

Recommendations for Reforming **NYISO** to Lower Consumers' Electricity Bills

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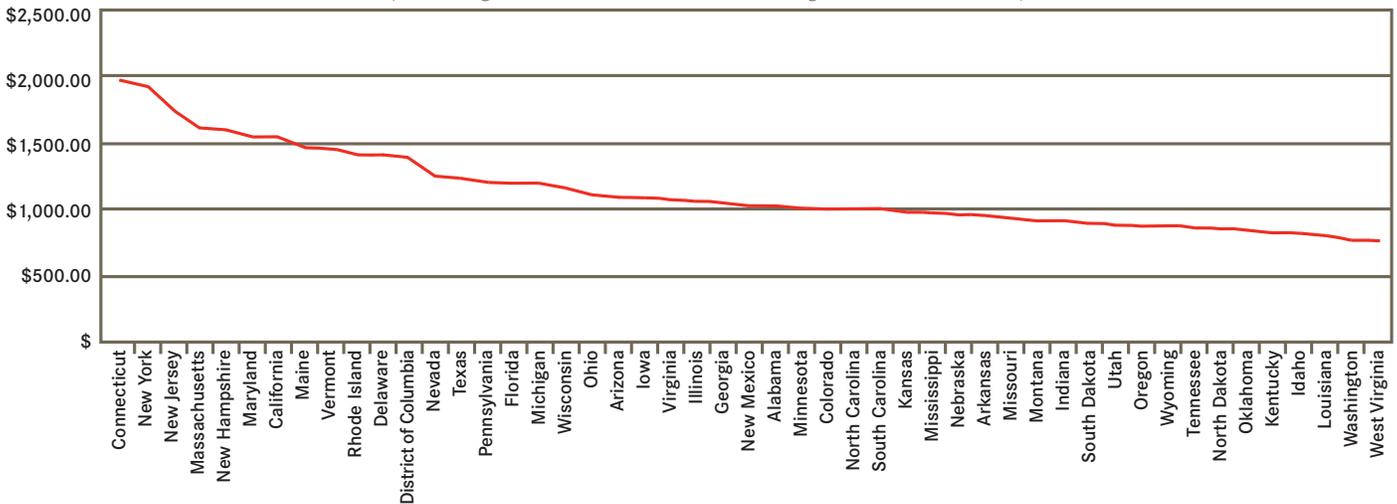
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No Accountability Causes Problems in Electricity Markets in New York

New York households pay among the highest for electricity in the country (see chart below).^{1,2} But few consumers realize that the high prices in New York are largely determined in the wholesale electricity market which is overseen by a private organization, funded by ratepayers, however with almost no accountability to the public. What makes this scenario even more troublesome are reports of gaming or price manipulation in the marketplace it administers.³ The organization in question, the New York Independent System Operator, Inc. (“NYISO”), is a not-for-profit corporation that was created in 1999 after the New York Public Service Commission set out to restructure the state’s retail electricity markets and deregulate wholesale prices.

Residential Costs by State
(including District of Columbia; excluding Alaska and Hawaii)



Until the headlines this spring about price manipulation in the state’s wholesale electricity market, few of us had ever heard of NYISO or knew what it does. No New York State law created or supervises NYISO, which is governed by a self-perpetuating board, writes its own rules, charges consumers for its operations, and oversees wholesale electricity prices without any real accountability to the public or any elected official including the Governor of New York or the state legislature.⁴

Every day, the electric utilities serving New Yorkers buy power from the generators that participate in market-clearing price auctions run by NYISO. Unlike the types of auctions familiar to most of us, in NYISO’s auctions the sellers, the bids, and the calculations are all secret.⁵ The auctions are designed so that the price of the highest bid for wholesale electricity is paid to all generators (sellers), even those willing to sell for less. It’s no wonder our retail rates are so high.

Because NYISO’s policies clearly affect the electricity prices paid by consumers, AARP recommends reforms that will provide checks and balances that help protect consumers against high wholesale prices while maintaining reliable service.

What Is NYISO?

The Northeast blackout of 1965 inspired the creation of the New York Power Pool in 1966, which was replaced by the New York Independent System Operator in late 1999. In its own words, “The NYISO is the independent body responsible under tariffs approved by the Federal Energy Regulatory Commission for maintaining bulk power system reliability, providing open access transmission service, and administering the wholesale energy, capacity, and ancillary services markets in New York.”⁶ However, NYISO was not established by any state law. It is run by a ten-person board of directors, elected by the selfsame board.⁷ Although its actions directly influence retail electricity prices, NYISO’s private status exempts it from the open meetings/open documents laws of the State of New York. NYISO has no real accountability to the public.

The majority of NYISO’s revenue for operating the electricity grid and wholesale electricity spot markets is eventually collected from retail electric ratepayers via their utility bills. This figure (\$140,644,871 in 2008)⁸ has grown dramatically over the last several years. In 2000 NYISO collected just over \$60 million from ratepayers.⁹ NYISO collects its expenses based on a tariff filed with the federal government, which allows for automatic adjustment of its fees based on the amount of its expenses, with no meaningful federal or state government oversight of its budget.

NYISO’s Revenues

Source 2000-2008 NYSIO Annual Reports
http://www.nyiso.com/public/media_room/publications_presentations/index.jsp

2000	\$61,373,324
2001	\$87,048,756
2002	\$98,379,113
2003	\$116,822,858
2004	\$136,620,291
2005	\$144,882,248
2006	\$142,353,676
2007	\$146,892,009
2008	\$140,644,871

Despite its lack of accountability, NYISO’s policies and practices directly impact electricity prices paid by consumers. Today, utilities buy 55% of their generation through the markets administered by NYISO and the rest through power contracts, many of which are believed to be indexed to NYISO spot market prices.¹⁰ Before New York State deregulated its electricity market, consumers’ electricity rates were based on the cost of production.

Under the NYISO-administered markets of today, power is bought and sold on the basis of bids—where utilities pay the market clearing price to acquire power for resale to consumers. Under NYISO’s rules, all generators are paid the highest bid price for the amount of energy needed the next day or hour, regardless of what they bid and regardless of their costs. A central feature of markets such as those administered by NYISO is their opacity: calculations, bidders, and bids are secret under NYISO’s rules. The one regulatory body with limited authority over NYISO, the Federal Energy Regulatory Commission (FERC), condones this type of market structure. In 2007 AARP and 40 other organizations asked FERC to investigate justness and reasonableness of wholesale prices in private spot markets, but FERC refused.¹¹

How NYISO contributes to the high prices paid by New Yorkers

Across the country electric market deregulation has produced higher rate increases for consumers than in regulated states, and New York is no exception. In fact, New Yorkers pay among the highest utility rates in the nation. Based on the latest-available data from the US Energy Information Administration households in New York on average pay \$185.39 more annually for electricity than would residential customers in any other continental state except Connecticut (for the same amount of usage).^{12, 13}

Concern about how NYISO wholesale electricity market pricing policies relate to high electricity prices paid by consumers led to a joint hearing in March 2009 held by the Assembly Committee on Energy and the Committee on Corporations, Authorities and Commissions. New York State legislators questioned the NYISO market clearing price auction where utilities must pay all generators the highest price bid into the market. Lawmakers learned from energy expert Robert McCullough that New York customers pay an estimated \$2.2 billion a year in artificial and unnecessary electricity rates on their electric bills, because:

- **NYISO's wholesale electricity auctions are not transparent**
- **50% of the energy in New York State comes from just a few players**
- **NYISO strongly prefers natural gas, a nonrenewable, imported and expensive fuel, over renewable sources to make electricity.**¹⁴

Examining the use of the non-economic bidding practices that drive up the cost of electricity for New Yorkers, a McCullough Research analysis found: "Our database of NYISO bids, for example, has non-economic bids (over \$900/MWh) made by 95 different bidders. On average, each bidder submitted non-economic bids for seven different generating units."¹⁵

Another problem is the delay in posting bidding data long after the auctions have taken place. A McCullough Research report prepared for AARP on the benefits of more transparency (openness) in the ISO market in Texas found that "cutting the lag for reporting real time bids in the wholesale market from 60 days to 2 days... will save consumers in Texas \$956 million annually, or about \$52.00 on an average annual household electric bill."¹⁶

Reducing the delay in reporting bids is important for transparency. Bidders in the wholesale market interact frequently and learn each other's behavior, and as a recent report concluded, "encouraging coordinated bidding strategies and even tacit collusion." The sooner this type of behavior is revealed to the public and regulators, the sooner action can be taken to stop it.¹⁷ Over the years, other reports and news articles analyzing NYISO and similarly structured wholesale electricity markets have also found much to criticize.¹⁸

AARP Recommendations for Reforms of NYISO

AARP believes the New York State Legislature should pass legislation that at a minimum provides transparency and oversight of NYISO's operations.

1) Accountability – The State Legislature should pass reforms allowing the Governor and the Legislature to appoint NYISO's board of directors

The Governor, the Senate, and the Assembly would each appoint members to serve on NYISO's board of directors, including representatives of residential and other retail customer groups. With this change, NYISO's board members would be accountable to the public. Currently, NYISO is not accountable to state elected officials or the public.

2) Transparency – Require the bids, bidders, and computer computations in NYISO's wholesale electricity market auctions to be public after no longer than two days

When bidders know that their behavior is transparent, there should be fewer opportunities for collusion and market manipulation. Publishing unmasked data in two days should make it easier for state regulators and consumers to spot potential problems earlier. While NYISO has proposed reducing its delay from six months to three months, ISOs in other countries have adopted a two-day delay as a suitable period before bids become public.¹⁹

3) Oversight

- Require the New York Public Service Commission to review the NYISO budget and approve the fee charged to consumers for NYISO's operations. New York consumers ought to know how their money is spent.
- Require NYISO to follow New York's open meeting law. New York State electric utility reliability pricing and policies can no longer afford to be managed by a self-selecting private utility board that is allowed to meet outside of public view.

Conclusion

Although NYISO cannot directly raise or lower wholesale electricity prices, its actions significantly impact the prices paid by New Yorkers for electricity. Numerous reports and the recent press regarding market manipulation show that NYISO's lack of accountability, transparency, and oversight is not in the public interest and has not served consumers in our state. While reforms of NYISO are not the total solution to New York's high electricity prices,²⁰ the State Legislature must pass these reforms that go a long way towards restoring confidence in the state's wholesale electricity market, and we believe will also mitigate rate increases, if not lower rates altogether.

¹ At the time of this report, the latest available (July 2009) EIA data is available at <http://www.eia.doe.gov/cneaf/electricity/page/eia826.html>.

² For population and household data used in this report, see U.S. Census Bureau's data series "2000 PHC-T-17" at <http://www.census.gov/population/www/cen2000/briefs/tablist.html> and national and state population estimates at <http://www.census.gov/popest/states/NST-ann-est.html>.

³ "Three power generators may have cost consumers," Larry Rulison, Albany Times Union, September 11, 2009.

⁴ See http://www.nyiso.com/public/company/about_us/index.jsp

⁵ New York Independent System Operator's Market-Clearing Price Auction Is Too Expensive for New York, McCullough Research, March 3, 2009, <http://www.mresearch.com/pdfs/375.pdf>

⁶ Comments of The New York Independent System Operator, Inc. (Case No. 09-E-0115 – Proceeding on Motion of the Commission to Consider Demand Response Initiatives before the New York Public Service Commission), page 2 <http://documents.dps.state.ny.us/public/Common/ViewDoc.aspx?DocRefId={A58C6CFC-AE39-47B5-8DD3-0FF2CF39529D}>.

⁷ The Independent System Operator Agreement and NYISO's by-laws define the composition, function and duties of officers, standing and other committees, procedures for compensation, etc. See <http://www.nyiso.com/public/documents/regulatory/agreements.jsp>.

⁸ NYISO Annual Report 2008, http://www.nyiso.com/public/webdocs/company/about_us/annual_report/2008nyiso_areport_final.pdf.

⁹ NYISO Annual Report 2000, http://www.nyiso.com/public/webdocs/company/about_us/annual_report/annual2000_final.pdf.

¹⁰ <http://www.eei.org/meetings/Meeting%20Documents/NYISOonelson.ppt#396,15>, NY Electricity Markets

¹¹ Docket Nos. RM07-19-000 and AD07-7-000, Wholesale Competition in Regions with Organized Electricity Markets, Before the United States of America Federal Energy Regulatory Commission, Request of AARP, et al, To Expand the Scope of Section 206 Proceeding, December 17, 2007.

¹² \$185.39 is the difference between estimates of how much an average New York household is paying for electricity annually and how much the same household would pay if it faced the residential electricity prices in the next (3rd) most expensive state. In other words, the quantity of consumed electricity is kept constant here in order to compare the differences in spending that arise from only price differences across states (not consumption patterns).

¹³ At the time of this report, the latest available (July 2009) EIA data is available at <http://www.eia.doe.gov/cneaf/electricity/page/eia826.html>

¹⁴ New York Independent System Operator's Market-Clearing Price Auction Is Too Expensive for New York, McCullough Research, March 3, 2009, <http://www.mresearch.com/pdfs/375.pdf>.

¹⁵ New Yorkers Lost \$2.2 Billion Because of NYISO Practices: The Debate Continues and A Short Review of Anomalous Bidding at the New York ISO from September 2007 through August 2008, McCullough Research, March 30, 2009, page 7, <http://www.mresearch.com/pdfs/392.pdf>.

¹⁶ Transparency in ERCOT: A No-cost Strategy to Reduce Electricity Prices in Texas (a report to AARP), McCullough Research, May 5, 2009, <http://www.mresearch.com/pdfs/398.pdf>.

¹⁷ APPA's Competitive Market Plan: A Roadmap for Reforming Wholesale Electricity Markets, February 2009, page 23, [footnote omitted], <http://www.APPAnet.org>.

¹⁸ Some examples are: Designing a Wholesale Market That Benefits Consumers, Frank Wolak, Stanford University, October 15, 2001; Protecting the Market from "Hockey Stick" Pricing: How the Public Utility Commission of Texas is Dealing with Potential Price Gouging, David Hurlbut, Keith Rogas, and Shmuel Oren, The Electricity Journal, April 2004; Regulating Competition in Wholesale Electricity Supply, Frank Wolak, Stanford University, revised November 12, 2007; The High Cost of Restructuring, Robert McCullough, Berne Martin Howard and Michael Deen, Public Utilities Fortnightly, February 2008; Consumers in Peril: Why RTO-Run Electricity Markets Fail to Produce Just and Reasonable Rates, American Public Power Association, February 2008; Electricity Restructuring: FERC Could Take Additional Steps to Analyze Regional Transmission Organizations' Benefits and Performance, GAO-08-987, September 2008; Electricity Prices and Costs Under Regulation and Restructuring (PowerPoint presentation), Jay Apt and Lester Lave, Carnegie Mellon University, and Seth Blumsack, The Pennsylvania State University, September 29, 2008; Current and Future Wholesale Electricity Markets (testimony before the Pennsylvania Public Utility Commission), Kenneth Rose, November 6, 2008; Public Utility Law Project of New York, Inc. (testimony before the New York State Assembly Standing Committee on Corporations, Authorities, and Commissions and the Standing Committee on Energy Hearing to Examine the State of New York's Electric Commodity Market Under the Stewardship of the New York Independent System Operator), Gerald A. Norlander, Esq., Executive Director, March 5, 2009; Benefits of Electric Restructuring Revisited, Rudden's Energy Strategies Report, April 27, 2009.

¹⁹ See for example the description of Australian market in Order Adopting Amendment to §25.505 As Approved at the August 16, 2007, Open Meeting – Project No. 33490 – Public Utility Commission of Texas; also see Project No. 31972.

²⁰ AARP supports additional reforms that include allowing utilities to own generation plants that operate under cost of service regulation and requiring utilities to purchase power for default service under a portfolio approach overseen by the New York Public Service Commission.