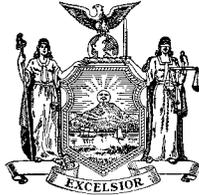


STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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Secretary

January 22, 2004

Honorable Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Room 1-A209
Washington, D.C. 20426

Re: Docket No. EL03-204-000 - AES Somerset, LLC

Dear Secretary Salas:

For filing, please find the Petition for Rehearing of the New York State Public Service Commission in the above-entitled proceeding. Should you have any questions, please feel free to contact me at (518) 473-7136.

Very truly yours,

Leonard Van Ryn
Assistant Counsel

Attachment

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

AES Somerset, LLC) Docket No. EL03-204-000

PETITION FOR REHEARING

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, the Public Service Commission of the State of New York (NYPSC) hereby submits its Petition For Rehearing in the captioned proceeding.

Copies of all documents and correspondence should be sent to:

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BACKGROUND

In its December 23, 2003 Order Granting Complaint in this proceeding, the Commission ruled that AES Somerset, LLC (AES Somerset) could meet its electric load at its coal-fired generation facility under the New York System Operator's (NYISO) Commission-jurisdictional station power tariff, to the exclusion of taking service under Niagara Mohawk Power Corporation's

(Niagara Mohawk) state-jurisdictional standby service tariff. The Commission premised its decision in part on a finding that no sale occurs when an out-of-service generator purchases and consumes energy for station power uses.¹ Under the NYISO tariff, the Commission reasoned, there is no sale when the generator nets the cost of that energy against the price paid for its output when it is operating or the cost of output from a generator the same entity owns at a remote location.

Irrespective of the accounting for the cost of the generator's station use energy under the NYISO tariff, however, a retail sale occurs because the out-of-service generator takes delivery of and consumes energy. While it may be useful to account for that energy consumption through netting, that does not change the fact that the energy consumed is being purchased and used at retail. That retail sale is outside the scope of the Commission's jurisdiction under the Federal Power Act (FPA) and is subject to exclusive state jurisdiction.

According to the Commission, taking station power service under the NYISO tariff at the transmission level encompasses all of a generator's electric service needs, and so precludes a utility from billing any state-jurisdiction utility

¹ Station power is the electric energy used for the heating, lighting, air-conditioning and office equipment needs of the buildings on a generating facility site, and for operating the electric equipment that is on the generating facility site.

charges. The Commission, however, previously decided that State retail charges can co-exist with Commission-jurisdictional transmission services charges.² The Order Granting Complaint finding to the contrary arbitrarily deviates from policies the Commission expressed in prior Orders, where it decided there is an element of local distribution service in any unbundled retail transaction, and that State jurisdiction over delivery service includes the authority to impose non-bypassable distribution or retail stranded cost charges.

The Commission justifies its decision on the grounds that charging AES Somerset for state retail services would be discriminatory because Niagara Mohawk did not charge itself for those services when it owned generation plants. The character of service provided at a time before AES Somerset owned its coal-fired facility, before the NYISO commenced operation and before competition was introduced into New York's electric market, are not evidence that discrimination exists now.

Moreover, the Commission has disregarded the adverse financial impact of its decision on Niagara Mohawk, its service territory and its ratepayers. The generators themselves may face adverse financial consequences, if the Commission's

² PJM Interconnection, LLC, 94 FERC ¶61,251 (2001)(PJM II).

unwarranted extension of benefits to them proves illusory.

Accordingly, the Commission should grant rehearing.

SPECIFICATION OF ERRORS

NYPSC requests that the Commission grant rehearing on the Order Granting Complaint, based on the following errors of fact and law:

1. The Commission erred in barring the imposition of state charges for energy service to a generator engaged in a netting transaction, because the generator consumes energy in a retail sale subject to state jurisdiction, and appropriate charges for retail services may be attached to that retail sale.
2. The Commission erred when it arbitrarily deviated from policies expressed in prior Orders, where it decided that there is an element of local distribution service in any unbundled retail transaction, including those at the transmission level, and that State jurisdiction over delivery service includes the authority to impose non-bypassable distribution or retail stranded cost charges.
3. The Commission erred in finding that utilities in New York might discriminate in favor of utility-owned generators and against independently-owned generators; New York utilities cannot practice that form of discrimination because they do not own generators.

ARGUMENT

- I. Netting Results In a Retail Sale Subject to State Jurisdiction.
 - a. The Commission's Determination That Netting Does Not Create a Retail Sale Is Unsustainable.

When a generator is operating, and draws its electricity directly from its generating equipment, it self-supplies station power and there is no sale of energy. When a generator does not operate, however, its netting of the cost of the energy delivered to it against the price paid for its prior production, or for production at a remote location, is a retail sale, notwithstanding the net pricing arrangement under the NYISO station power tariff. While the Commission has jurisdiction to decide what is a wholesale sale, it concedes that none is present in station use;³ once that determination is made, the Commission lacks the authority to intrude upon a state's exercise of jurisdiction over the energy consumed in a retail sale.

Generators netting their energy costs most certainly do consume retail energy supply from the NYISO markets when their equipment is incapable of generating. Otherwise, they

³ PJM II, at 61,894.

would not be able to run their non-generation equipment or restart their generators. While netting may be a useful approach to accounting for that station use energy, it does not change the fact that the energy consumed is being purchased and used at retail. For the Commission to expand its jurisdiction into the area of these state-regulated retail energy sales would be ultra vires, because FPA §201 limits its jurisdiction to wholesale sales and matters not subject to regulation by the states.

The Commission justifies its conclusion that there is no retail sale on the grounds that a generator that nets "us[es] its own generating resources for the purpose of self-supply."⁴ But a generator that is out-of-operation most certainly cannot supply itself; the electricity it uses must come from an outside party, whether that outside party is a NYISO market or another source. The usage drawn from that remote source clearly constitutes a retail sale.

Moreover, there is a retail sale even if an out-of-service generator nets its usage against production from another generator it owns off-site at a remote location. Under New York law, a retail sale occurs unless "electricity is generated or

⁴ 105 FERC ¶61,336, Slip Op. at 8.

distributed by the producer solely on or through private property...for its own use or the use of its tenants and not for sale to others."⁵ A delivery to a generator from a remote location does not take place "solely on or through private property," so a retail sale results. The Commission is without jurisdiction to override or preempt this provision of state law governing retail sales.

The Commission's effort to distinguish retail energy usage by a transmission level generator from such usage by a distribution level customer does not cure its lack of jurisdiction. The Commission's jurisdiction over transmission delivery service does not extend to jurisdiction over the energy service consumed in a retail sale, even if the customer purchasing the energy is connected exclusively at the transmission level.

Indeed, the Commission recently found that there is a retail sale when a transmission-level generator purchases its station use energy from an independent third party.⁶ A purchase from the NYISO market through netting, or netting against generation produced at a remote location, is a third-party

⁵ New York Public Service Law (PSL) §2(13).

⁶ Northeast Utility Services Company, 101 FERC ¶61,327 (2002).

retail purchase and sale just the same, even though the cost is accounted for through netting. Consequently,

there is a delivery of energy that is consumed by an end-user (in this case, a generator receiving station power), the transaction retains an element of state jurisdiction, and [a utility] may impose state-approved charges on such retail deliveries regardless of who provides the energy (emphasis added).⁷

The Commission's subsequent effort in the Order Granting Complaint to explain away this prior and accurate evaluation of station power usage is not convincing. In support of its analysis, the Commission cites its Warrior Run decision for the proposition that Niagara Mohawk cannot charge a transmission-level customer for distribution services.⁸ But Niagara Mohawk does not seek recovery of distribution services costs from these generators. The stranded energy costs it would recover are not a distribution service, albeit those stranded costs, as the Commission recognized in Order No. 888,⁹ must be recovered in a non-bypassable charge. Warrior Run is therefore irrelevant, because it does not cure the Commission's lack of jurisdiction over retail energy services, irrespective of

⁷ Northeast Utility Services Company, 101 FERC at 62,363.

⁸ AES Warrior Run, Inc., 104 FERC ¶61,051 (2003).

⁹ Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services By Public Utilities, Order No. 888, FERC Stats. & Regs. ¶31,036 (1996).

whether the customer connects at the transmission or distribution level.

Since the retail sale accompanying the delivery of netted energy is beyond the Commission's jurisdiction, the tariffs it approves for the NYISO cannot price the provision of that retail energy service in any form without state approval. Retail energy is a service that can only be obtained under state-jurisdictional tariffs at prices set in conformance with state law.

The Commission has already been overruled once on this point, in Detroit Edison Co. v FERC, 334 F.3d 48 (D.C. Cir. 2003). That court found that the Commission could not provide for the retail sale of energy through Commission-jurisdictional tariffs -- exactly what it seeks to do here. The distinction the Commission draws -- that Detroit Edison adheres only to distribution-level service -- is not persuasive; again, the Commission lacks jurisdiction over retail energy sales to transmission-level customers to the same extent as it lacks that jurisdiction over retail energy sales to distribution-level customers.

Therefore, the Commission cannot overrule state law governing energy sales at retail when it approves a NYISO tariff allowing generators to net. NYPSC may attach to those energy sales at retail appropriate non-bypassable charges for the

services provided, including charges for recovering stranded costs.

b. Retail Sales Service to Generators
Includes Components Outside the
Scope of the Netting Tariff.

The Commission maintains that the transmission level customers obtain all the electric services they need through the NYISO station power tariff, and so any Niagara Mohawk standby service charge would be duplicative. This argument lacks merit.

Contrary to the Commission's argument, a retail sale is a service in addition to the services provided under the NYISO netting tariff. Even if a generator takes direct service from a NYISO energy market, as permitted in New York under state retail tariffs, it is still taking retail energy service within Niagara Mohawk's service territory. Niagara Mohawk remains the provider of last resort energy to all customers located within its service territory, including AES Somerset, however connected to the electric grid.¹⁰

Moreover, it is the utility that is ultimately responsible for ensuring the reliability of service throughout

¹⁰ Notwithstanding that AES Somerset interconnects with the New York grid through facilities owned by it and the New York Power Authority, AES Somerset is still located in Niagara Mohawk's service territory, Niagara Mohawk still meters and charges for the retail sales made to AES Somerset, and Niagara Mohawk is still responsible for ensuring that energy service to AES Somerset is reliable.

its service territory, including the reliability of the energy service the generator consumes when out-of-operation. Stranded cost recovery is essential to preserving the financial health and viability of the entity that undertakes that critically important task, from which the generators benefit. Without reliable service, they would be unable to restart their generators and sell into the market where they make their profit.

The utility's obligation to preserve reliability is a service furnished to generators outside the services furnished and priced under the netting tariff. As that tariff provides, a generator nets only the cost of the energy it uses against prior or remote location production, and so does not pay anything for reliability of energy service even though it benefits from Niagara Mohawk's ability to keep the system functioning smoothly. Because stranded cost recovery is an element essential to the financial health of Niagara Mohawk,¹¹ that cost is a component of the reliability service a generator receives when a retail sale of energy is made to it through netting.

It is discriminatory to shift the burden of stranded cost recovery away from AES Somerset, who benefits from the utility's financial health and viability, to other customers.

¹¹ NYPSC Docket No. 94-E-0098, Niagara Mohawk Power Corporation - Rates, Opinion No. 98-8 (issued March 20, 1998).

The Commission fails to explain why an out-of-service generator should be exempt from standby rates and stranded cost recovery, when an industrial customer with the same load and usage characteristics, because it meets its load with on-site generation most of the time, must pay standby rates that include stranded costs when its generation is out-of-service.

Consequently, the Commission should reverse its decision, by granting rehearing and rejecting AES Somerset's complaint.

II. The Commission's Deviation from Its Prior Policies Permitting States to Impose Retail Charges is Arbitrary and Capricious.

In its Order No. 888, the Commission found that "there is an element of local distribution service in any unbundled retail transaction,"¹² and State jurisdiction over delivery service includes the "authority to impose non-bypassable distribution or retail stranded cost charges."¹³ Elaborating upon that principle, the Commission found in the BART Orders that, even where there are no identifiable local distribution facilities, states retain authority over retail delivery to end-users and so may assess separate charges for distribution service in addition to the Commission's jurisdictional charges

¹² Order No. 888 at 31,783.

¹³ Order No. 888 at 31,781-82.

for transmission service.¹⁴ This State authority over distribution service permits the use of suitably-developed retail rates for standby service, which may include non-bypassable customer or stranded cost charges, for customers taking delivery at either transmission or distribution levels.

The Commission's effort to distinguish the circumstances of generators like AES Somerset from the provisions of Order No. 888 and the BART Orders are irrational.¹⁵ Although the Commission properly notes that Order No. 888 is intended to allow utilities to recover their stranded costs, it then goes on to propound that "when a utility divests its generators as part of its retail restructuring, the sale negates the need for stranded cost recovery under the Order No. 888 model."¹⁶

A utility that has divested its generation, however, is in even greater need of recovering its stranded costs than one that has not. Following divestiture, it cannot recover its

¹⁴ San Francisco Bay Area Rapid Transit District, 87 FERC ¶61,255 (1999)(BART Order) and 90 FERC ¶61,291 (2000)(BART Rehearing Order)(collectively, BART Orders).

¹⁵ Neither the Order Denying Complaint, nor the Warrior Run decision upon which it relies, so much as mention the BART Orders.

¹⁶ 105 FERC ¶61,337, Slip Op. at 19.

stranded costs except through charges to its existing ratepayers. Moreover, that a utility chose divestiture as the means for establishing the magnitude of its stranded costs does not in any way distinguish it from the need for stranded cost recovery that drove the Order No. 888 provisions in the first instance.

Indeed, as the Commission conceded in the Order Granting Complaint, Order No. 888 was premised upon a finding that:

If power customers leave their utility systems to reach other power suppliers without paying their share of prudently-incurred generation cost, the generation cost incurred to serve those customers will be become stranded unless they can be recovered from other customers.¹⁷

This is exactly what the Commission proposes to allow generators to do. It will enable them to leave Niagara Mohawk's system, obtain their generation from someone else, and potentially force Niagara Mohawk's other ratepayers to bear those stranded costs. Utilities that advanced the competitive market policies the Commission expressed in Order No. 888 by divesting their generation plant should not find that their stranded cost recovery is impaired as a result of that divestiture, especially given the Commission's avowals in Order No. 888 that it would

¹⁷ 105 FERC ¶61,337, Slip Op. at 19, n.61.

not obstruct stranded cost recovery. Consequently, rehearing should be granted in order to reach a rational result.

III. Assessing State Retail Charges
Against AES Somerset For Services
Provided To It is Not Discriminatory.

As justification for the NYISO netting tariffs, the Commission maintains that it is discriminatory for Niagara Mohawk to charge AES Somerset for standby service because the utility did not assess those charges against itself when it owned generation facilities. This argument is flawed.

According to the Commission, discrimination exists because of the arrangements that were made for supplying station use energy to the AES Somerset facility at the time before AES Somerset purchased it, before the NYISO entered operation, and before competition was introduced in New York via the NYISO. Those arrangements have no bearing on the present circumstances. Niagara Mohawk has divested all of its generation, and the only other New York utility still owning significant generation plants, Rochester Gas and Electric Corporation, is in the process of selling its only nuclear facility and preparing for the closing of its one remaining coal facility. Consequently,

there is no cognizable discrimination against non-utility owned generation facilities in New York.¹⁸

The Commission also supports its discrimination finding here premised upon findings it made in PJM II. Those circumstances, however, are not comparable to New York's. Unlike in New York, utilities in PJM continue to own generation in competition with independent generators. Since the type of discrimination allegedly present in PJM cannot exist in New York, the discrimination argument drawn from PJM II is factually unsustainable when applied to New York.

Moreover, when New York's utilities were integrated, they recovered the cost of their station use energy and its delivery in their bundled retail charges to their customers. They did not suggest that their generators failed to consume energy for station use when out-of-service, and in fact did charge their ratepayers for the standby services that generators consumed. The Commission's unsustainable analysis of station power and standby service charges disregards the fact that a generator's consumption of energy when its generation equipment is out-of-service is not produced on-site and must be purchased

¹⁸ Even when it owned generation, no one successfully claimed that Niagara Mohawk was discriminating, when, for decades, it charged standby service rates to generators operating as qualifying facilities under the Public Utilities Regulatory Policies Act of 1978.

from elsewhere, whether a utility or a non-utility owns the generator.

The Commission's analysis of discrimination cannot justify the relief it granted. It should grant rehearing to reverse its finding that discrimination has occurred.

IV. The Commission Should Decide These Issues Promptly Because Delay is Causing Financial Harm to All Parties.

For the most part, the arguments NYPSC makes in this filing are not new to the Commission. NYPSC informed the Commission that it was intruding upon state jurisdiction over retail sales more than one year ago, in seeking rehearing, on December 23, 2002, of the Commission's NYISO Netting Order.¹⁹ To date, the Commission has not decided that Petition.

The Commission's failure to address the NYPSC's Petition for Rehearing harms all parties to these proceedings. While the Commission delays, Niagara Mohawk is denied the stranded cost recovery. Its ratepayers are open to the risk that the stranded costs not recovered from the generators will be recovered from them, thereby raising the prices they must pay for electricity. Higher electricity prices to those ratepayers can only redound to the detriment of the entire upstate New York economy.

¹⁹ New York Independent System Operator, Inc., 101 FERC ¶61,230 (2002).

Notwithstanding the Commission's failure to take into account the financial risks it is posing to Niagara Mohawk and its customers, there is another financial risk it should consider as it delays a decision on NYPSC's Petition for Rehearing. Generators also will suffer while the matter remains outstanding.

Even though the Order Granting Complaint prevents Niagara Mohawk from collecting the standby service charges it presents to the generators, the utility will continue to assess those charges, pending final resolution of this proceeding. While the matter is unresolved, the generators will face a steadily growing outstanding liability, a contingency that could constrain their financial flexibility.

As a result, the Commission should end the financial uncertainty it has created, by granting the NYPSC Petition for Rehearing here and of the NYISO Netting Order. If it does not grant the Petitions, it should at least decide them promptly, and leave it to the courts to resolve with finality the retail sales issue and other points raised in the Petitions.

CONCLUSION

The Commission should grant rehearing of the Order Granting Complaint because it went beyond its jurisdiction by intruding upon state-jurisdictional retail sales; it failed to proffer a rational explanation for its deviation from its prior policies; and, because it has failed to establish the existence of the discrimination it sees as a justification for the NYISO netting tariff.

Respectfully submitted,

Dawn Jablonski Ryman
General Counsel

Leonard Van Ryn
Assistant Counsel
Public Service Commission
of the State of New York
Three Empire State Plaza
Albany, New York 12223-1350

Dated: January 22, 2004
Albany, New York

CERTIFICATE OF SERVICE

I, Janet Burg, do hereby certify that I will serve on January 22, 2004 the foregoing Notice of Intervention and Comments of the Public Service Commission of the State of New York by depositing a copy thereof, first class postage prepaid, in the United States mail, properly addressed to each of the parties of record, indicated on the official service list compiled by the Secretary in this proceeding.

Date: January 22, 2004
Albany, New York

Janet Burg