# The Case for a Separate Voting Segment For ISOs, RTOs, and RROs In the NAESB WEQ

***Introduction***

On December 19, 2001 FERC issued an Order that requested the Wholesale Electric Industry to devise a single body that would be responsible for formulating and revising Business Practices governing the sale and transport of power into, out of, and through control areas. Leading up to that Order, the Gas Industry Standards Board (GISB) expanded its scope and modified its By-laws to form a new organization known as the North American Energy Standards Board (NAESB). This organization contains four quadrants, respectively for wholesale and retail Gas and Electricity. The Wholesale Electric Quadrant (WEQ) is in the process of forming, with the intention of becoming the single body responsible for Business Practice standards. As a part of that process, the stakeholders attending the formative meetings have been working hard to develop a segment composition and voting model that would be representative of the major groups of stakeholders participating in the Wholesale Electric Market.

At the May 5th NAESB WEQ meeting, by a narrow margin, the WEQ stakeholders voted to propose a five-segment voting model, reversing their previous decision to support the Electronic Scheduling Collaborative's designation of six segments. The rejected sixth segment had been designated for ISOs, RTOs and Regional Reliability Organizations (RROs). The five-segment model tended to locate the ISOs, RTOs, and RROs in a segment with transmission Owners. However, there were many expressions of dissatisfaction with this aspect of the five-segement model. This dissatisfaction was expressed, but not resolved at the subsequent May 29/30 stakeholders' meeting in Birmingham.. The purpose of this paper is to present the attributes, value and necessity for a six-segment model that provides for a separate segment for ISOs, RTOs, and RROs.

**Fundamental Requirement For Independence**

*Forcing the ISOs and RTOs to collaborate with another market segment that has a vested financial interest compromises their fundamental requirement for Independence*

As the disaggregation of vertically integrated utilities began to take place and the various components (generation, transmission, distribution, marketing and brokering) began to appear as separate organizations, the need arose for a separate and independent organization whose sole task it was to coordinate the activities of these entities. This organization would operate a market in which these entities could trade in a fair and equitable fashion. Implementing short and long term reliability standards of the bulk electric system is also in their scope of responsibility. In order to accomplish this, the organization must be independent and free of financial interest in any of the market segments. These organizations are ISOs and RTOs.

In recognition of the requirement for independence of RTOs and ISOs, FERC's Standard Market Design (SMD) and FERC Order 2000 state that the:

"Principle of independence is the bedrock upon which the ISO/RTO must be built." This is paramount, for both the reality and the perception to all market participants.

If the ISOs/RTOs are required to share a voting segment with a particular market segment (such as Transmission Owners), it would ultimately bring pressure upon them to compromise their independent viewpoint on some issue before the WEQ, in order to garner support from their "partner" on some other issue important to them. This sort of bartering for support is inevitable in this scenario. Because of their unique "revenue-neutral" position in the market, ISOs and RTOs will inevitably be at crossed purposes with any other market segment at one time or another in the process of formulating standards for Business Practices. Therefore, it is imperative that ISOs, RTOs, and, likewise, RROs be in a segment by themselves in order to preserve their fundamental requirement for independence from market interests and to serve their constituency in a non-discriminatory manner.

**Financial Interest**

*ISOs, RTOs, and RROs have no financial stake in the Wholesale Electric Market*

RTOs/ISOs can substantially effect the financial position of Market Participants in any of the other segments. For instance, the decision of how to price congestion can cause a varying result of profits to different entities. As a tariff administrator we have impact over the routing of new lines, which in turn impact Transmission Owners and generators - depending on the decision. If you look at A/S in defining types and quantities, we can impact generators regarding who gets service and on what terms, since we are the transmission gatekeepers. All these types of decisions will need to be made and if we are seen in perception as belong together with one segment then it looks as if our decisions might be biased. If put in any other segment the normal give and take between segment members (i.e. TOs and RTOs/ISOs/RROs) in reaching a decision would create at least the perception of RTOs/ISOs giving preferential treatment to the segment that they are placed in. In other words, no matter wich of the five segments segment RTOs and ISOs are placed in, another segment could always claim that the RTOs/ISOs are being discriminated against.

ISOs, RTOs, and RROs are, by design, independent of any financial stake in the wholesale electric market. In fact, they are the <u>only</u> segment that is. Therefore, there is no other logical place in the voting structure for them <u>except</u> in a segment separated from financial market interests.

***Balance Market Design with Reliability***

*The ISO/RTO/RRO segment is the only segment that is fundamentally committed to balancing the emphasis on Reliability and Compliance Concerns with the emphasis on Market Functionality*

Most people in the industry agree that there is a fundamental interaction between Electric System Reliability Rules and Wholesale Electric Market Rules. In general, changes in one arena have a

first order effect on functionality in the other arena. However, members of each of the other segments of the industry are businesses that are profit motivated.

ISOs and RTOs, are charged by definition with the dual responsibility to maintain a reliable electric system and to operate a fair and equitable market. This dual role is unique to ISOs and RTOs and at times puts them at odds with other segments of the market. For this reason, they must have the flexibility to exercise their unique role in the process of creating and modifying Business Practices as well as in the exercise of their day-to-day operations. They can only achieve this if they have their own voting segment.

**Wholesale Electric Markets Operating Experience**

*ISOs and RTOs have unique expertise and perspective with operating Wholesale Energy Markets*

Several of the ISO/RTOs already have extensive experience in setting up and operating Wholesale Electric Markets using the financially based transmission service model that has now become known as the Standard Market Design (SMD). These organizations, although disproportionately small in number, need to have a strong role in the standards setting process in order to ensure that the standards will actually work under SMD, as envisioned by FERC. In addition, the RTOs have a responsibility to carry out Market Monitoring and Mitigation Functions. Again, a strong voice is needed to ensure that proposed Market Rules do not undercut the RTOs' ability to carry out their Market Power Mitigation responsibilities. These goals can be best accomplished by ISOs and RTOs residing in a separate segment.

**FERC Policy and Standard Market Design**

*ISOs and RTOs are central to implementing wholesale electric markets and the Standard Market Design*

ISOs, RTOs and RROs are relatively few in number compared to other "market segments" but they play a large role in the operation of wholesale electric markets. This role is clearly described for RTOs by FERC in Order 2000. The FERC mandate for an ISO/RTO includes:

- Independence from market participants, both transmission and generation.
- Implement non-discriminatory independent day-ahead, real-time markets and imbalance markets that provide both supply and demand with proper price signals.
- Maintain exclusive authority over short-term reliability, including coordination of transmission and generation outages, reduction in reliance on reliability must run units, reduction in transmission congestion, calculation of regional TTC and ATC, etc.
- Promote efficient use of generation and transmission facilities and provide participants with a venue to vet long-term planning and expansion proposals whether transmission, generation or demand-side.
- Provide a market-monitoring function that reports to both the independent RTO board and FERC market monitoring that will identify market design flaws and necessary design changes, identify market power and propose remedial actions, detection and mitigation of economic and physical withholding, provide additional market mitigation by removing the control of transmission from transmission companies that compete in the generation market, etc.

ISOs and RTOs are an integral part of the Standard Market Design. It is unreasonable to expect market participants to willingly share power with ISOs, RTOs and RROs if they think they can be successful in subjugating their participation in formulating rules. Some market participants see this as a way of exercising control over the rule-making process that FERC has initiated in moving forward with its Standard Market Design.

**Rule Making Efficiency**

*Creating a 6th Segment for ISOs, RTOs and RROs will not result in inefficiencies in the rule-making process*

Because the ISOs, RTOs and RROs only interest will be in creating rules that are practical and workable, as well as consistent with SMD and Reliability principles, creating a separate segment for them will not lead to obstructionism on their part. They will be neutral on many economic issues because they do not have a financial interest in the outcome.

***Conclusion***

The RTOs/ISO/RROs have a legitimate business interest in the standards-setting organization and need a separate voice on the ratification of standards not just on the development of the standard. It is a matter of record that several ISOs/RTOs administer markets in today's environment and have extensive experience in crafting market standards. That experience will be invaluable in avoiding many of the pitfalls having already been experienced. According to Mr. William Boswell's letter dated May 31, 2002, NAESB will be a forum for the process for "…development and adoption of market standards in the electricity industry." The RTO/ISO/RROs are the entities that are responsible for maintaining the reliability of the grid, ensuring transmission bottlenecks are addressed on an interregional coordination basis, market monitoring, congestion management, energy imbalance markets and interregional planning. Additionally these organizations will be charged with complying with, and implementing whatever standards are approved. All of this will require effort by the RTO/ISO/RRO entities. To have these entities commingled with other market participants may stifle objective discourse and ultimately result in a standard that cannot be fully implemented.

---

This Position Paper is endorsed by the following organizations:

California ISO
ERCOT
Independent Market Operator (IMO)
ISO-New England (ISO-NE)
MAAC
Midwest ISO (MISO)
New York ISO (NYISO)
Northeast Power Coordinating Council (NPCC)
PJM
Southwest Power Pool (SPP)
WECC