

INITIAL FACILITY CERTIFICATION AND
PROCUREMENT

The New York Public Service Commission is considering matters pertinent to the implementation of the Retail Renewable Portfolio Standard (RPS) adopted in its Order Regarding Retail Renewable Portfolio Standard that was issued on September 24, 2004 in Case 03-E-0188 (Order).¹ In particular, the Commission is considering in this notice facility certification processes and procurement models for Main Tier resources that are most suitable under the specific market conditions created by the one-year extension of the federal Renewable Electricity Production Credit (also known as the Production Tax Credit or PTC). The PTC is currently slated to expire on December 31, 2005; that is, a project must reach commercial operation by this date to qualify for this federal tax credit.²

For projects that qualify, the PTC provides a ten-year stream of tax credits estimated at approximately 1.8¢/kWh for wind and closed-loop biomass and a five-year stream of tax credits estimated at approximately 0.9¢/kWh for open-loop biomass, landfill gas, solar and some other technologies. Several RPS-eligible resources (such as wind, closed-and-open-looped biomass, geothermal and solar energy, and landfill gas) are eligible under the extended PTC.

¹ All of the issues related to implementing the RPS are addressed in SAPA No. 03-E-0188SA2; this notice is limited to those issues pertinent to expedited measures designed to take advantage of federal tax credits.

² While Congress has extended the PTC in the past, Congress has also allowed it to lapse and then reauthorized it at a later date. Given the significant uncertainty as to the future availability of the PTC, even if the PTC were to be extended beyond the current expiration date, this information may not be known for quite some time.

As stated, the PTC is available only to projects that are in commercial operation by December 31, 2005. The limited one-year extension of the PTC creates the risk of a lost opportunity to reduce substantially the cost of the RPS to New York's ratepayers.³ Therefore, the Commission is considering establishing an expedited or fast-track procurement process aimed at contracting with eligible resources with sufficient lead-time to capture the benefit of substantial PTC leverage for New York ratepayers. The Commission is also considering whether new Main Tier facilities that are not eligible for the PTC should be allowed to participate in the initial solicitation and, if these facilities are so allowed, must they be operational before January 1, 2006 in order to receive RPS support.

Cost minimization is one of the Commission's primary RPS implementation objectives. The current availability of the PTC offers an opportunity to further this objective through the leveraging of the PTC value to the benefit of New York ratepayers. The value of PTC leveraging can be substantial. For example, if half of the 2006 RPS target MWh were to be procured via an expedited procurement solicitation, the net present value (NPV) of the PTC would be approximately \$97 million (at a 10% discount rate).⁴

³ In the RPS Cost Analysis (Appendix D to the Order), the PTC was assumed to be available for the duration of the RPS and its value was estimated to be significant.

⁴ The Commission acknowledges the possibility that, due to (1) less competitive pressure on price resulting from the narrowed eligibility for the PTC Fast Track procurement, and (2) potentially greater leverage of wind turbine equipment and service vendors over developers driven by impending PTC expiration, not all of this value would be captured. Even if only 75% of this value could be captured via fast track procurement, however, the value to New York ratepayers would exceed NPV of \$72 million. The Commission is considering authorizing NYSERDA to reserve the right to reject bids should development prospects with associated pricing not be deemed acceptable.

Comments are requested on expedited certification procedures and procurement processes as soon as possible because the Commission may consider immediate adoption of the proposal on an emergency basis pursuant to section 202(6) of the State Administrative Procedures Act (SAPA). The Commission may accept, reject or modify any proposed criteria and procurement models. A discussion of approaches to facility certification criteria and the procurement models under consideration as potentially adaptable to the expedited procedures follows.

I. FACILITY CERTIFICATION

In designing effective and transparent facility certification procedures, the Commission is considering these objectives:

- Provide certainty to developers to minimize pre-development cost and risk due to uncertainty in potential eligibility;
- Minimize administrative burdens to generators and regulators;
- Minimize time requirements so as not to unduly slow the procurement process;
- Ensure that only eligible projects are certified;
- Create an open and transparent process; and
- Afford confidentiality to developers during the development process

As a part of the design of the on-going, permanent RPS program, the Commission is considering requiring all potential renewable energy projects to seek provisional or operational certification by the New York State Energy Research and Development Authority (NYSERDA) as a pre-condition for participating in an authorized central procurement solicitation (projects that are not so certified would not be eligible to participate). Provisional certification would be necessary for facilities that are not yet

constructed. A request for operational certification would be required for facilities that are constructed and operating at the time of the procurement and for all provisionally certified facilities prior to the payment of any incentives if the facility is selected through a procurement solicitation. It is anticipated that NYSERDA may require this operational certification to be renewed periodically, perhaps once every two years, and may require facilities to notify NYSERDA of any material change to avoid disqualification.

Alternatively, some states use an optional “advisory ruling” process in advance of solicitations, which allows developers whose projects are still in the development stage to assess the likelihood and conditions under which the project would qualify for RPS support. Other states require provisional certification only of those projects that are selected or that are finalists for selection. The Commission is considering these approaches as well.

Under the expedited procedure, in order to take advantage of the market conditions created by the PTC, the Commission is considering authorizing NYSERDA to use a streamlined certification procedure, whereby a facility would self-certify in its submission its eligibility to participate in the RPS. Such certification would be subject to provisional verification prior to contract execution. Operational certification upon commercial operation, and upon renewal dates, would be required before incentives are paid.

The Commission may assign to NYSERDA the task of developing the appropriate forms and procedures for self-certification and for provisional and operational certifications, with NYSERDA making initial determinations of eligibility in this process. The Commission would hear any appeals of NYSERDA’s decisions. In

addition, developers would be able to identify information that should be treated confidentially during provisional certification pursuant to New York Public Officers Law § 87(2)(d), 21 NYCRR Part 501, and 16 NYCRR Part 6.

II. PROCUREMENT MODELS

A. Procurement Objectives

Among the objectives to be furthered through the design of any RPS procurement method, including the expedited procurement process now under consideration, are the following:

- Minimize cost to end use customers;
- Contract with projects that have good probability of achieving operation;
- Support project financing;
- Maximize leverage of the program by considering other factors such as the Federal PTC;
- Achieve RPS quantity objectives;
- Minimize interference with competitive wholesale markets.

- Capture economic development opportunities;
- Encourage viable competitive renewable energy and green power markets;
- Create a base of information and experience to facilitate transition to more market based procurement approaches; and
- Create a foundation for future flexibility and process evolution.

With regard to an expedited procurement process, it is the Commission's understanding that for developers to close financing and order equipment with sufficient lead-time to construct prior to the PTC deadline, awards must be made by no later than the end of January, 2005. Accordingly, in order to capture the opportunity offered by extension of the PTC, thereby furthering the stated objective of minimizing costs to ratepayers, the Commission is considering steps that would allow NYSERDA to prepare

and issue a competitive solicitation on a timeline that would allow selection and award by the end of January, 2005. In addition, the Commission is considering measures to enhance the competitive nature of the initial solicitation by allowing new Main Tier RPS facilities to participate even if they are not eligible for PTC credits, provided they must be commercially operating before January 1, 2006 to receive production incentives.

B. Procurement Approaches

The Commission is considering authorizing NYSERDA to use its discretion in choosing among the following three options as the most advantageous expedited procurement process:⁵

1. Auction format;
2. Request for Proposals (RFP); or
3. Standard offer.

Regardless of the option chosen, NYSERDA would provide a financial incentive in the form of a premium payment to renewable generators based on energy produced on the condition, that in exchange for this payment, NYSERDA would obtain control of the associated renewable energy attributes and the generator would be precluded from selling those attributes. Such a structure (or some similar form) is intended to ensure that New York State ratepayers obtain an identifiable result from the RPS surcharge on their bills.

A brief description of each of these three procurement approaches being considered is provided below:

⁵ We encourage parties to propose other options that may better allow us to move forward on fast track solicitation.

1. Auctions

- *Auctions* may be used by either a seller or purchaser in circumstances in which the good or service is sufficiently defined such that the winner(s) can be determined solely by its price and not by other factors such as quality or dependability.

In certain markets, spot power is transacted on the basis of hourly (or other) auctions. In addition, provider of last resort (POLR) service may be acquired through auctions that are held periodically, as may be required (e.g., New Jersey Basic Generation Service, discussed further below). In both instances, the auction procurement targets are fixed, delivery is not in question once the bidders qualify (they are licensed and creditworthy), the contracts are standard and the winning bids are unambiguous. Moreover, unless the bidder has violated some pertinent rule (regarding bid collusion, for example), the winners are appropriately paid for what they deliver.

Auctions can be structured such that the winning bidders can be paid the same price – known as a clearing or uniform price – or paid what they bid. The choice may depend upon the specific details of the auction and the type of auction to be utilized; conversely, the choice may also influence the selection of a specific auction model.

iii) Ascending-Bid Auctions

Ascending bid auctions are open auctions where bidding starts at a price set by the buyer or auctioneer and is raised in increments until the desired quantity is available.

iv) Descending-Bid Auctions

Descending bid (or clock) auctions are open auctions where bidding starts at a price set by the buyer, or auctioneer. The auction price is lowered in increments until the amount of the commodity offered equals the amount demanded. This auction is known as a “Dutch Auction.”

v) Multiple Unit Auctions

Auctions involving the transaction of multiple units or items, which is the context for this RPS procurement, are of two general types:

- “Sequential” auctions transact the units in an auction in sequence until all units are transacted.
- “Simultaneous” auctions transact all units at one time and price.

Many alternative structures for multiple unit auctions are used in a variety of situations. Three examples from recent practice are summarized briefly for illustration:

- a) Simultaneous Descending Clock Auction – New Jersey’s Basic Generation Service (BGS, a.k.a. provider of last resort service) is served by power suppliers selected through an annual descending bid auction of this type. The state’s BGS load is divided into 100 MW slices. The auction selects suppliers to provide BGS under terms of a standard, one-year contract.
- b) NYISO Transmission Congestion Contracts (TCC) Auction – NYISO conducts semi-annual and monthly auctions of TCCs (financial contracts to hedge congestion costs). The TCC auction allocates available TCCs in standard contracts (six-month – five-year terms) through a series of bids.
- c) Hybrid Model - A multiple round descending clock auction for an undetermined number of rounds followed by a final round in which sealed bids are submitted. All winning bidders would receive the same price. The number of bidding rounds in the clock auction would be determined by when the excess energy bid falls below a threshold amount. This approach is adapted

from a process used in the Netherlands to purchase commodity.

Auction formats are used in day-ahead energy markets and capacity markets, as well.

Factors to consider in determining whether an auction can be an effective mechanism include:

- Are there sufficient numbers of bidders to make the auction competitive?
- Are the commodities offered by bidders equally valued by the central procurer?
- Is there potential for one or a few bidders to dominate the auction?
- Is there opportunity for collusion among the bidders?
- Are there barriers to entry in the auction?

2. Request for Proposals (RFP)

The Request for Proposals (RFP) approach is well suited to situations where multiple objectives are to be considered and weighed. This is typically the case where attributes other than price are crucial, where the commodity is not uniform, where there is development or quantity risk, where there is flexibility on the amount to be procured, and/or where some negotiation with the highest-ranking bidder(s) is contemplated. Note also that “pay-as-bid” is typically a component of the RFP approach.

RFPs are also adaptable to situations where there is substantial variability in the projects offered. For example, when different terms and conditions are in order, location-based effects are relevant, operating characteristics for competing technologies are quite different, project and technology risks are unique,

and developer experience is important, the RFP approach may be the most applicable/effective.

In the energy business, RFPs have been widely used by, for example, utilities that have sought power from a mix of resources, or from resources with different fuels or pricing structures (so as to create a hedged portfolio, for instance), or with respect to contracting with independent power producers (including PURPA Qualifying Facilities) for power from facilities that were, at the time, not yet in service. Competitive bidding was also used extensively in the divestiture of generating assets during the implementation of restructuring. In general, those transactions that are longer term or more complex are less amenable to a pure price auction and more amenable to RFP or competitive negotiation formats.

Factors to evaluate in this regard include:

- The extent to which non-price considerations are to be explicit criteria in evaluation proposals (such as project type diversity, locational diversity, etc.);
- The extent to which alternative or non-standard contract terms and conditions are to be considered; and
- The extent to which project specific due diligence will be required as part of the bid evaluation to obtain assurance on project viability.

3. Standard Offers

A standard offer approach provides eligible participants the opportunity to take a contract at a pre-specified price, quantity and duration. Consistent with that year's procurement needs, projects meeting established threshold requirements would be eligible to obtain the stated price, terms and conditions. In essence, the standard offer approach is a simple auction format, where the clearing price is

administratively set in advance. The advantages of a standard offer are that it is simpler to administer and simpler and less risky for the project applicant than auctions or RFP formats. Establishing a standard set of terms and conditions that is suitable for most participants and establishing a basis for administratively setting the price level are among the challenges posed by the standard offer format.

Standard offers have been used in a number of contexts. In the power industry, standard offer contracts have been used historically for small qualifying facility contracts under PURPA. A standard offer is also analogous to any number of coupon or rebate programs, where a fixed price or rebate is offered to a large number of buyers.

III. CONCLUSION

The Commission is seeking comment on the issues presented above regarding the design of the certification processes as well as procurement methods to take advantage of the one-year extension of the PTC. Comments are requested as soon as possible because the Commission may consider immediate adoption of the proposals on an emergency basis pursuant to section 202(6) of SAPA.