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February 6, 2002

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

Re: Docket No. RM02-1-000 - Standardizing
Generator Interconnection Agreements
and Procedures

Dear Secretary Salas:

For filing please find the Motion for Late Intervention and Comments of the New York State Public Service Commission in the above-entitled proceedings. Should you have any questions, please feel free to contact me at (518) 486-2652.

Very truly yours,

Saul A. Rigberg
Assistant Counsel

Enclosures

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

)
STANDARDIZING GENERATOR INTERCONNECTION)
AGREEMENTS AND PROCEDURES)Docket No. RM02-1-000
)

**MOTION FOR LATE INTERVENTION AND COMMENTS OF THE
PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK**

Pursuant to an Advanced Notice of Proposed Rulemaking (ANOPR), dated October 25, 2001,¹ a Notice of Extension of Time, dated January 16, 2002, and Rule 214(d)(1) of the Commission's Rules of Practice and Procedure (18 C.F.R. §385.214), the Public Service Commission of the State of New York (NYPSC) hereby submits its Motion For Late Intervention and Comments. The issuance of the ANOPR is an important first step in realizing the Commission's goal, which the NYPSC supports, of encouraging the siting and construction of efficient transmission facilities.

The NYPSC regulates the provision of retail electric service in New York State and to a limited extent most of the entities participating in the markets administered by the New York Independent System Operator, Inc. (NYISO). The NYPSC's interest in this proceeding cannot be represented adequately by any other party.

¹ 97 FERC ¶ 61,069.

Because we were unable to complete our review, NYPSC did not timely file comments. The NYPSC's intervention, three business days late, will advance the public interest and will not prejudice any party or disrupt the proceeding because the date passed only a short time ago and the Commission has not acted. Thus, this motion should be granted.

Copies of all correspondence and pleadings should be addressed to:

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SUMMARY

Although the ANOPR explains that cost responsibility issues will be addressed in a subsequent rulemaking, the Commission should establish at the outset that one standard pricing regime may not be equally appropriate for all market designs. For example, the cost recovery approach for network upgrades embodied in the ANOPR may not provide adequate market-driven price signals in an independent system operator (ISO)/regional transmission organization (RTO) environment with LBMP pricing, particularly when transmission owners do not own generation.

Further, the ANOPR's proposed queuing regime may result in inefficient consideration of generation projects and gaming of

the process to the benefit of market participants with market power. Finally, the NYPSC seeks two clarifications: (1) that the proposed 20 MW exemption applies only to transmission systems but does not apply to local distribution systems and (2) that transmission providers would be required to identify market areas as optimal generator sites rather than specific substations.

BACKGROUND

The Commission stated that its goal is to create a nationally consistent method for interconnecting competitive wholesale generation resources to electric transmission service providers' facilities that would: 1) encourage needed investment in infrastructure; 2) remove incentives for transmission providers to favor their own generation; 3) ease entry for competitors; and 4) encourage efficient siting decisions. The Commission explained in the ANOPR that it is considering modeling its approach on the "Standard Generation Interconnection Agreement" and "Generation Interconnection Procedures" of the Electric Reliability Counsel of Texas (ERCOT), as supplemented and modified by "best practices" distilled from generator interconnection agreements and procedures that have been approved by the Commission in past cases.

The Commission further explained that for the purposes of commenting in this proceeding, one should assume that its "current pricing policy" (Attachment B to the ANOPR) is in effect.² This pricing policy has two main components:

- 1) The generator developer is obligated to pay for 100 percent of the cost of all facilities needed to establish the direct electric interconnection between its facility and the transmission provider's network.
- 2) While the generator developer is required to pay up front for upgrades of all network facilities that would not be needed "but for" the new generator from the point where it connects to the grid, it is entitled to a credit, to be applied through future transmission rates as it takes transmission service, for any such costs it is required to bear.³

² The Commission noted that it may alter this approach in the future, stating that cost responsibility and pricing will be addressed in a subsequent rulemaking. As explained below, the Commission has approved a different pricing policy for the ISOs.

³ Attachment B further explains that the transmission rates through which this credit would be applied will include rates for all transmission service utilized by the generator after the date of the interconnection. Such service would include not only new point to point service taken by the generator from the location of its new facility, but also any other transmission service taken by that generator from the transmission provider. In addition, the credit would be applied to the rates for any transmission service, including both point to point and network service, used by loads to deliver the output of the new facility to their location.

The second component does not correspond to the "but for" cost responsibility regime approved by the Commission and in effect at the NYISO and its neighboring ISO.⁴ Generators constructing plants in the NYISO Control Area have equal and competitive access to the transmission system. Therefore, they pay for, without reimbursement, the full cost of all facilities, including network upgrade costs, that would not have been required "but for" the interconnection.

In addition to seeking comments on the ANOPR, the Commission initiated a collaborative stakeholder process for review of the issues presented. The stakeholder process evolved into two drafting groups, one of which produced a Standard Generator Interconnection Procedures (Interconnection Procedures) document and the other of which produced a Standard Generator Interconnection and Operating Agreement (Interconnection Agreement). These works in progress, which total more than 200 pages and demonstrate a wide divergence of opinion among generators and transmission owners, were filed with the Commission on January 11, 2002.

⁴New York Independent System Operator, Inc., Docket No. ER01-2967-000, Order Accepting Tariff Revisions Subject to Modifications, 97 FERC ¶ 61,118 (2001); Consumers Energy Co., Docket No. ER01-1587-001, Order On Rehearing, 96 FERC ¶ 61,132 (2001); PJM Interconnection, L.L.C., Docket No. ER99-2340-000, Order Accepting For Filing Amendments to Open Access Tariff and Operating Agreement, As Modified, 87 FERC ¶ 61,299 (1999).

I. THE COMMISSION SHOULD CLARIFY THAT ITS COST RESPONSIBILITY "BEST PRACTICES" APPROACH MAY NOT WORK WELL IN A MARKET-DRIVEN ISO/RTO ENVIRONMENT.

The pricing policy described in Attachment B is one of two pricing regimes that have been approved by the Commission. The Attachment B approach is in effect for individual transmission owners (TOs) in situations where vertically integrated generation and transmission are bundled under utility-specific Open Access Transmission Tariffs. This approach helps ensure that vertically integrated TOs do not give preferential treatment to their own generation to the disadvantage of non-affiliated generation.

Vertically integrated TOs possess powerful incentives to use their transmission and distribution (T&D) monopoly to favor their own generation by making transmission expensive, thereby disadvantaging rival generators or potential rival generators. In parts of the country with vertically integrated TOs, a critical requirement of any interconnection policy is the need to counteract the incentives that the TO has to disadvantage rival generators. Accomplishing this goal may require denying TOs control over decisions regarding transmission reinforcements and cost allocation.⁵

⁵See, for example, the NYPSC's "Statement of Policy Regarding Vertical Market Power," issued in Case 96-E-0900 on July 17, 1998. It is appended as Attachment 1.

In control areas with little vertical integration and with ISO-administered markets, however, the Commission has authorized a different approach that relies on market-driven price signals in regional bid-based markets with LBMP in place. A cost responsibility regime that encourages generator siting in optimal locations more closely simulates a competitive market. As the Commission staff stated in a recent concept paper, dated December 17, 2001 (at page 2), as a component of its vision of future wholesale electric markets: "Good market-driven price signals will exist to support well-planned investment in new generation and new transmission when and where they are needed, and in a timely manner (before shortages occur)." We support the concept of constructing well-planned transmission and those who benefit from new transmission should pay an appropriate share.

Listed below are several suggested principles and conclusions relevant to pricing policies in a market environment (I.A.). For the reasons discussed, these principles are served by a policy requiring generators to fund transmission upgrades they require except in unique circumstances (I.B.). Finally, we recommend that the final rule in this docket maintain the ISO protocols pending resolution of the cost allocation NOPR (I.C.).

A. A Regional Tariff Administered By An ISO or RTO Should Be Market-Oriented.

The goal of assigning cost responsibility for transmission upgrades should reflect the principle that competition and market-based solutions generally result in more efficient allocation of societal resources. Consistent with this fundamental premise are the following:

- Reliability and reasonable prices are primary goals.
- New generation and transmission expansion will be required, and in some cases, may be substitutes for the other.

These guiding principles lead the NYPSC to several observations and conclusions:

- Efficient system planning requires a balance between transmission and generation development, with a focus on market signals and reliability.
- Generators' choice of sites should be guided by LBMPs (higher prices should attract new generation).
- In some extreme cases, market signals may be inadequate. Desirable generation may be dissuaded from siting where LBMPs are high because of high interconnection or deliverability costs or environmental factors. It may then be necessary for state regulators to order a transmission owner to construct new transmission facilities, with the costs spread among the appropriate body of ratepayers.
- While the Commission is properly striving for simplicity, it is not likely that a single cost responsibility approach would work equally well with every regulatory regime and every market design.

Perhaps two or three approaches, or general guidelines rather than a narrowly focussed prescriptive rule, would better accomplish the Commission's goal.

The NYPSC recommends that these guiding principles and observations serve as a foundation of the subsequent pricing rulemaking.

B. The NYISO OATT Contains Elements Of An Optimal Cost Responsibility Model.

Under the NYISO model, TOs are responsible for the cost of "System Upgrade Facilities" that are needed to maintain system reliability "anyway" (that is, without considering the impact of developers' projects). Generation developers are responsible for the cost of System Upgrade Facilities that would not be needed to maintain system reliability "but for" the impact of their projects on the system. These "anyway" and "but for" costs are determined by the Annual Transmission Baseline Assessment (ATBA)⁶

⁶The specific purpose of the ATBA is to identify the System Upgrade Facilities that TOs are expected to need to reliably meet the load projected for the New York Control Area, with cost estimates for those System Upgrade Facilities. NYISO staff, with initial input from each TO, builds an integrated NYISO-wide ATBA that identifies each anticipated System Upgrade Facility project and its estimated costs, and includes other related information.

and the Annual Transmission Reliability Assessment (ATRA).⁷ The results of the two assessments are netted, and each developer is assigned responsibility for the cost of the net impact of its project on the reliability of the transmission system.

This approach encourages the developer to site the project in a cost-effective manner, maximizing anticipated profits by selecting potential sites that consider reliability impact costs as well as market prices that reflect existing transmission constraints. This paradigm provides a market-based incentive for the developer to determine what level of upgrades it is willing to support. Given that the upgrade costs must be recovered in the market price for the generation output, the market ensures that retail consumers pay for only those upgrades for which they receive a direct benefit. It also would discourage, for instance, a developer from proposing to site new generation in western New York with intentions of delivering

⁷The specific purpose of the ATRA is to identify the System Upgrade Facilities required for the projects in the Class Year group of projects, with cost estimates for those System Upgrade Facilities. NYISO staff, with input from Market Participants, including the Class Year Developers, updates the System Reliability Impact Studies that were previously performed for each project, to determine the pro rata contribution of each project in the Class Year to each of the System Upgrade Facilities in the updates, and to determine each developer's cost responsibility. NYISO staff then provides each Class Year Developer with a dollar figure for its cost responsibility, with specified supporting information.

energy to New York City, unless development costs and market LBMP differentials supported such a decision.⁸

An additional attribute of the NYISO model that is missing from the best practices approach is that new generation, existing generation, and merchant transmission developers are all on an even standing, facing the same financing and economic viability challenges. In contrast, under the best practices model, new generation would receive this favorable treatment (i.e., reimbursement) while leaving pre-existing generation with no easy opportunity (i.e., no reimbursement) to improve its deliverability situation (even a situation exacerbated by new generation) and merchant transmission developers are discouraged from stepping forward.⁹

The NYISO's LBMP model, however, provides for a variety of solutions to congestion problems while ensuring that the system will not be overbuilt. The ISO model in New York has encouraged efficient siting of generation near loads where congestion exists. Four developers have already filed siting applications for merchant transmission that would be built into the constrained New York City/Long Island market.

⁸We offer in Attachment 2 two scenarios as examples of the attributes of LBMP pricing in this context.

⁹Under the existing NYISO market design, both new generation and existing generation facilities have equal access to the transmission system due to the LBMP pricing system.

We note, however, that there may be some circumstances that do not provide adequate market signals for the construction of new transmission lines. In those cases, the NYPSC may have to direct transmission owners to file for construction of those facilities. For example, a local load pocket may experience LBMPs that are significantly above those that occur outside the pocket. A new transmission line may relieve congestion to such an extent that the LBMPs inside the pocket would fall to the level of those outside the pocket. Further, the aggregate benefit of these lower prices may greatly outweigh the cost of the new line. In such a situation, the proper decision, from society's perspective, is to build the line. However, because there would be no LBMP differential to compensate any new owner of congestion rights, an entrepreneur may be disinclined to invest in such a line. Under such circumstances, the regulated TO may be required to invest in such a beneficial project.

**C. Interconnection Procedures and Agreement Provisions
Should be Flexible**

Several of the provisions contained in the proposed Interconnection Procedures and Interconnection Agreement submitted on January 11, 2002 appear to be founded on the cost allocation assumptions provided in Attachment B. Given that the Commission will be addressing cost allocation issues in an

upcoming NOPR,¹⁰ the provisions should either be revised not to be dependent on any particular cost allocation methodology or identified for revision after resolution of the cost allocation NOPR.

Insofar as the ANOPR has focused on products to be used by fully integrated utilities with the assumption that transmission owners bear the cost for interconnection-related upgrades, its orientation is counter to what is in practice within the ISOs. To avoid planning uncertainty, the Commission should include provision 31.15 of the draft Interconnection Agreement in its final rule, which would maintain the ISO protocols until resolution of the cost allocation NOPR.¹¹

II. A QUEUING REGIME SHOULD ALLOW PROJECTS TO ADVANCE WITHOUT UNREASONABLE TIMING IMPEDIMENTS.

The ERCOT interconnection model and the proposed Interconnection Procedures submitted January 11, 2002 provide for a queue position for study and resource priority based on when a transmission provider receives an interconnection

¹⁰ Section 11.4 of the Interconnection Agreement explicitly acknowledges a difference of opinion on this subject between generators and transmission owners.

¹¹Section 31.15 states: "Many provisions of the Agreement reflect terms and conditions applicable where ISO/RTOs are not currently in place. To the extent that any provision of this Agreement is inconsistent with any tariff or agreement approved by the FERC for an ISO/RTO, the ISO/RTO tariff or agreement shall control unless and until modified by the Commission."

request. While the NYPSC agrees that it is desirable to have a process to orderly move projects through the study process and to determine assumptions as to which proposed generation projects are modeled in the studies, there are two major drawbacks to the proposed approach if it is rigidly applied.

The first is that projects that are likely to improve system reliability or to decrease pressure on energy prices may be trapped in a low position in the queue that would prevent their timely consideration in favor of more speculative projects that submitted their paperwork ahead of the other projects.¹² If a project developer in the latter part of the queue wants to build generation sooner than parties that are earlier in the queue, they should be allowed to have studies expeditiously performed, possibly by qualified consultants and submitted to the ISO and state regulators for the necessary approvals, so that needed generation would not be held back from consideration.

The second drawback is that the queue proposal contained in the draft Interconnection Procedures document allows a developer to potentially tie up scarce transmission resources for up to

¹² While the NYSPSC agrees that determining which projects may be most beneficial to a particular control area is arguably subjective, we urge the Commission to allow for careful consideration of input from those closest to the situation, namely, the ISOs and state regulators.

ten years (section 3.3.1). This provision could allow gaming of the planning process. For example, generation owners could exercise market power where the transmission system was constrained. Especially in New York City and urban areas of the Northeast, those same areas of the transmission system are likely to have scarce interconnection facilities. Consequently, for the relatively minimal cost of having studies performed and exercising site control, an existing generator could prevent the allocation of interconnection resources (e.g., a breaker position) to a competitor. At a minimum, if the proposed queue process is adopted, firm milestones should be in place that ensure that projects either move forward or the resources are reallocated.

Should the Commission decide to retain the draft queue provisions, section 4.3 is key to preventing the creation of a "market" for queue position.¹³ Without this provision, the queue could become jammed with "paper" projects whose sponsors have no intention of development and are betting that a lower-ranked project would be willing to purchase their queue position. This practice slows the process, encourages unearned profits, and drives costs up to developers and, ultimately, to retail

¹³Section 4.3 states: "A generator may transfer its queue position to another entity only if such entity acquires the specific facility identified in the Interconnection Request and the Point of Interconnection does not change."

consumers. Preferably, the process should have guidelines that promote the development of the most efficient projects, not just the projects that "hurried in the door" with minimally efficient designs.

The problem of determining which proposed generation projects should be included in study assumptions is likewise resolved by the inclusion of section 4.2, which provides the option of "clustering" projects for study. This provision would allow the determination of system upgrade requirements communally, and therefore, should be retained. There is a similar process currently in place at the PJM and New York ISOs.

III. CLARIFICATION IS REQUIRED ON THE TREATMENT OF PROJECTS THAT ARE 20 MW AND BELOW

One of the Commission's proposed "best practices" is that special treatment should be afforded projects with ratings of 20 MW and below. These projects are to be exempt from paying for interconnection studies or network upgrades. We request clarification that these exemptions would apply only to the impacts on transmission systems caused by the generator's interconnection and not to projects affecting distribution systems. Smaller projects are more likely to be located on lower level systems and may have significant impacts on local distribution facilities that would require a more extensive study as well as local distribution system upgrades.

IV. NYPSC REQUESTS THAT TRANSMISSION OWNERS NOT BE REQUIRED TO IDENTIFY SPECIFIC SUBSTATIONS

The Commission has identified as a "best practice" the requirement that transmission owners post optimal and non-optimal sites for the interconnection of generation to the transmission system. We request clarification that the transmission owners would be required to identify market areas only and not specific substations. Identification of specific substations could pinpoint vulnerabilities in the system and thereby compromise security of the nation's electric system.¹⁴

¹⁴The NYPSC is also concerned that the draft Interconnection Agreement lacks the requirement that the developers' interconnection equipment must be in compliance with existing standards such as United Laboratories and other national electric codes. Developers of both transmission and generation must abide by good utility practice and be held to accepted standards.

CONCLUSION

For all of the reasons expressed above, the NYPSC respectfully urges the Commission to recognize that one standard cost responsibility paradigm may not work well with every market design. We also request the Commission to consider a queuing model that allows projects to advance without unreasonable timing impediments.

Respectfully submitted,

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Dated: February 6, 2002
Albany, New York

STATEMENT OF POLICY REGARDING VERTICAL MARKET POWER

In creating a competitive electric market, the Commission has viewed divestiture as a key means of achieving an environment where the incentives to abuse market power are minimized. Recognizing that vigilant regulatory oversight cannot timely identify and remedy all abuses, it is preferable to properly align incentives in the first instance.

Vertical market power occurs when an entity that has market power in one stage of the production process leverages that power to gain advantage in a different stage of the production process. A transmission and distribution company (T&D company) with an affiliate owning generation may, in certain circumstances, be able to adversely influence prices in that generator's market to the advantage of the combined operation. Two examples are given below:

- The affiliate's generator is located in the same market as the T&D company. The T&D company has an incentive to make entry by generators into its own territory difficult, and therefore, expensive for a new entrant by either delaying or imposing unrealistic interconnection requirements, and thereby raising prices in the region. A T&D company affiliate that owns generation in an energy market in which it has only a small T&D service territory in that market (in terms of the market's square miles) could overcome the presumption, described below, by showing that the percentage of the overall market that the T&D company controls via its service territory is insubstantial; provided, however, that if the energy market is a high cost market the T&D company must also have no ability to influence transmission constraints into the high cost market.

- The affiliate's generator is on the high cost side of a transmission constraint and the T&D company has the ability to influence the

ATTACHMENT 1

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transmission constraint. The T&D company has the incentive to retain the constraint to keep the market price high on the high cost side of the constraint.

To guard against undesirable incentives, a rebuttal presumption will exist for purposes of the Commission's Section 70 review of the transfer of generation assets, that ownership of generation by a T&D company affiliate would unacceptably exacerbate the potential for vertical market power. To overcome the presumption the T&D company affiliate would have to demonstrate that vertical market power could not be exercised because the circumstances do not give the T&D company an opportunity to exercise market power, or because reasonable means exist to mitigate market power. Alternatively, the T&D company would need to demonstrate that substantial ratepayer benefits, together with mitigation measures, warrant overcoming the presumption. Possible means of mitigating market power include:

- Limitation on the degree of control over the constraining transmission interface held by the T&D utility.
- A pledge by the T&D utility to pursue transmission projects recommended by the Commission or by the ISO, together with a proposal that would neutralize profit maximizing incentives on generation that is within the market power control area pending the completion of all reasonable efforts by the T&D company to complete recommended transmission projects.
- An agreement by the T&D company to participate in a binding arbitration in the event of a dispute over a new generator's interconnection requirements in the T&D utility's territory.

Example 1

The first example assumes a broad definition of "upgrades" and compares the ANOPR's Attachment B pricing approach to the NYISO's current policy. Consider two LBMP regions, A and B with $LBMP_A = \$30/MWh$ and $LBMP_B = \$55/MWh$.

Power tries to flow from low cost A to high cost B, but is constrained. Suppose new transmission would cost the equivalent of \$37 per MWh. Suppose also that it would cost \$31 to build and operate a new plant in Zone A and \$45 to build and operate a new plant in Zone B. The least-cost solution from society's point of view is for the \$45 plant to build in Zone B. Building a plant in Zone A plus a line to connect it to Zone B would cost \$68/MWh ($\$31 + \37). If the policy were to make the Generator Developer pay for the cost of transmission reinforcement (or simply accept its zone's LBMP without the upgrade), the correct societal result will occur. However, if the policy were to force the TOs to pay the \$37, then the generator will build in Zone A since the developer's costs will be \$31, not \$45. Unfortunately, with this policy, total costs to society will be \$68/MWh rather than \$45/MWh.

Example 2

The second example assumes a more narrow definition of "upgrade" costs and compares the two approaches to assigning cost responsibility.

A Generator Developer is considering building a plant in a zone that generally provides an LBMP at \$40/MWh. It would cost \$34/MWh to build and operate at Site 1 and \$35/MWh at Site 2. The upgrade costs that would not have been required "but for" the interconnection will be \$10/MWh at Site 1 and \$2/MWh at Site 2. Total costs will be lower at Site 2 (\$37) than at Site 1 (\$44). In fact, building no plant is more efficient than building at Site 1 (value of the extra power is the LBMP at \$40 while the extra cost is \$44). If the Generator must pay the upgrade costs caused by its interconnection, then it has the incentive to correctly choose Site 2. However, if TOs pay for the upgrade costs, then the Generator will only look at the costs to build and operate and, thus, has the incentive to choose Site 1 (\$34) over Site 2 (\$35). Not only did the developer not receive the incentive to site the plant efficiently, society would be better off if this plant (including the required upgrade) were not built at all.

CERTIFICATE OF SERVICE

I, Karen Houle, do hereby certify that I will serve on February 6, 2002, the foregoing Motion for Late 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: February 6, 2002
Albany, New York

Karen Houle