**Comments of Howard A. Fromer, Director of Market Policy**
**PSEG Power New York Inc.**
**On Behalf of Public Service Enterprise Group**
**(October 16, 2007)**

Good morning. My name is Howard A. Fromer, and I am the Director of Market Policy for PSEG Power New York. Thank you for the opportunity to participate in this panel.

My purpose in speaking today is to convey the views of PSEG regarding the NYISO's Comprehensive Planning Process and its efforts to comply with FERC's Order 890, although I believe most members of the Other Suppliers Sector would share these views, if asked.

At the outset, I want to emphasize that the combination of LMP, reserve markets and locational capacity markets in NY provide a sound market platform that can help developers decide where, when and what to construct to maintain reliability and improve market efficiencies.

Over the past few years, significant market enhancements have been made, including the capacity demand curves and scarcity pricing. <u>In the long-term</u>, these should help to produce efficient and predictable energy and capacity price signals that should allow rational investment decisions to be made. Other enhancements are under discussion, including forward capacity markets and the establishment of deliverability requirements that would have to be met in order for a facility to qualify for capacity.

With respect to comprehensive planning, the focus of today's panel, our basic message is that **New York got it right** with the process originally adopted by the Management Committee and ISO Board and approved by FERC several years ago.

1. **That process focuses primarily on reliability needs – identifying problems and requiring solutions.** With respect to economic planning, we also make data available to market to assist participants in making more informed business decisions.
2. **That process places primary emphasis on market solutions**. It is always the preferred solution.
3. With respect to potential solutions, **that process is alternative neutral**. Transmission, Generation and DSM may all be proposed to satisfy identified reliability needs.
4. **We are even project sponsor neutral**. Even where a regulated solution is necessary, we allow third parties to propose alternative regulated solutions to the backstop projects offered by the TOs.
5. Collectively, these important planning process components allow the ISO to fulfill its mandate to assure NY retains its currently reliable bulk power system without undermining the primacy of market solutions.

Unfortunately, Order 890 threatens to jeopardize NY's carefully crafted process, with its focus on reliability needs, and which had the support of the overwhelming majority of market participants.

As you are aware, PSEG has sought rehearing of Order 890 and challenged FERC's economic planning policy, which appears to require mandatory cost allocation for economic projects and impose a PJM regime on New York, as flawed and misguided, and we await FERC's decision.

As to the NYISO's September 14th draft proposal for complying with Order 890, we are generally pleased with the direction taken:

- The proposal continues to recognize reliance on markets first;
- Puts emphasis on doing studies and providing congestion data, both historic and projected, to the market to assist potential developers in making more informed business decisions;
- To its credit, the NYISO's proposed Straw Proposal would require that environmental effects of the proposed economic project be evaluated and included in the benefits analysis; and
- Does not mandate the building or funding of economic projects.

In response to the most troublesome part of Order 890 – Mandatory Cost Allocation for economic projects – and which we think has no place in a market, **we are particularly pleased that the revisions to Attachment Y to the OATT proposed by the NYISO include a provision requiring that a "super-majority" of the identified beneficiaries must expressly approve of the project** in order for the developer to obtain the benefits of the mandatory cost recovery provisions that FERC suggests must be part of the Tariff. We believe such a requirement is critical, since market participants should not be forced to pay for an economic project they did not ask for, may not want, and may not even be economic from their cost benefit perspective.

As you are aware, two alternative Economic Cost Allocation proposals are included in the NYISO's September 14 posting. One of those alternatives was a joint proposal sponsored by Con Edison and PSEG. It is important to emphasize that on the key issue of who decides whether an economic project should move forward, **the Con**

**Ed/PSEG proposal is quite similar to the NYISO's proposal. Both propose that a super majority of the identified beneficiaries must vote to approve the project before funding under the OTT would be allowed.**

This requirement assures that only those economic projects can move forward and receive project funding through the OATT where the vast majority of designated beneficiaries conclude that the project makes economic sense. At the same time, a super majority requirement also protects a large minority of beneficiaries from being forced to pay for a project they do not want.

This requirement for a super majority vote by the beneficiaries is the single biggest difference between the proposals from the NYISO and Con Ed/PSEG on the one hand, and the third Economic Cost Allocation proposal submitted by National Grid. That proposal, which has received little support in the stakeholder process, would require beneficiaries to pay for economic projects without regard to whether they agreed that the project was beneficial to them over the 15 year period that National Grid proposes be used to determine whether the project is cost effective.

We remain very concerned about the accuracy of long-term forecasts that will be used to measure the economic benefits of these projects, especially fuel cost assumptions and other market risks that should be reflected in project pro-formas.

We are also concerned about the very real possibility of low-balled cost projections that underestimate the true costs of the project or that fail to include necessary project elements that the project would necessitate. To guard against this, it is important that any procedures we ultimately adopt include a requirement that cost overruns for these "merchant" economic projects be borne by the project developer who voluntarily proposes the economic project. When a developer is not required to build an economic project and seeks to use a tariff funding requirement to build a project not needed for reliability but, rather, to provide economic benefits to a set of beneficiaries, the developer must bear the risks associated with that project.

In summary, PSEG believes that ongoing efforts by FERC to require the NYISO to adopt a planning process that goes beyond mandating solutions to identified reliability needs and ventures into mandating economic projects would hinder merchant investment, especially in high construction cost regions like NYC, because it dramatically increases the risk that the merchant investment could become uneconomic as a result of the mandated economic project. If an economic cost allocation process is required by FERC, then it must contain a provision requiring approval by a super majority of beneficiaries in order to receive funding through a Tariff based cost allocation process, as has been proposed by both the NYISO and Con Ed/PSEG.

Thank you again. I would be happy to answer any questions that you may have.