NEW YORK STATE
PUBLIC SERVICE COMMISSION

Case 03-E-0188 - Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard

COMMENTS OF INDEPENDENT POWER PRODUCERS OF NEW YORK, INC. ON PROPOSED RULE MAKING

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Dated: December 27, 2004
Albany, New York

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INTRODUCTION

On November 10, 2004, the New York State Public Service Commission ("Commission") published a notice of proposed rule making, identified as 03-E-0188SA2, in the *State Register* seeking comments on measures intended to implement the renewable portfolio standard ("RPS") that was adopted by the Commission in an order issued on September 24, 2004.[1] The proposed rule making (the "Proposed Rule") was distributed to parties in Case 03-E-0188 via electronic mail on November 12, 2004. In response to the Commission's request for comments on the Proposed Rule, Independent Power Producers of New York, Inc. ("IPPNY")[2] hereby submits the following comments on the Proposed Rule.

- The New York State Energy Research and Development Authority's ("NYSERDA") evaluation of bids and payment for renewable attributes or renewable energy credits ("RECs") should be on a fixed price rather than a

[1] Case 03-E-0188, *Order Regarding Retail Renewable Portfolio Standard* (September 24, 2004)("RPS Order").

[2] IPPNY is a not-for-profit trade association representing the independent power industry in New York State. Its members include more than 100 companies involved in the development, operation and ownership of electric generators and the marketing and sale of electric power in New York.

variable price basis. If the Commission decides to adopt an approach with variable pricing, it should order NYSERDA to pay renewable resources a fixed REC price that is inversely indexed to annual average zonal locational based marginal prices ("LBMPs").

- While NYESRDA should have the discretion to experiment with different solicitation formats for the early stages of REC procurement, the Commission should make clear its strong preference for the auction format for procurement of most RECs.
- The Commission should require NYSERDA to develop measures that ensure selected projects are constructed in a timely manner. The Commission should grant NYSERDA discretion to modify the measures so they can be refined as project development and construction unfold and experience is gained.
- The Commission should adopt clear and concise guidelines on how it will determine whether existing renewable resources are eligible for RPS benefits.
- The Commission should make the requirements for biomass certification less onerous.
- The Commission should require NYSERDA to consult with the New York Independent System Operator ("NYISO") so that it may monitor and report on any adverse impacts the RPS has on competitive energy markets and system reliability as part of the Commission's proposed monitoring and evaluation program.

I. THE FINAL RULE SHOULD MAKE CLEAR THAT RENEWABLE RESOURCES MUST BID AND BE PAID FOR RECS ON A FIXED, RATHER THAN A VARIABLE PRICE, BASIS.

The Commission's RPS Order did not provide any guidance on how bids should be designed or how premiums should be paid to renewable resources, leaving this critical issue to be addressed by NYSERDA and Department of Public Service ("DPS") Staff and approved by the Commission in the implementation phase. In the Proposed Rule, the Commission is considering authorizing NYSERDA to use product pricing approaches such as fixed single price, preset prices that vary over the contract term, indexed pricing, and contract for differences ("CFDs"). The Proposed Rule states that pricing approaches should be studied to determine impacts on market behavior because "a pricing structure found to be favorable to the financial community could cause unintended negative consequences when used in the markets administered by the NYISO."[3] The CFD approach, whereby NYSERDA would commit to paying winning bidders their total bid price, or the "strike price," minus the LBMP, is an approach that will have significant adverse effects on the competitive wholesale market, and therefore must not be adopted.

A. THE COMMISSION'S ORDER ADOPTING A RULE SHOULD PROHIBIT USE OF THE CFD PROPOSAL BECAUSE IT WILL HARM THE EFFICIENCY AND COMPETITIVENESS OF ELECTRICITY MARKETS.

By its very design, the wholesale electricity market structure in New York values energy when and where it is needed most. The CFD proposal ignores this basic tenet of the New York market design. Renewable resources that are chosen via the competitive solicitation would have no economic interest in following market price signals because these resources receive their full

[3] Proposed Rule at 20.

payment irrespective of the level of market clearing price. If these resources are paid based on CFDs, they, unlike other suppliers, would have no incentive to ensure that maintenance of their facilities was performed at times that maximized the underlying value of energy to the State. Nor would they have any incentive to supply energy at times that maximized its value to the State. To the contrary, the energy produced by renewable facilities would have the same value to the resource regardless of the value of that energy to society at large. The impacts on the operation and dispatch of the system will be significant.

Use of the CFD proposal will also harm the efficiency and competitiveness of the electricity markets because it could lead to uneconomic decisions with respect to the selection of renewable resources, thereby promoting the construction and operation of unnecessarily costly renewable resources. In its worst variation, the CFD payment would be provided through a standard offer contract where any qualifying resource that agreed to sell at a defined price could win a contract. In this case, contracts would be awarded to the resources that could be developed at the lowest cost, irrespective of where they were sited. No consideration would be given to the value of the resources' output in the wholesale electricity market. This is contrary to the structure of the locational based market in which these resources will participate.

For example, a resource with a bid of $70/MWh that was only delivered during the spring when the value of its energy on the wholesale market was $30/MWh would win over another resource that bid $75/MWh but that delivered its energy in the summer with its value on the wholesale market equal to $60/MWh. In the first case, the premium for the renewable resource is $40/MWh while in the second case the premium is only $15/MWh. Clearly, the second resource is the more desirable resource from an economic perspective yet, under the CFD proposal, the less desirable resource would be chosen because its total bid cost was the lowest.

The improper selection of the first resource under the CFD approach would be made more extreme if the first resource is located in an area where there is a larger installed capacity margin and the second resource is located in a region with a smaller installed capacity margin.

It is possible to use a more complicated variation of the CFD proposal by attempting to determine the premiums that are implicit in each of the total price bids and to rank the bids based upon minimizing the premium. However, this would require NYSERDA to estimate future wholesale market revenues that would apply to each bidder in each location across the duration of its contract. Not only would NYSERDA have to estimate wholesale energy costs in general, it would have to estimate the amount that each bidding renewable resource would deliver at different times of the year and at different times of the day and the value of the energy at the times that the resources are delivering the energy. Finally, NYSERDA would be required to estimate the amount of installed capacity that each renewable resource would provide and the value of that capacity.

While this more complicated and error-prone proposal could be applied to renewable resources located in New York, it does not appear possible that the CFD mechanism could be applied to renewable resources that sell into the New York RPS program from outside the State. Pursuant to the RPS Order, out-of-State renewable resources are not required to deliver the energy they produce into New York at the time that they produce the energy. Out-of-State renewable resources can sell the energy in their home states or provinces at the time it is produced, as long as they deliver an equivalent amount of energy into New York at some time during the month. Implementing the CFD approach requires defining the energy value that will be deducted to determine the "difference" that would be paid by NYSERDA. In the case of imports, it will be difficult to define the difference since the delivery period will be independent

of the time at which the energy is generated. It will also be difficult to determine the "difference" associated with imports because the NYISO does not estimate a price for the resources' locations.

The CFD proposal is fraught with problems because it shifts all of the risk of forecasting errors to NYSERDA, and ultimately, New York ratepayers. NYSERDA would take all the risk for errors in these estimates while it is the renewable resource itself that is in the best position to estimate and control its energy and capacity deliveries. It rewards inefficiency because renewable resources are paid their total bid price regardless of the revenues they receive from the wholesale electric market. No matter how much expertise NYSERDA applies to evaluating total price bids, the result will undoubtedly be biased in one direction or the other against what a competitive fixed price approach would produce. This increases the potential that NYSERDA chooses resources that do not appropriately represent the underlying benefit of the resource in the wholesale market, to the detriment of the wholesale market, the resources that were not chosen and, ultimately, consumers.

In contrast, while no long-term forecast can ever be perfect, sophisticated and prudent developers, which have great expertise through competing in electricity markets, are in a better position to estimate future market prices in preparing their bids. It is the developers that should appropriately bear the risk associated with incorrect estimates. A fixed price bid approach, where suppliers bid solely on a fixed price REC product, awards the most efficient developers, ensuring that resources are sited in the best locations.

The CFD approach is also problematic because it is unlikely that NYSERDA would be able to develop objective criteria for ranking and choosing among bidders. The use of CFDs, by its nature, requires myriad assumptions to be made about the underlying value of factors that will

drive the wholesale value of energy and about each individual bidder's expected energy delivery. One way to attempt to make this process objective would be for the Commission to conduct proceedings to determine the acceptable assumptions for load growth, fuel prices, resource availability and the representation of the transmission system. In the case of CFDs for the RPS, all of these assumptions would need to be defined, including the appropriate representations for any potential RPS bidders. While this process can produce a defined set of assumptions, those assumptions are likely to be stale by the time the Commission approves them. Thus, a process would also be needed to revise the assumptions, revisions that are likely to also be stale in short order.

An alternative to a Commission conducted process would be to grant NYSERDA the flexibility to develop the appropriate assumptions for representing the wholesale electric system and the underlying resources' operation. NYSERDA would be able to use the most current information to estimate the wholesale market value and the resources' representations. Even with this information, however, the myriad of assumptions that must be made under this approach raises serious questions of whether the Commission could ensure that the bid evaluation process and awarding of contracts is performed fairly. This complication could possibly be reduced by having bidders provide NYSERDA with the assumptions they use for their proposed projects. However, it would be difficult for NYSERDA to assess whether these assumptions were valid and not the result of efforts by bidders to make their projects appear to provide more wholesale value than they will actually provide. The CFD would effectively protect bidders from any errors that might result from an improper representation.

In contrast to the CFD approach, NYSERDA has the expertise in place to evaluate fixed price bids. The fixed price approach would select suppliers with the lowest bids, ensuring that

bidders take the risk for any errors or misrepresentations of their projects and that all bidders are evaluated on a fair and competitive basis.

B. IF THE COMMISSION DECIDES TO ADOPT A VARIABLE PRICE APPROACH, IT SHOULD REQUIRE NYSERDA TO PAY A PRICE THAT IS INVERSELY INDEXED TO AVERAGE ANNUAL LBMPS.

As explained above, the CFD approach will have significant adverse affects on the competitive wholesale market because it ignores the basic tenet that the wholesale electricity market structure in New York values energy when and where it is needed most. Renewable resources that are chosen via the competitive solicitation would have no economic interest in following market price signals because these resources receive their full payment irrespective of the level of market clearing price. IPPNY understands the some parties may prefer a CFD approach because it protects ratepayers from being required to make windfall payments to renewable resources if energy prices increase beyond levels necessary to cover renewable resources' costs. If the Commission decides to adopt a variable price approach, it should ensure that it will protect ratepayers from being required to make windfall payments while at the same time encouraging renewable resources to respond to market price signals. One proposal that would achieve these goals would be to pay renewable resources a REC price that is inversely indexed to annual average zonal LBMPs (the "Indexed REC Payment Approach").

The basis of the Indexed REC Payment Approach is to capture the broad market changes in the price of energy without making resources immune to when they deliver energy. As the annual average zonal LBMP rises, the REC price would be reduced. Likewise, if the annual average zonal LBMP falls, the REC price would be increased. Since the adjustment to the REC is based upon the annual average change in LBMP, it preserves the incentive to produce energy when it is most valuable, while protecting consumers from paying for RECs if energy prices rise

to levels where that payment is no longer necessary. Because REC payments would not vary with short-term fluctuations in energy prices, renewable resources would be appropriately encouraged to respond to market prices in the same manner as traditional resources competing in the energy market.

In addition to protecting consumers from overpayments and protecting the market from energy deliveries when they are not desirable, the Indexed REC Payment Approach will be much simpler to implement than a CFD proposal. Most importantly, NYSERDA will not have to estimate the timing and value of the energy deliveries from each of the prospective renewable resources, like it would have to if it adopted the CFD approach. Under the Indexed REC Payment Approach, these estimates will be made by renewable resources, which are in the best position to make these estimates and which should appropriately bear the risk of the quality of their estimates.

II. THE COMMISSION SHOULD MAKE CLEAR ITS STRONG PREFERENCE FOR THE AUCTION FORMAT.

The Proposed Rule states that the Commission is considering authorizing NYSERDA to use its discretion in choosing among alternative procurement models, including an auction format, request for proposals and standard offer. IPPNY agrees that NYSERDA should be granted discretion in choosing solicitation formats in the early stages of RPS procurement. As NYSERDA gains experience in its procurement of RECs and how market conditions affect bidding behavior, however, most RECs should be procured through the auction format. Auctions provide the best means to minimize costs for the purchaser while ensuring that bidders are evaluated fairly and transparently. Bidding is likely to be more competitive if bidders know that their bids will be evaluated objectively. If RECs are bid and paid based on a fixed price and

terms and conditions are standardized, bidders need not be concerned that NYSERDA will use subjective factors in weighing competing bids.

The Proposed Rule recognized that the auction-style procurement might work well for periodic solicitations for larger Main Tier projects, "particularly once standard terms and conditions are established and as the renewables market becomes more liquid."[4] The Commission ruled in its December 16, 2004 Order Authorizing Fast Track Certification and Procurement that an RFP approach should be used for the first solicitation of RECs because there is not sufficient time to conduct an auction.[5] After gaining experience with conducting the first RFP and executing contracts with winning bidders, it should not be difficult for NYSERDA to develop standard terms and conditions for future auctions.

III. THE COMMISSION SHOULD REQUIRE NYSERDA TO DEVELOP MEASURES THAT ENSURE SELECTED PROJECTS ARE CONSTRUCTED IN TIME TO MEET RPS TARGETS.

The Commission's December 16, 2004 Order approved measures designed to ensure that only generation providers that are capable of bringing their projects to commercial operation on a timely basis should be awarded contracts. The Commission found bid deposits and letters of credit as conditions of contract awards to be reasonable and stated that the amounts contained in financial instruments should be sufficient to discourage bidding by developers that have no probability of having their projects placed in service by the end of 2005. The Commission also ruled that NYSERDA should consider conditions designed to ensure that a project would have a high likelihood of achieving certain milestones during the year.

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[4] *Id.* at 13.

[5] Case 03-E-0188, Order Authorizing Fast Track Certification and Procurement (December 16, 2004) at 26.

Bid deposits, letters of credit and milestones are necessary to ensure that bids are only awarded to projects that are likely to be developed in the time frame set by the solicitation. Milestones were an important feature in the Commission's contract approval process related to its implementation and enforcement of the Public Utilities Regulatory Policies Act and may be even more important in the RPS context because of the need to maximize benefits from the federal production tax credit ("PTC"). If a winning bidder does not develop a project in time to benefit from the PTC, the benefits of the PTC may be forever lost. This late project may have displaced a project that could have benefited from the PTC. While some parties have proposed specific levels of financial commitments and milestones, NYSERDA should have the discretion to modify the levels and milestones as it gains greater experience with RPS solicitations and timelines for project development and construction.

IV. THE COMMISSION SHOULD ADOPT CLEAR AND CONCISE GUIDELINES ON HOW IT WILL DETERMINE WHETHER EXISTING RENEWABLE RESOURCES ARE ELIGIBLE FOR RPS BENEFITS.

The Proposed Rule states that the Commission is considering criteria for evaluating whether existing hydroelectric facilities of five MW or less, existing direct combustion biomass facilities and existing wind facilities require RPS support to remain financially viable. The listed criteria are merely issues that the Commission will address in making its decision. The Proposed Rule is silent as to how the Commission proposes to apply the criteria. The Commission's order should describe how it will apply the criteria and provide clearly defined thresholds that existing facilities must meet to be eligible for RPS benefits. Without clear thresholds established up front, the process the Commission proposes is likely to lead to subjective and arbitrary judgments concerning how the criteria should be applied to different facilities.

In addition, the Proposed Rule should confirm that: 1. “existing direct combustion biomass facilities" include existing co-firing capabilities at fossil fuel plants, and 2. the five MW threshold for hydroelectric facilities is on a per unit, rather than a per site, basis. The Commission should also consider adopting a more streamlined process for projects under 1 MW because small projects may find the Commission information requirements to be too onerous to sell RECs in the New York RPS. Other issues the Commission’s rule should address are: How long would an existing facility be certified for? Would certified facilities be required to complete an onerous re-certification process every year? If co-firing does qualify, how will eligibility be determined when the facility is profitable running on fossil fuel but not co-firing with biomass? The Commission should consider ordering DPS Staff to institute a new working group to assist it in better defining these issues and to develop firm, clear criteria.

V. THE COMMISSION’S PROPOSED REQUIREMENTS FOR BIOMASS CERTIFICATION SHOULD BE MADE LESS ONEROUS.

The Proposed Rule states that the Commission is considering requiring biomass facilities to develop forest management plans that would address overall management goals and performance standards for procuring the biomass resource. The Proposed Rule also would require biomass facilities to develop “separate and discrete” harvest plans for each of their harvesting operations.

Requiring a separate and distinct plan for each supplier's harvesting operation(s) is likely to be very time consuming because biomass facilities will likely harvest resources from many small lots. The Commission should not require harvest plans for lots less than a harvested area of 25 acres. In addition, lots that are being managed by another forest management group should be exempt from the harvest plan requirement. If another forest management group is managing the lot(s), the Commission should only require biomass facilities to document for each applicable

tract of land, the owner, the forest manager, the location and any other pertinent information available regarding the harvest. Finally, any fuel derived from forest land clearing for rights-of-way and development should be exempt from the harvest plan requirement. Before the Commission approves final requirements for biomass certification, it should order DPS Staff to hold a technical conference with interested parties to determine the likely impacts of proposed requirements and whether they will promote or inhibit development of biomass renewable energy projects.

VI. THE COMMISSION SHOULD REQUIRE NYSERDA TO CONSULT WITH THE NYISO SO THAT IT MAY MONITOR AND REPORT ON ANY ADVERSE IMPACTS THE RPS HAS ON COMPETITIVE ENERGY MARKETS AND SYSTEM RELIABILITY AS PART OF THE COMMISSION'S PROPOSED MONITORING AND EVALUATION PROGRAM.

In comments submitted in the RPS proceeding before the Commission and administrative law judge, IPPNY and other parties urged the Commission to develop and administer the RPS in a manner that is consistent with, and does not undermine in any respect, the functioning of reliable, non-discriminatory, competitive energy markets in New York. The Commission demonstrated its commitment to ensuring that the RPS does not harm competitive markets in its RPS Order, where it adopted, as one if its seven RPS objectives, "competitive neutrality: develop an RPS compatible with competition in energy markets in New York State."[6] In the RPS Order, the Commission also ruled that system reliability "is of paramount importance and concern" and stated that it would closely monitor RPS implementation throughout its life for reliability impacts.[7]

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[6] RPS Order at 24.

[7] *Id*. at 69.

The RPS Order directed NYSERDA to establish a monitoring and evaluation ("M&E") program to ensure that administration of the RPS is transparent, efficient and verifiable. While the Proposed Rule proposes that NYSERDA assess the costs and benefits of the RPS program, it does not specifically require NYSERDA to monitor and evaluate the impacts of the RPS on competitive energy markets and system reliability in New York. The Commission should include in the final list of M&E activities a requirement that NYSERDA consult with the NYISO and report on any adverse impacts of the RPS on competitive energy markets and system reliability.

CONCLUSION

In light of the foregoing, the Commission should:

- order NYSERDA to evaluate bids and pay for RECs on a fixed price rather than a variable price basis, but if the Commission decides to adopt an approach with variable pricing, it should order NYSERDA to pay renewable resources a fixed REC price that is inversely indexed to annual average zonal LBMPs;
- make clear its strong preference for the auction format for procurement of most RECs;
- require NYSERDA to develop measures that ensure selected projects are timely constructed;
- adopt clear and concise guidelines on how it will determine whether existing renewable resources are eligible for RPS benefits;
- make the requirements for biomass certification less onerous;
- require NYSERDA to consult with the NYISO so that it may monitor and report on any adverse impacts the RPS has on competitive energy markets and system

reliability as part of the Commission's proposed monitoring and evaluation program.

Respectfully submitted,

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