

December 22, 2004

Honorable Jaclyn A. Brillling
Secretary
State of New York
Public Service Commission
Three Empire State Plaza, 19th Floor
Albany, New York 12223-1350

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

Notice of Proposed Rulemaking published November 10, 2004 (SAPA ID No. PSC-45-04-00013-P)

Notice of Proposed Rulemaking published November 10, 2004 (SAPA ID No. PSC-45-04-00014-P)

Dear Secretary Brillling:

Enclosed for filing please find an original and five copies of the Comments of the New York Independent System Operator, Inc. on Proposed Rulemaking. In addition, please date-stamp the additional copy and return it to our messenger.

Thank you for your assistance in this matter.

Respectfully submitted,

/s/ *Karen Georgenson Gach*

Karen Georgenson Gach
Senior Attorney

cc: RPS List Server Subscribers (via e-mail)

Encls.

NEW YORK STATE
PUBLIC SERVICE COMMISSION

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

**COMMENTS OF THE NEW YORK INDEPENDENT SYSTEM
OPERATOR, INC. ON PROPOSED RULEMAKING**

Dated: December 22, 2004
Albany, New York

New York Independent System
Operator, Inc.
290 Washington Ave. Extension
Albany, New York 12203

NEW YORK STATE
PUBLIC SERVICE COMMISSION

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

**COMMENTS OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR,
INC. ON PROPOSED RULEMAKING**

On November 10, 2004, the New York State Public Service Commission (“Commission”) published two Notices of Proposed Rulemaking (“Notices”), identified as SAPA No. 03-E-1088SA2 and SAPA No. 03-E-1088SA3, in the *State Register*. These Notices indicate that the Commission is requesting comments on certain proposed measures intended to implement the renewable portfolio standard (“RPS”) that was adopted by the Commission by order issued September 24, 2004 (“RPS Order”). These proposed measures are described in the Express Terms for these SAPA Notices (“Express Terms”). The measures identified in the Express Terms for SAPA No. 03-E-1088SA3 are limited to a proposed expedited, initial facility certification processes and procurement models for Main Tier resources suitable under the market conditions created by the one-year extension of the federal Renewable Energy Production Tax Credit (“PTC”). The measures identified in the Express Terms for SAPA No. 03-E-1088SA2 address the entire implantation plan, not limited to the federal PTC.

The New York Independent System Operator, Inc. (“NYISO”) hereby submits its Comments on both Notices. The issues addressed in these Comments are not directly discussed within the Express Terms. However, these issues are critical to the RPS implementation process and should be considered by the Commission in adopting a procurement methodology.

I. The Final Rules Should Adopt Procurement Mechanisms that Expose Participants to Market Forces.

The Commission should consider the potential impacts of the procurement process on the competitive markets and avoid a process that may unintentionally distort those markets.

Significantly, the RPS Order is silent on how contracts between RPS resources and NYSERDA should be structured. However, this is an issue that the Commission should address before the procurement process begins. The NYISO is concerned with the potential impact of certain contract structures on the efficient operation of the wholesale power markets.

In particular, if RPS resources are permitted to enter into a type of Contract for Differences (“CFDs”) with NYSERDA, undesirable impacts on the wholesale markets could result. These contracts, supported by some parties in this proceeding, would require NYSERDA to pay the resource the difference between the LBMP and the total contract amount, guaranteeing that the resource receive its total bid price. This results in a variable premium or subsidy that floats with changes in LBMP revenues. This structure improperly insulates the RPS resources from the normal incentives provided by market forces to produce when LBMPs are higher than the resource’s incremental production costs and to cease production when LBMPs fall below production costs.

Exacerbating the NYISO’s concern about the incentives provided by some contract structures is the fact that a significant percentage of the RPS resources could be located west of the Central-East constraint, where most of New York’s lower incremental cost generating units are located. According to the NYISO’s 2003 Load and Capacity Data report, 3,008 MW of coal, 3,103 MW of nuclear, and 3,537 MW of hydropower resources are located in the western New York Zones A-D. Most of this 9,648 MW is relatively low cost, with hydro resources having

essentially zero or even negative incremental costs. These resources can reasonably be expected to bid into the NYISO's energy markets as "price takers" with very low energy bids.

The addition of another 2,000 MW of low incremental cost RPS resources in the same region will place further downward pressure on Western New York LBMPs. In an effort to get its units scheduled, an RPS resource might be forced to submit negative bids. While negative bids would not affect RPS resources if their contracts provide a "floating premium" that varies with LBMPs, it could have an adverse impact on other price takers. Negative bids can send the energy price negative and require energy suppliers to pay load to take power. The NYISO encourages the Commission to avoid contract designs that insulate RPS suppliers from routine market forces or provide perverse operating incentives.

The Commission should, therefore, consider a procurement mechanism that seeks to minimize overall REC costs rather than one that minimizes the REC premium alone. The NYISO also encourages the Commission to adopt mechanisms that encourage new RPS resources to locate in areas where additional energy is most needed and to operate when prices are at levels that permit recover of operating costs for these units. While structuring the contracts in this way could shift some timing and locational risks to RPS developers (since resource location and timing are often dictated by resource availability) and could result in higher RPS premiums, it would better allocate the risks between RPS developers.

Accordingly, it is vitally important that the Commission ensure that the procurement mechanism it establishes expose those participating in it to market forces. This is important to maintain the health of New York's competitive wholesale electric market. Any RPS procurement process has to be specifically designed to avoid creating unintended and harmful financial consequences for non-subsidized market participants and customers.

II. The Final Rule Should Require that Interim Requirements on Intermittent Resources Be Applied During the Procurement Process.

The impact of intermittent resources on reliability and wholesale markets should be reflected in the procurement process. The NYISO acknowledges the Commission's desire to move ahead with financial incentives in the near term and understands the time limitations involved, particularly in developing an expedited procurement process in light of the extension of the PTC. This expedited schedule, however, will result in procurement and other RPS processes being implemented before the Phase II Report is issued and before the results of the Phase I Report can be fully implemented.¹ In this context, the Commission should impose certain interim requirements on intermittent resources, reflecting the results of the Phase I Report and incorporating the results of the Phase II Report, in order to ensure reliability.²

The Commission should impose a statewide interim limit on the amount of wind capacity that is eligible for RPS incentives.³ Further, the Commission should impose interim locational limits on RPS incentive eligibility for new projects proposing to locate in those Load Zones where the total megawatts of the proposed project, and those already sited and/or approved, approaches the physical limitations of the transmission system, as provided in the Phase I Report.⁴ These limits should be applied by NYSERDA during the procurement process.

¹ The RPS Order requires that Commission Staff review and analyze the Phase II Report, when available, and make recommendations regarding modifications to the RPS program that are required to maintain system reliability. RPS Order at 69. It is critical that the findings of the Phase II Report be accommodated by the RPS program.

² The NYISO is evaluating the impacts of intermittent resources on the efficiency and effectiveness of the wholesale market. The NYISO's independent Market Advisor is currently evaluating RPS-resource procurement options that would bring these resources on-line in a manner that minimizes adverse impacts on the wholesale market's efficiency and competitiveness. The NYISO will provide the resulting conclusions and recommendations as soon as they are available.

³ If adopted, limitations on new development should remain in place until the Phase II Report is analyzed and its recommendations are incorporated into both the Commission's, and the NYISO's, analysis.

⁴ Table 4.5 of the Phase I Report provides the maximum megawatts, by Load Zone, that could be safely sited, given the thermal limits of the transmission system. These are interim numbers, however, because the NYISO does not

In determining appropriate interim statewide incentive limits the Commission may take guidance from the current limits established in NYISO tariffs that identify the set of intermittent resources exempt from the operation of certain market rules. NYISO's tariffs presently exempt existing, and up to 500 MWs of new, intermittent resources from the operation of certain market rules that would otherwise penalize units that cannot control their fuel resources.⁵

The Commission should limit the RPS eligibility of wind projects to those that incorporate the Interconnection Best Practices listed in the Phase I Report.⁶ The NYISO is developing the process by which these Best Practices will be incorporated into the NYISO interconnection process. Therefore, it is appropriate to limit RPS eligibility to projects that comply with those practices.

Finally, the award of RPS incentives should be conditioned on the requirement that the resource implement recommended practices contained in the Phase II Report. Phase II will recommend, among other things, changes to reliability standards, criteria, and rules for planning and operating the New York transmission system (*e.g.*, any special requirements or conditions that should be placed on wind generation development) to meet the overall needs of New York for a reliable electric grid. Phase II will also refine the conclusions made in Phase I of the study. The requirement that RPS resources comply with the results of the Phase II Report will not disadvantage RPS resources since the Phase II Report should be complete early in 2005.

III. Conclusion

yet know whether more restrictive zonal limitations on wind development may be required to mitigate or avoid operational problems. It may not be prudent to encourage new development in areas where operational issues, to be studied more thoroughly in Phase II, may ultimately preclude it.

⁵ This exemption is made available to intermittent resources existing at the inception of the NYISO.

⁶ Phase I Report, p. 2.3. These Best Practices are the following: (1) a voltage regulation at the point-of-interconnection, with a guaranteed power factor range, (2) low voltage ride-through, (3) a specified level of monitoring, metering, and event recording, and (4) power curtailment capability.

The New York Independent System Operator, Inc. respectfully requests that the Commission implement procurement practices that are consistent with these Comments.

Respectfully submitted,

/s/ Karen Georgenson Gach

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