monitoring. In this docket, as well as in the SMD NOPR, the Commission should make a clear and unequivocal statement in favor of providing state regulators access to market data collected by the RTO for market monitoring purposes.

NECPUC has previously advocated for state regulator access to market data in the RTO's possession for market monitoring purposes, as long as the regulator can assure confidential treatment of the data. In Docket No. EL00-109, for example, NECPUC supported a motion by the Maine Public Utilities Commission (MPUC) requesting disclosure of certain ICAP bid data. It also asked the Commission to clarify that under the NEPOOL Information Policy, ISO-NE may disclose confidential market data to state utility regulatory commissions if the state commission issues an order protecting confidential material. NECPUC expressed its agreement with the MPUC "that the Commission's policy favors disclosure of the information at issue to state commissions." Answer of the New England Conference of Public Utilities Commissioners in Support of Motion of the Maine Public Utilities Commission for Disclosure of Information. The MPUC Motion had pointed out that the Commission, in numerous cases and its Order No. 2000, "has found that state regulators should have access to market information necessary for monitoring purposes." Further, the MPUC noted that this policy toward allowing access "is grounded in the Commission's recognition that state regulators have a strong interest in ensuring that wholesale markets function properly because of the effect of wholesale markets on the operation of competition in state retail markets." Motion of the Maine Public Utilities Commission for Disclosure of Information, dated November 13, 2000 in Docket No. EL00-109.

The Commission denied this motion, finding it was moot, given ISO-NE's eventual release of the bid data at issue, *see NSTAR Services Company v. New England Power Pool*, 99 FERC ¶ 61,188, n.14 (2002), and thus this policy question of significant import to state regulators still needs clarification by the Commission. Such a clarification will save stakeholders significant resources that would otherwise be depleted in an effort to resolve this ongoing question.<sup>9</sup>

#### **IV. SYSTEM AND RESOURCE PLANNING AND EXPANSION**

##### **A. Access to Planning Data and Terms of Negotiations**

The NERTO Petition includes a transmission plan with a backstop of regulated transmission solutions to needs that have not been met with market responses. Actions taken in response to a planning backstop will have financial implications for investors operating in the competitive markets. For this reason it is important to establish a planning process that is truly open and even-handed. That is, the planning process should not focus solely on transmission solutions but instead should ensure parity among resource options. Further, access to planning data must be available to all market participants.

NERTO has no authority to mandate transmission construction and, therefore, proposes to solve constraints through the cooperation of Transmission Owners (TOs). In the NERTO Petition, TOs will sign a voluntary transmission owners' agreement that will commit them to respond to a NERTO directive to build transmission. It is reasonable to expect that the TOs will negotiate something of value in exchange for these agreements. The terms of such negotiations are a critical element of any RTO and must be fully aired

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<sup>9</sup> State regulators in New England will continue to require such information from time to time because of their obligation to oversee retail competition and the relationship between competitiveness (or absence of

by market participants and state and federal regulators. The Petition contains no such information.

B. System Upgrades

Given the NERTO proposal's approach of relying on market forces with a planning backstop, there is a need for greater clarity both on when system upgrades will be built and who will pay for them. Absent that, market participants face the prospect of arbitrary decisions by the planning entity, and they are unlikely to invest when confronted with the possibility that such decisions will devalue their investment. Simply put, unregulated companies need to know where they stand before they commit their resources.

Bringing clarity to the subject requires that certain terms and concepts found in the NERTO proposal be more clearly defined. For example, the proposal purports to distinguish between "reliability" and "market efficiency" upgrades, but does so in a way that leaves room for very different interpretations. Filing, Attachment VII, NERTO Planning and Expansion Process, at 4. Terms of this nature must be crisply defined, unless it is determined that they do not constitute meaningful distinctions, in which case they should be abandoned as not serving a useful purpose in resolving the cost issues involved in transmission upgrades. We note that expeditiously addressing resource cost allocation questions must be done, regardless of whether NERTO, or even a stand-alone RTO, is established.

NECPUC also requests clarification on how the funding mechanism will be approved. The Petition states, "[U]ltimately, the Commission and/or state regulators will be asked to accept the funding mechanism approved by the NERTO Board." Filing

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competition) in the wholesale and retail markets.

at 101. We are concerned if the “and/or” language is meant to signify that utilities may bypass state review of cost recovery. The Commission should clarify the process through which it would approve the funding mechanism for specific upgrades and that state regulators are not an optional step along the way.

## **V. CONCLUSION**

Based on the foregoing, NECPUC respectfully asks the Commission to:

- I. apply the principles contained herein when evaluating the NERTO proposal or any proposals for a stand-alone New England RTO; and
- II. clarify the Commission’s views regarding:
  - a. independence of RTOs and their Boards;
  - b. the availability of data and other information in system planning and expansion; and
  - c. the role of state regulators in cost recovery.

Respectfully submitted,

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Dated: November 8, 2002

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of the foregoing document by first class mail upon each party on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 8<sup>th</sup> day of November, 2002.

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John E. McCaffrey