

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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INTRODUCTION

On November 10, 2004, the New York State Public Service Commission (“Commission”) published a notice of proposed rule making, identified as 03-E-0188SA3, 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”), which was distributed to parties in Case 03-E-0188 via electronic mail on November 12, 2004, states that “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).”²

The Proposed Rule contemplates “an expedited or fast-track procurement process aimed at contracting with eligible resources with sufficient lead-time to capture the benefit of

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

² Proposed Rule at 1.

substantial PTC leverage for New York ratepayers” because the PTC is only available to projects that are in commercial operation at the time the PTC expires on December 31, 2005.³ The Proposed Rule states that awards must be made no later than the end of January, 2005 to allow time for developers to have facilities operational by the end of 2005. The Proposed Rule requests comments 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).

In response to the Commission’s request for comments on the Proposed Rule, Independent Power Producers of New York, Inc. (“IPPNY”)⁴ hereby submits comments on one issue that the Commission should address prior to the commencement of the first competitive solicitation for renewable resource attributes or renewable energy credits (“RECs”). The issue, which the Proposed Rule does not address, concerns how bids should be designed in a competitive solicitation and how incentives or premiums should be paid to renewable resources. Throughout the Commission’s RPS proceeding, IPPNY demonstrated that the RPS program must be designed in a way that will not undermine the competitive wholesale energy markets in New York. As discussed below, this result may only be achieved if the New York State Energy Research and Development Authority’s (“NYSERDA”) evaluation of bids and payment for RECs is on a fixed price rather than a variable price basis.

³ *Id.* at 2.

⁴ 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.

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 resolved by NYSERDA and Department of Public Service Staff in the implementation phase. The Proposed Rule, while proposing to authorize NYSERDA to use its discretion in choosing a procurement method, does not provide any details on the bid design and payment issue. The Proposed Rule simply states that regardless of the procurement option NYSERDA chooses, it "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."⁵

In comments submitted in the RPS proceeding, some parties advocated that a central procurement agency⁶ solicit bids in the form of a "total" price for RECs and energy. Under this total price proposal, which is also described as a contract for differences ("CFD") proposal, NYSERDA would commit to paying winning bidders their total bid price, or the "strike price," minus the locational based marginal price ("LBMP"). For example, if the winning bid is for \$80/MWh for the year 2006, and the LBMP received by the winning bidder averages \$50/MWh in year 2006, NYSERDA would pay the winning bidder \$30/MWh.

⁵ Proposed Rule at 6.

⁶ (now chosen to be NYSERDA)

Because the Proposed Rule is silent as to how bids should be designed and premiums should be paid and gives NYSERDA discretion to choose a procurement method, IPPNY is concerned that without clear orders from the Commission, NYSERDA will adopt a CFD approach for evaluating bids and awarding incentives for RECs. As demonstrated herein, such an approach will have significant adverse effects on the competitive wholesale market. These impacts can easily be avoided by using a better designed approach. Thus, a CFD approach 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 have their generation determined by natural forces such as wind and 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. 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 wind 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. 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 it will provide less installed capacity value and the second resource would provide more installed capacity value.

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 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 is not clear how 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' location.

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 will be able to assemble the resources and complete the analysis necessary to evaluate bids before winning bidders are selected by the end of January 2005. Moreover, 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.

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 assumption 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 honest 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.

Either of these approaches for determining the underlying value of proposed projects would be highly time-consuming and could not be implemented in the short time period remaining before the end of January 2005. As discussed above, it is unlikely that these approaches could be implemented in an objective manner in the long term.

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. THE PROPOSED RULE CONSTITUTES AN IMPERMISSIBLE DELEGATION OF RATE MAKING AUTHORITY TO NYSERDA.

While the Proposed Rule is silent on the bid evaluation process NYSERDA will employ, it is clear that the rate impacts of the bid process upon electricity prices will be directly flowed through to retail ratepayers. The Commission's silent delegation of the bid evaluation process to NYSERDA, without clear guidance on the evaluation process, amounts to an improper delegation of the Commission's jurisdiction to review and approve the rates and charges to the State's retail electric ratepayers.

Unlike the System Benefits Charge ("SBC"), which has been set and authorized by the Commission, under the RPS Order and the Proposed Rule, the bid evaluation process and REC payments would be left to NYSERDA's discretion without guidelines. As discussed above, potential use of a CFD price approach introduces further risk into the retail and wholesale markets.

Pursuant to its statutory obligation to ensure that retail rates are just, reasonable, and non-discriminatory, the Commission should review the REC bid evaluation process prior to implementation by NYSERDA to ensure that the concomitant costs to ratepayers will be just and reasonable. Once NYSERDA executes contracts with renewable resources, the Commission will have no choice but to flow through the costs of those contracts to ratepayers. Any risk of Commission interference with cost recovery will likely impair the ability of developers to finance their projects.

The need for the Commission's direction and oversight on the bid evaluation process is significant. A drop in the wholesale market value from the level NYSERDA assumed in its RPS estimate would cause the amount of the REC payments to grow substantially. For example, a

\$10/MWh change in wholesale prices due to fuel price fluctuations is well within the realm of reason over a period of a year or two years. If NYSERDA issued CFDs on the basis of estimating that it would be paying an average of \$5/MWh in REC premiums, an overall \$10/MWh drop in the wholesale value of the energy could easily result in NYSERDA making REC premium payments that are three times the level originally intended.

CONCLUSION

Based on the foregoing, the final rule must explicitly direct NYSERDA to evaluate bids and award REC payments on a fixed rather than a variable priced basis.

Respectfully submitted,

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