

# POWER MOVES!

Newsletter of the New York Energy Buyers Forum  
Late Fall 2002

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The New York Energy Buyers Forum would like to thank **THOMPSON HINE** for underwriting the publication of this newsletter.

## NYEBF Continues New Educational Initiative

Earlier this year, the NYEBF Steering Committee decided to refocus our educational seminars in an effort to provide greater value to our fellow members. Under the new plan, we have held a practical and timely, energy budgeting seminar and an informative Installed Capacity panel, which included participation from the Federal Energy Regulatory Commission (FERC). These events were well received and well attended.

We are very proud to be presenting in our November 20<sup>th</sup> seminar, a topic of significant local and national importance, FERC's proposed "Standard Market Design" (SMD). The SMD is of such importance that REBNY, BOMANY, and Ernst & Young LLP agreed to cosponsor the event in order to share this valuable information with their members and clients. The SMD has the ability to radically alter the electricity industry and the nature of how we look at electricity supply and procurement. We have gathered a prestigious panel of industry experts and expect an enlightening discussion. **We highly recommend this seminar for those individuals responsible for controlling operating costs and for strategic planning. We have deliberately structured this newsletter to support the November 20th event and to help promote the solid foundation of knowledge that is necessary in understanding the SMD and its impact on our future.**

*Daniel Levin*

**The New York Energy Buyers Forum would like to acknowledge and thank the cosponsors of the SMD seminar: The Real Estate Board of New York, Building Owners and Managers of New York, and Ernst & Young Real Estate Advisory Services.**

## Upcoming NYEBF Seminar: "How FERC's Standard Market Design Could Affect Your Bottom Line"

**November 20<sup>th</sup>, 8:45 am – 11:00 am**

**Ernst & Young Building, 5 Times Square**  
(SW corner 42<sup>nd</sup> Street and 7<sup>th</sup> Avenue)

The Forum's chair, Jay Raphaelson, said "FERC is pushing a sweeping reform of wholesale power markets that could affect pricing and reliability in our area. Some proposals are new, such as enforced load curtailments, while others are reforms that could save money for some of us while raising costs for others. We want to know if these changes are feasible, and how they could affect commercial and institutional power users. This event is a good opportunity to see how these proposed changes could affect how we buy power, and what impact they may have on adding the new generation needed to create a competitive and reliable power market."

### Confirmed panelists include:

- Scott Miller, Senior Advisor on Markets, Federal Energy Regulatory Commission
- Bill Museler, CEO, NY Independent System Operator
- Chris DeGraffenreid, New York Power Authority
- Brian Hayduk, Constellation NewEnergy
- Terry Kain, Keyspan-Ravenswood

The panel will be moderated by Lindsay Audin, the Forum's associate director.

Admission is free for NYEBF members, \$50 for members of BOMA or REBNY, and \$100 for non-members. All attendees (including members) are asked to RSVP to the Forum at (212) 419-1919 or [events@nyebf.org](mailto:events@nyebf.org) by November 15<sup>th</sup>. Refreshments will be served. Further information about the New York Energy Buyers Forum may be found at [www.nyebf.org](http://www.nyebf.org).

## Understanding the FERC Standard Market Design

In 1992, the Energy Policy Act provided a statutory foundation for opening access to utility electric transmission systems. The Federal Energy Regulatory Commission (FERC) built on this foundation in 1996 with Order No. 888, which required public utilities to provide open access electric transmission service to wholesale and unbundled retail customers under standardized terms and conditions. It also required transmission-owning customers seeking service under an open access tariff to reciprocate with comparable service on their own systems.

FERC continued its initiatives in 1999 with issuance of Order No. 2000, which all but required utilities to transfer operational control of their transmission facilities to independent entities called Regional Transmission Organizations (RTOs), which would administer transmission access and planning and congestion management. FERC hoped that this measure would eliminate any residual ability of transmission owners to use operational control of their facilities to their competitive advantage. FERC also made it clear that an Independent System Operator (ISO) would be regarded as an RTO provided that it met the RTO criteria.

The pace of compliance with Order No. 2000 has been uneven. Some regions of the country, particularly the Northeast, are already well advanced, with sophisticated market structures and mechanisms in place. In the West and Southeast, RTOs are beginning to emerge, although some are meeting scrutiny, if not resistance, from state regulatory agencies.

In July 2002, FERC commenced a third giant step in its campaign to eliminate discrimination and inefficiency in the wholesale marketplace by issuing its Notice of Proposed Rulemaking (NOPR) on Standard Market Design (SMD). The SMD reflects FERC's perception that the absence of standardization in market rules within and between regional markets has resulted in the continuation of discriminatory practices and impeded progress toward an efficient and competitive wholesale market. FERC has surveyed the existing market

design practices in various regions and proposes to build on this experience by incorporating the "best practices" in its rules.

Among the significant elements of the SMD are the following:

- **Single Transmission Service:** The several transmission services under the existing standard tariff would be replaced with a single service – Network Access Service – for all transmission customers, including wholesale, unbundled retail, and bundled retail customers. The intent of this is that all transmission customers (including retail end-users) will be treated in the same manner. This could either decrease or increase transmission costs to bundled retail customers depending upon how transmission costs are currently reflected in bundled rates.
- **Independent Transmission Providers:** In furtherance of the Order No. 2000 objectives, the operation of all utility transmission facilities would be controlled by some form of Independent Transmission Provider ("ITP"), whether it be an RTO or some less inclusive entity on an interim basis.
- **ITP Powers:** In addition to providing transmission services, the ITP would administer wholesale day-ahead and real-time power markets, as well as spot markets for ancillary services and transmission congestion rights (see below).
- **Locational Marginal Pricing:** The ITP would employ Locational Marginal Pricing (LMP), whereby separate energy prices would be set for each geographical node on the grid and separate transmission prices would be set for service between any two nodes. During periods of congestion, prices would be based on the highest cost of accessible generation, thus reflecting the true value of the assets providing the service. Transmission customers in congested areas may thus be subject to higher transmission costs during peak periods unless they hold CRRs (see below).

## Understanding SMD (continued)

- **Congestion Revenue Rights:** As a further means of managing congestion, the ITP would sell Congestion Revenue Rights (CRRs) covering all of the transmission transfer capability on the grid. The CRRs, which could also be traded in a secondary market, would allow market participants to secure access on specific transmission paths and avoid LMP congestion charges. This market would provide transmission customers with access to an important hedging device.
- **Resource Adequacy:** Load-Serving Entities (LSEs), such as traditional utilities and retail power marketers, would be expected to maintain a 12-18% reserve between peak demand and firm capacity. This margin could be comprised of both generating capacity and demand response capability – i.e., the ability to reduce energy use as the need arises. An LSE not meeting the reserve requirement would be financially penalized if it took power from the spot market during a power shortage. Or, the spot market service to the LSE could be curtailed first if the shortage warranted curtailment. To the extent that LSEs have to acquire such reserve margins, this could add to the cost of power for retail customers.
- **Mitigation and Monitoring:** In order to mitigate market power in spot markets, bids of essential units would be capped. Predetermined conditions such as unusually high prices or loads would also trigger a review of generator bids for possible exercises of market power.

FERC has involved industry participants and governmental entities in the SMD rulemaking. Initial written comments on most NOPR issues are due November 15, 2002. FERC has deferred the comment deadline for “thorny” issues – i.e., pricing proposals for network upgrades and expansion, the resource adequacy requirement, and CRRs – until January 10, 2003, to permit further conferences. Reply comments are to be submitted by February 17, 2003. The final rule is not likely to be issued until

months later. At this time, the proposed final date for implementation of the SMD is September 30, 2004, although factors such as further rulemaking, litigation and political processes could well delay or otherwise affect implementation.

When all is said and done, how monolithic is the market design edifice likely to be? The rulemaking, after all, is about standard market design, and the desire to eliminate Balkanization among regional markets is a central motivating factor. Notwithstanding FERC’s clear preference for uniformity, however, recent indications are that there will be no cram-down of a one-size-fits-all set of rules.

First, the NOPR itself allows for the possibility of regional variation. In recent public statements, FERC Chairman Wood articulated the need to balance the benefits of uniform practices against regional preferences on market design issues.

Second, the rulemaking is still very much a work in progress. FERC is actively soliciting dialogue on various issues at public conferences, and is in the process of receiving and digesting what is and will continue to be a massive volume of written comments from all sectors of the industry. The rule that finally emerges may be even more flexible than what has been proposed.

Third, FERC has made clear that it will honor the integrity of approved RTO features that do not fit the final SMD mold. In October 2002 orders granting preliminary approval to two RTOs in the Southwest and Southeast, FERC stated, “It is not this Commission’s intent to overturn, in the final SMD rule, decisions that are made in this docket.”

Some regional variations in market design, therefore, are likely to survive the SMD final rule, at least in the near term. Yet it appears equally likely that the key features of a standardized market design framework must also be included in the final rule if FERC’s vision of a seamless, efficient, and competitive market of nationwide scope is to be realized. The immediate impact of that framework on market participants will vary regionally, depending on how many elements of the SMD are already up and running in a particular region. For that reason, as FERC currently envisions the SMD,

transmission customers within New York, New England, and the mid-Atlantic states (encompassed within the PJM ISO) are likely to see fewer changes than transmission customers in other regions.

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### Possible Impacts of FERC'S SMD

Through a proposal called the "Standard Market Design" (SMD), the Federal Energy Regulatory Commission (FERC) is seeking to eliminate various problems in wholesale (and, to some degree, retail) power markets. While some of its proposals are already in effect in our area (e.g., locational marginal pricing), others (such as enforced load curtailments) are both new and controversial. This article reviews the relevant aspects of the SMD as it may affect commercial/institutional power customers in the NYC area.

#### What FERC's SMD Will And Won't Do

It will ***not***:

- Directly deregulate/restructure utilities at the retail level; that's still up to the states.
- Fix financial problems of power suppliers (e.g., Enron, Dynegy, PG&E).
- Add new generation where presently needed.
- Give FERC new transmission line siting powers.
- Guarantee any rate reductions (or increases) for anybody.

Here are a few key issues FERC is addressing in the SMD (some may not look new to you):

- All utility transmission systems (including coops and municipal systems) would be controlled by centralized regional agencies (RTOs) with powers broader than ISOs.
- RTOs become "Independent Transmission Providers" that operate wholesale day-ahead and real-time markets and push for transmission upgrades as needed.

- Load Serving Entities (LSE) - utilities and retail power marketers - must maintain a 12-18% capacity reserve margin. NY presently calls for an 18% reserve margin.
- If an LSE takes more power than it supplied to the grid, it would be charged heavy penalties (\$1/kWh or more). This process is already in effect in the PJM area, and could replace the ICAP deficiency charge system in NY.
- Mandatory power curtailments (on an LSE and subsequently the LSE's customer base) may also be allowed to enforce this policy.
- Demand response capability would be considered equivalent to contracted generating capacity.
- Locational Marginal Pricing (LMP) becomes necessary to reflect the true value of generating and transmission assets. Congestion contracts (which already exist in NY) would allow LSEs to cap transmission costs in advance.
- To simplify installation of new generation, common standards for interconnecting new plants would be adopted by all transmission owners (mainly utilities).

#### When Should I Expect To See Impacts From SMD?

FERC's initial implementation schedule is set to start in mid-2003 and stretches into mid-2004, but shifting comment deadlines and threats of lawsuits will likely push that back by a year. FERC has White House backing for its policies, so major changes in some form are probably inevitable. Here are a few general predictions.

1. Impacts will differ widely, but more of the U.S. (especially older cities) would see power pricing that varies more based on time-of-use and seasons (like we see in NYC).
2. Where utilities lose monopoly advantages over their transmission systems, T&D rates may increase but commodity prices may drop a bit.

## Impacts (continued)

3. If the \$/kW-month ICAP charge is replaced by a \$/MW-hr charge, off-peak prices may drop a bit, but on-peak power pricing may jump. This may be seen as higher peak demand charges and/or tighter contractual rules for usage outside of one's normal load profile, and/or increased efforts to move toward real-time pricing.
4. More sophisticated contract options (i.e., beyond fixed pricing) may appear, but longer-term contracts (3-5 years or more) may become the norm to get better pricing.
5. Demand response programs (including use of customer-owned generation) may be expanded and/or pushed harder.
6. Average power prices may rise for customers with low load factors and inflexible loads, and drop for those with high load factors and/or flexible demand.

### So What, Who Cares, and What Should I Do If You're Right?

Consider the long-term (i.e., beyond the next 2-3 years) impacts of these changes. Are any major HVAC, lighting, or process load upgrades (with 10+ year lifetimes) being planned? If so, choosing the most energy efficient and flexible options (e.g., hybrid chiller plants, dimming systems, thermal storage) may help hedge against volatile/rising power pricing. Be open to a multi-year contract, with demand response options, financial hedging tools, and a cap/floor pricing regime. At the very least, watch out for short-term actions (like widespread use of window A/C units) that could make your load profile more sensitive to peak demand.

FERC IS REQUESTING COMMENTS FROM THE PUBLIC ON ITS SMD PLAN. ON NOVEMBER 20<sup>TH</sup>, THE NYEBF IS HOLDING A MORNING SEMINAR WHERE A FERC REPRESENTATIVE AND CURRENT MARKET PARTICIPANTS ARE GOING TO DISCUSS THE POTENTIAL IMPACT OF THE SMD PLAN ON THE NY ELECTRICITY MARKET. THIS EVENT WILL BE YOUR OPPORTUNITY TO

LEARN ABOUT THE SMD AND ITS FUTURE IMPACT ON YOUR PROPERTY.

*Lindsay Audin*

## Con Edison Steam Seeking Rate Relief

NYEBF representatives met with Con Edison on October 18, 2002, regarding the recent filing with Public Service Commission (PSC) for steam rate relief.

Con Edison stated that the rate year that ended on September 30, 2002 was extremely poor. Its typical ROI is between 10% and 11%. This past year its ROI was 0%. Con Edison also stated that its overriding interest was to stay within the rate schedule. Consequently, it filed a petition seeking the following three rate relief mechanisms rather than a rate increase:

### Reduced Property Taxes

Con Edison has asked the PSC to allow it to keep 100% of the \$7.2 million property tax relief on steam plants that it received from the City. Normally, \$5.8 million of \$7.2 million would be passed through to ratepayers.

### Steam Line Loss Variance

Con Edison has requested that the PSC waive the penalty for this year and next year. Con Edison is allowed a line loss of 13.5% before penalties are imposed by the PSC. This line loss is the difference between the steam sent out from their plants and the total consumption as measured on customer meters. This past year, Con Edison experienced a 17.2% line loss, which resulted in a \$7.2 million penalty that would normally be passed on to ratepayers. Con Edison attributes the line loss to lower sales volume due to the mild winter and the loss of the World Trade Center, which represents \$5.2 million in lost sales. Con Edison stated that thermal losses that were consistent over time also contributed to the line losses. NYEBF challenged the theory that was presented and Con Edison agreed to provide NYEBF with a copy of its consultant's study for our review.

## Con Ed Steam (continued)

### Embedded Fixed Costs

Con Edison has proposed recovering the \$5.2 million in revenue due to the loss of the World Trade Center through a weather normalization formula. Con Edison claims that the terms of the settlement entitle it to re-open the previous rate case if its returns fell significantly below those projected. Con Edison projects that customer bills would increase 1 ¼% if temperatures are consistent with last year. If it is a colder winter, there would be no need to increase customer bills because the losses from last year would be negated by increased sales. Con Edison would limit their recovery to the \$5.2 million.

### The NYEBF Response

The Steering Committee is reviewing Con Ed's claims and each proposed rate relief measure. A formal response to the PSC will be drafted with our recommendations for a fair revenue and rate neutral plan. Any members interested in assisting in this process should contact Lindsay Audin at 914 271-6501.

### Potential Impact of Steam Rate Filing

For a typical 200,000 sq. ft. office building in New York City, the rate relief requested by Con Edison's steam division (about a 1.25% increase) would cost an extra \$2500 to \$4500 a year, depending on the age of the building and its use of steam for cooling as well as for heating.

*JR, YW, DL, and LA*

***Members are encouraged to assist with the next issue of Power Moves! Contact Daniel Levin at [dan.levin@ey.com](mailto:dan.levin@ey.com) to suggest future topics that would be of interest to our membership, to contribute articles, or to provide other support towards the publication of this newsletter.***

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Thompson Hine is proud to support the efforts of the NY Energy Buyers Forum and welcomes your inquiries. For more information concerning the services provided by Thompson Hine, call us or visit our website.

*The New York Energy Buyers Forum is a non-profit corporation formed to help its members obtain lower utility costs. For more information about the NYEBF or to join, please contact us or visit our website.*

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