NEW YORK STATE
PUBLIC SERVICE COMMISSION

Case 15-E-0302 - Proceeding on Motion of the Commission to Implement a Large-Scale Renewable Program and a Clean Energy Standard.

COMMENTS OF INDEPENDENT POWER PRODUCERS OF NEW YORK, INC.

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On January 26, 2016, the Staff of the Department of Public Service ("DPS") filed its *Staff White Paper on Clean Energy Standard* ("White Paper") with the New York State Public Service Commission ("Commission") in the expanded form of the above-captioned case. The Commission initiated this case, limited in its original form to addressing renewable resources, upon the filing by the New York State Energy Research and Development Authority ("NYSERDA") of its report entitled *Large-Scale Renewable Energy Development in New York: Options and Assessment* ("NYSERDA Report") with the Commission on June 1, 2015. The NYSERDA Report examined the benefits and drawbacks of a series of options to serve as the model for the continued development and procurement of large-scale renewable ("LSR") energy resources.

On December 2, 2015, the Governor directed DPS Staff to develop a Clean Energy Standard ("CES") "to cost effectively and efficiently achieve our environmental objective of reducing carbon emissions 40% by 2030," which may be accomplished by mandating that 50% of all electricity used in the State must be generated from renewable energy resources by 2030 ("50 by 30 mandate") as identified in the 2015 State Energy Plan ("SEP"). On January 21, 2016, the Commission expanded the scope of the LSR proceeding to encompass the CES, and it

ordered Staff to develop a White Paper for stakeholder comment which would form the basis for Staff to propose a CES program to the Commission to consider at its June 2016 session.[1]

In its White Paper, Staff makes a variety of recommendations that are intended to meet the 50 by 30 mandate. Staff states that the SEP's goals are some of the most ambitious clean energy targets in the country, will require "concerted action across a range of issues," and must be addressed "with the paramount concern of maintaining customer interests."[2] These targets, which include the 50 by 30 mandate, a 40% reduction in greenhouse gas emissions from 1990 levels by 2030, and 600 trillion Btu in energy efficiency gains by 2040, are intended to drive the State towards the longer-term goal of decreasing greenhouse gas (including carbon dioxide ("carbon")) emissions from all sources within the State by 80% below 1990 levels by 2050. Per Staff, interim goals would be set to produce year-over-year carbon reductions leading to the 40% carbon emission reduction by 2030, which level would then be maintained under the CES program for the foreseeable future. In addition to meeting the 50 by 30 mandate, Staff makes proposals in the White Paper that are intended to achieve other policy objectives, including supporting the construction of new renewable generation in New York, preventing "backsliding" by supporting existing non-emitting renewable and certain existing non-emitting nuclear resources, and promoting the progress of the Commission's Reforming the Energy Vision ("REV") market objectives to encourage consumer-oriented, market-based solutions to expand the development of distributed energy resources ("DER").

[1] Case 15-E-0302, *In the Matter of the Implementation of a Large Scale Renewable Program*, Order Expanding Scope of Proceeding and Seeking Comments (Jan. 21, 2016).

[2] White Paper at 1–2.

Pursuant to the Secretary's CES Notices, Independent Power Producers of New York, Inc. ("IPPNY") hereby submits its comments on the White Paper.[3] IPPNY is a not-for-profit trade association representing the independent power industry in New York State. Its members include nearly 100 companies involved in the development, operation, and ownership of electric generating facilities and the marketing and sale of electric power in New York's electricity markets.[4] IPPNY submitted comments on the NYSERDA Report on August 12, 2015.[5] IPPNY's fundamental interest is in the continued development and enhancement of reliable and efficient integrated regional wholesale competitive electricity markets. With respect to the White Paper, IPPNY's interest lies mainly in ensuring that the Commission's CES and LSR policies are developed in a manner that are consistent with, and do not undermine in any respect, the functioning of non-discriminatory, competitive energy markets in New York and its surrounding regions.

As discussed below, the Commission should take the following actions with respect to Staff's recommendations in its White Paper:

1. The Commission should adopt Staff's proposal that retail load serving entities ("LSEs") be required to supply a defined percentage of their retail loads with supply generated by new and existing renewable resources defined in Appendix C (the "LSE Mandate").[6] At the same time, the Commission should be consistent with the value it

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[3] Case 15-E-0302, *supra*, Notice Soliciting Comments and Providing for Technical Conference and Public Statement Hearings (Jan. 25, 2016); *see also* Case 15-E-0302, *supra*, Notice of Comment Period for Staff White Paper and Cost Study (Apr. 8, 2016) (collectively, "CES Notices").

[4] IPPNY's comments do not necessarily represent the positions of each of its members.

[5] Case 15-E-0302, *supra*, Comments of Independent Power Producers of New York, Inc. (Aug. 12, 2015) ("IPPNY August Comments").

[6] Appendix B contained within the Commission's September 24, 2004 order addresses eligibility under the RPS program. Case 03-E-0188, *Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard*, Order Regarding Renewable Portfolio Standard (Sept. 24, 2004), Appendix B. The Commission's April

places on carbon reduction by also incorporating a market-based approach that internalizes the cost of carbon and other emission allowances in wholesale energy prices and allows zero and low emission resources to benefit from their lower carbon emissions profile, consistent with the SEP's goals.

2. If the Commission adopts Staff's recommendation to make out-of-State renewable resources eligible to participate in the CES program, the Commission should clarify that out-of-State resources owned or supported, directly or indirectly, by government entities are not eligible.[7]

3. If the Commission adopts an administrative construct in the short term that includes a payment stream to nuclear facilities for the value of their zero carbon emission electric generation, the Commission should provide for the eligibility of all operating nuclear facilities because the value of zero emission credits ("ZEC") to stabilize current carbon emissions today for the system as a whole and to assist the State in meeting its 40% carbon reduction end state is the same whether or not a facility is financially distressed or has completed its license renewal proceeding.

14, 2005 order allowed for a process to establish eligibility of additional technologies and resources under the RPS program. Case 03-E-0188, *supra*, Order Approving Implementation Plan, Adopting Clarifications, and Modifying Environmental Disclosure Program (April 14, 2005). Consistent with the discussion in IPPNY's August 13, 2015 comments in this Case 15-E-0302, in determining eligibility under the CES program, the State should build upon the list of technologies that are eligible under Appendix B of the Commission's September 24, 2004 order to include other technologies and explicitly to provide equal treatment and opportunity to emerging technologies such as high-efficiency linear generators.

[7] Of significant concern, in its Cost Study, DPS Staff unilaterally elected to study a "high imports" sensitivity that is predicated upon a 1,000 MW line running from Canada into New York State, the costs of which are assumed to be "100% socialized." Case 15-E-0302, *supra*, Clean Energy Standard White Paper – Cost study (Apr. 8, 2016), at 212 ("Cost Study"). The Commission should prohibit such an approach because clean energy suppliers will not be able to compete on a level playing field, thereby producing inefficient results. Note that unless specifically stated otherwise, IPPNY's simple references to the Cost Study are not intended to convey that IPPNY is opining at this point on the merit of the Cost Study, and IPPNY intends to submit separate comments on the Cost Study by the due date of June 6, 2016.

4. The Commission should reject Staff's proposal that electric distribution utilities ("EDCs") be required to purchase some or all energy from renewable facilities under bundled power purchase agreements ("PPAs"), because, as IPPNY has long documented, bundled PPAs could insulate LSRs from conducting their operations consistent with competitive market price signals and harm the wholesale competitive electricity market. The Commission should continue to call for renewable energy credits ("RECs") on a fixed price per kWh basis. This approach also would ensure that the future procurement of these resources under the CES program would not begin to cause or contribute to out-of-merit dispatch or otherwise alter the current practice of operating the electric system on the basis of economic dispatch subject to meeting reliability concerns. This approach could include the long-term, REC-only contracts that NYSERDA has executed to date and which Staff recommends NYSERDA continue to execute as long as it is structured to align with implementation of a market-based CES program. No matter which structure is chosen, however, such contracts should include provisions that will ensure that these resources, like their predecessor RPS resources, will continue to have an economic interest in responding to market prices, which is necessary to support market efficiency and reliability. In the IPPNY August Comments, IPPNY questioned the Commission's jurisdiction to order EDCs to enter into contracts with renewable resources to acquire energy at wholesale because the United States Courts of Appeals for the Third and Fourth Circuits held that states are preempted by the Federal Power Act ("FPA") from ordering utilities to sign contracts with wholesale generators that

establish a wholesale rate.[8] On April 19, 2016, the United States Supreme Court affirmed the decision of the Court of Appeals for the Fourth Circuit.[9] While IPPNY continues to review the Hughes decision and reserves the right to supplement its position in its White Paper reply comments, any administrative construct the Commission adopts for the CES program in the short term to provide incentives to non-emitting resources (not otherwise socialized as per footnote 7) must be structured in a way that is consistent with *Hughes* and it must provide for all non-emitting resources to be eligible to participate in the program applying the same eligibility requirements.

5. The Commission should adopt Staff's recommendation that the Commission continue its long-standing policy generally prohibiting EDCs from owning generation, including renewable generation. The Commission should also prohibit the EDCs' non-regulated affiliates from owning generation in the EDCs' service territories and reject Staff's recommendation that utility-owned generation ("UOG") be permitted in exceptional circumstances consistent with the Commission's DER ruling in its REV Framework Order because the underlying facts and circumstances differ for DER versus renewable resources.[10] Specifically, the Commission's ruling in its REV Framework Order assumed that EDCs would not be able to exercise vertical market

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[8] *See PPL EnergyPlus, LLC v. Solomon*, 766 F.3d 241 (3d Cir. 2014); *PPL EnergyPlus, LLC v. Nazarian*, 753 F.3d 467 (4th Cir. 2014). The New York Court of Appeals also held that the Commission is preempted by the FPA from ordering utilities to sign contracts with wholesale generators that are not qualifying facilities under the Public Utility Regulatory Policies Act of 1978. *Consol. Edison Co. of N.Y., Inc. v. Pub. Serv. Comm'n. of N.Y.*, 63 N.Y.2d 424 (1984), *appeal dismissed*, 470 U.S. 1075 (1985).

[9] *Hughes v. Talen Energy Marketing, LLC*, Nos. 14–614, 14–623, 2016 WL 1562481 (Apr. 19, 2016).

[10] Case 14-M-0101, *Proceeding on Motion of the Commission in Regard to Reforming the Energy Vision*, Order Adopting Regulatory Policy Framework and Implementation Plan (Feb. 26, 2015) ("REV Framework Order").

power ("VMP") by owning DER because DER does not compete in bid-based markets. In direct contrast, LSRs compete in bid-based markets. Thus, EDC and EDC-affiliate ownership in the LSR context raises a significant threat of VMP that requires the Commission to impose tighter EDC restrictions on LSR ownership than DER ownership.

6. The Commission should not make a decision on the proposals included in the White Paper until the State Resource Planning Study ("SRP Study") that is being conducted jointly by the New York Independent System Operator, Inc. ("NYISO") and the EDCs to examine the effects of various public policies, including the 50 by 30 mandate and the State's compliance with the federal Environmental Protection Agency's ("EPA") Clean Power Plan ("CPP"), is completed. The Commission cannot reasonably be in a position to make sound policy decisions on the major issues before it, which could have significant cost impacts and reliability implications, until it has such relevant information at hand.

In compliance with the January 25 Notice, IPPNY's comments are organized in accordance with the sections and subsections of the White Paper.[11]

II.A.1 50 by 30 Goal, Obligation, and Compliance Mechanism Calculating the 50 by 30 Mandate

In its White Paper, Staff recommends that the CES goals be met by requiring all retail LSEs, including EDCs serving in their capacity as the commodity provider of last resort, to meet the LSE Mandate.[12] Staff explains that the LSE Mandate is consistent with the RPS approaches

[11] IPPNY's silence regarding Staff's recommendations on other topics in the White Paper should not be construed as IPPNY's consent to these recommendations.

[12] White Paper at 10.

in neighboring states and will enable efficient trading among the states to achieve the most cost-effective renewable energy portfolio. Staff states that the LSE Mandate serves the important policy goal of placing "compliance costs primarily in the generation supply charges where they are most appropriately applied."[13] Staff further states that, "[s]ince emissions result from generation, emission reductions can best be achieved when their cost is reflected in energy prices."[14]

Staff proposes that LSEs demonstrate compliance with the LSE Mandate by acquiring tradable RECs produced by existing and new eligible renewable resources to meet annual REC goals at prices effectively capped by an Alternative Compliance Payment ("ACP") price."[15] Staff recommends that the Commission perform triennial reviews to establish the annual REC targets on a triennial basis, with goals established for 2017, 2020, 2023, 2026, and 2029. Staff proposes that the Commission only set the goals for 2017 and 2020 and adjust the ACP periodically to reflect the experience of the markets. To incentivize financing, Staff proposes to provide further clarity that, once achieved in 2030, the CES program will be used to maintain the 2030 levels "for a sufficient period."[16] Staff recommends that it provide, in consultation with NYSERDA, an Implementation Plan for review and comment within 30 days after issuance of the Commission's order in this proceeding addressing these and other issues.[17]

Subject to the two considerations set forth below, IPPNY supports, as an interim measure, Staff's proposal to shift the procurement model away from the existing non-binding

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[13] *Id.*

[14] *Id.* at 11.

[15] *Id.* at 14.

[16] *Id.* at 25.

[17] No time frame is provided for the Implementation Plan to be put into place, although the White Paper specifies that ZEC payments would begin April 1, 2017.

centralized approach to an administrative construct where binding compliance obligations are placed on LSEs subject to an ACP cap based on Commission-established annual goals. The LSE Mandate will send a clear signal to LSR developers and operators of New York's commitment to compensate clean energy suppliers for the value of the service they are providing to the system, which will encourage investment in project development and operations to meet the Commission's goals in a timely manner and ensure that consumer expenditures are bounded by the Commission's ACP cap. For the CES program to efficiently and cost-effectively meet the identified carbon reductions, participation should be open to all existing and new, low and zero emission resources on equal terms. IPPNY supports Staff's proposal that existing renewable resources be eligible to participate in the CES program as it will help ensure that existing progress towards the State's goal is maintained and that associated investment is retained in a viable and sustainable manner in the State. IPPNY also supports Staff's recommendation that the Commission perform triennial reviews to determine future targets and necessary adjustments to the ACP cap to reflect changing market conditions.

Adoption of Staff's proposal must be guided by two considerations. First, as the 50 by 30 mandate will dramatically increase the level of intermittent renewable resources that will be relied upon to serve load, it is also critically important that the Commission study the potential impacts and costs of this level of renewable generation on the electric grid, as well as the ability and cost of any modifications that are necessary to protect the reliability of the electric system. IPPNY understands that Staff has asked the NYISO and the EDCs to conduct the SRP Study to examine the effects of various public policies, including the 50 by 30 mandate and the State's compliance with the EPA's CPP, but that this study will not be completed until August 2016. The Commission's suggestion that it will issue a ruling on the White Paper at its June session,

two months before completion of the SRP study, puts the proverbial cart before the horse. The Commission should not make major policy decisions that could have significant cost impacts and reliability implications until it has all relevant facts before it, particularly given the fact that the base case and sensitivity case results have yet to be issued, and, thus, there is no study information available at this juncture.[18] Indeed, in light of the Commission's subsequent proposal to use a temporary maintenance tier-type contract approach as an interim measure for addressing—to the extent possible—more immediate timing considerations that a subset of nuclear resources may be facing, a rush to judgment in the main CES case is all the more ill-advised.

Second, it is critical that the State have a consistent carbon price signal to ensure that resources are economically dispatched, foster needed investment to attract new, and retain existing, renewable and other low or non-emitting energy resources, and encourage efficiency improvements in all existing resources that help lower emission rates. All resources (both at the wholesale level through market-based programs that internalize the price of carbon in energy prices and LSR programs and at the distribution level as a result of the implementation of REV's outcomes) should see the same carbon price signal to promote efficient operation of and investment in clean energy sources. While IPPNY supports Staff's proposed LSE Mandate as a short-term measure to meet CES goals, the Commission's goal should be to promote reduced carbon emissions from the entire generation portfolio—as well as in other sectors of the economy—and to provide incentives for facilities to make improvements that reduce their emission rate of carbon/MWh below their historical rates. Thus, while moving forward with the

[18] *See* Leka Gjonaj, *New York State Resource Planning Analysis*, DPS (Jan. 27, 2016), http://www.nyiso.com/public/webdocs/markets_operations/committees/mc/meeting_materials/2016-01-27/Agenda%2004_NYSDPS%20SRP%20Presentation.pdf (presentation to the NYISO Management Committee base case and sensitivity case results which were to have been issued in February and March, respectively).

CES as an interim measure in the short term, the Commission should at the same time adopt a market-based approach that provides a single, market-wide carbon price by internalizing the value of carbon in wholesale energy prices.[19] IPPNY further encourages the Commission to recognize the importance of pursuing cost-effective opportunities for carbon reductions in other sectors of the economy (*e.g.*, transportation and buildings), many of which may prove to be lower cost, more effective, and less prone to unintended, negative consequences than over-reliance on carbon reductions from the electric power sector.

The NYISO energy markets properly allow market participants to reflect the cost of carbon emission allowances, as well as other monetized environmental emissions, into their marginal cost of energy production, providing some relative benefit to low or zero emissions energy sources. This approach establishes a visible value for low or zero emission sources, creating an efficient and cost-effective means for all producers and consumers to factor the cost of emissions into economic decision-making in ways that spur innovation, minimize the cost of controlling emissions, maintain electricity system reliability, and work in harmony with the least cost dispatching principles that are critical to the operation of the wholesale competitive electricity markets.

While Staff correctly recognizes that "emission reductions can best be achieved when their cost is reflected in energy prices,"[20] its proposal does not actually incorporate the value of emissions reductions into energy prices. Instead, it simply slides the individualized per kWh assessment from being collected as a surcharge on all EDC bills to being captured as a surcharge on commodity bills collected by LSEs. Failing to pay resources for the value of carbon

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[19] IPPNY acknowledges that the State participates with other states in the Regional Greenhouse Gas Initiative ("RGGI"), which is the sole State program intended to internalize the value of carbon in energy prices.

[20] White Paper at 11.

emissions reductions as an actual component of the competitive electricity market price itself distorts market outcomes by sending incorrect signals to the units that receive all their revenues from the market.

Further, Staff's proposed LSE Mandate ultimately may result in compensatory carbon increases across the remainder of the States that participate in RGGI. Any reduction in carbon emissions in New York resulting from the CES may simply allow greater emissions in other RGGI states as generators in other states could purchase the allowances that New York generators would have otherwise purchased. New York could avoid this result by reducing the amount of allowances made available for sale through RGGI to prevent generators in other states buying them and compensating for the CES-based carbon reductions in New York. However, there is nothing in the White Paper indicating that the State will reduce its allocation of RGGI allowances or seek to reduce the region-wide level of RGGI allowances. Nor does the Cost Study reflect this strategy as a cost of the CES program. The reduction in the RGGI allowance clearing price as a result of a surplus of allowances (if the RGGI program is not changed by the RGGI states to reduce the amount of RGGI allowances offered for sale by New York to reflect lower emissions in New York arising from an increase in non-emitting resources under the CES program) would also worsen the failure to internalize the true cost of the carbon emissions reductions by all types of electric generating facilities in market prices. In contrast, pursuing the emissions reductions through a cap and trade program would result in an appropriately higher valuation for carbon allowances and increased revenues for New York from the sale of allowances.

II.A.2 Eligibility and Tiers

To reduce compliance costs for LSEs and consumers, Staff recommends that the Commission allow renewable generation deliverable to the NYISO's control area to be eligible to participate in the CES program so long as out-of-State resources obtain the necessary transmission rights to deliver their power into New York. If the Commission adopts Staff's recommendation, the Commission should clarify that out-of-State resources owned or supported, directly or indirectly, by government entities are not eligible to participate in the CES program. At the Commission's February 26, 2016 Technical Conference, Staff stated that they view large-scale Canadian hydro as a qualifying resource under the White Paper. As IPPNY repeatedly has demonstrated, New York should not adopt policies that could lead to New York State electricity consumers subsidizing—or providing an outlet for the product of—foreign governments' efforts to build massive energy facilities. Government-owned projects, or projects whose costs are socialized, should not be eligible to participate in the CES program. Allowing a project subsidized by a foreign government, directly or indirectly, to compete with merchant projects raises the same unlevel playing field dynamic as UOGs described below, and, thus, should be proscribed for the same reasons.[21] Moreover, such massive, large-scale hydro projects are enormous construction projects at distant locations far from New York and create vast carbon footprints during such construction that would undermine the very goals the CES was intended to achieve.

II.B. Nuclear Tiers/II.C. The Role of Long-Term Contracting Mechanisms

Staff proposes in the White Paper that the Commission require EDCs to acquire a designated level of bundled energy and/or capacity and RECs through long-term PPAs to enable

[21] The Cost Study identifies the Champlain Hudson Power Express transmission project as one candidate. By its own estimate, the project's costs exceeded $2 billion.

a sufficient level of development of certain new renewable generation.[22] Staff states that the amount of mandatory EDC PPAs should be set at a level that reduces compliance costs while allowing for the development of a self-initiated market.[23] Staff also recommends that NYSERDA continue its solicitations for contracts to purchase RECs during the initial years of the CES and that such RECs be allocated or sold to LSEs for the fulfillment of their CES obligation.[24]

The Commission should reject Staff's proposal that EDCs be required to enter into long-term PPAs. Basing public policy programs on pricing mechanisms that insulate generators from competitive market prices, such as long-term, fixed-price energy contracts, can make generators participating in these programs indifferent to market prices that may signal the need to reduce output or curtail service to assure the reliability of the electric system. Markets work best where all participants have a stake in market rules and prices.

In the IPPNY August Comments, IPPNY cited to recent United States Court of Appeals decisions that held that states are preempted by the FPA from ordering utilities to sign contracts with wholesale generators that establish a wholesale rate. As discussed, *supra*, the United States Supreme Court in *Hughes* affirmed the decision of the Fourth Circuit Court of Appeals, which held that Maryland is preempted from requiring EDCs to enter into contracts that are conditioned on participating in the wholesale capacity auction and are tied to wholesale market prices.

While IPPNY continues to review the *Hughes* decision and reserves the right to supplement its position in its White Paper reply comments, given that IPPNY has only had a few

[22] White Paper at 36–37.

[23] *Id.* at 40.

[24] *Id.* at 41.

days to consider this decision before these initial comments were due, *Hughes* further supports IPPNY's position that the Commission should rely on a market-based structure for the CES program that internalizes the value of carbon in wholesale energy prices. Any administrative construct the Commission adopts for the CES program in the short term to provide incentives to non-emitting resources must be structured in a way that is consistent with *Hughes*, and it must provide for all non-emitting resources (not otherwise socialized as per footnote 7) to be eligible to participate in the program applying the same eligibility requirements.

IPPNY supports Staff's proposal that NYSERDA continue its solicitations for contracts to purchase RECs because this approach has the least impact on the competitive wholesale market, assuming that the contracts are for RECs at a fixed price and they are structured to align with the implementation of a market-based CES program.[25] However, it is critical for these fixed price per kWh contracts to be structured properly. By its very design, the wholesale electricity market structure in New York values energy when and where it is needed most. By and large, traditional generators within the NYISO bid positive values for incremental energy because they can save fuel costs by reducing their generation levels. At any time that the NYISO energy market produces a negative price, the market is indicating that one or more transmission elements on the electric system are overloaded and the NYISO does not have sufficient generation that can be reduced quickly enough to relieve the overload. In those instances, the only way that the NYISO can relieve the overload is to reduce the generation with the lowest variable cost. Requiring resources to be subject to the real-time prices ensures that they are serving their own best interests by reducing energy when that response is needed by the system.

[25] To the extent the Commission has fallen short of meeting its full renewable goals through NYSERDA's central procurement auction, the limiting factors have been the budget and frequency of auctions, not the lack of interest from project developers.

Further, if generators are not responsive to market price signals and continue to operate when their output may threaten system reliability, the NYISO can be forced to take out-of-market actions to maintain the reliability of the system. The costs of the NYISO's actions are not reflected in market prices but are recovered in additional, unhedgeable uplift payments from consumers. Failing to structure this program correctly will ultimately distort competitive market price signals, harm the efficiency of the market, and be more expensive for consumers.

Therefore, the Commission should specify that the fixed price per kWh contracts must be structured to ensure a resource's payments reflect market prices so that it will be in the resource's economic interest to reduce output in the face of negative prices, which is the action needed by the system. Thus, the Commission should prohibit payments from being made during hours in which prices at the generator's location are less than or equal to zero. Like all other resources participating in the NYISO's energy market, these resources also should be required to make payments to the NYISO if they do not follow NYISO market signals and continue to produce energy when prices are negative. This approach would ensure that resources are not encouraged to operate when the system has too much generating capacity on-line. The Commission should, thus, order Staff to include a procurement approach in its Implementation Plan that reduces energy risk to developers while ensuring resources are responsive to fluctuating wholesale energy market prices.

II.C.4 Utility Ownership and Self-Initiated Market Development

In its White Paper, Staff states that one of the most contested issues in the LSR proceeding is whether the Commission should permit UOG. Staff states that "the debate is with respect to activities of the utilities' regulated distribution companies, not their non-regulated

affiliates."[26] Staff indicates that non-restructured or partially restructured states permit UOG but that UOG is not permitted, with very limited exceptions, in the Northeast.[27] While it suggests that EDCs may have a lower cost of capital than private investors and that EDCs may have an ability to benefit from federal tax credits, Staff acknowledges that the competitive threat of UOG in New York may discourage private investment in the State "and the effect will be less rather than more competitive efficiency."[28] Staff therefore recommends that, to encourage competitive entry of renewable resources, the Commission should "adhere to the principles articulated in the Framework Order wherein utility ownership of generation is only permitted in exceptional circumstances where there are demonstrable consumer benefits that could not otherwise be achieved."[29]

Staff proposes, however, that EDCs be allowed to own generation if the private market does not develop "sufficient levels of instate resources."[30] Staff also recommends that EDCs be permitted to invest in renewable projects "to lower costs of compliance with the CES while at the same time demonstrating how the utility investment will advance and not inhibit private investment."[31]

In the REV Framework Order, the Commission found that the risk of EDC ownership of DER undermining markets was greater than the potential benefit of EDC ownership to accelerate market growth. The Commission concluded that EDC ownership was contrary to REV's basic tenet that competitive markets and risk-based capital should be relied on to finance development,

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[26] White Paper at 41.

[27] *Id.* at 43.

[28] *Id.*

[29] *Id.* at 44.

[30] *Id.*

[31] *Id.*

as opposed to ratepayer funding, and that potential EDC ownership would chill private investment due to the EDCs' incumbent advantages. The Commission stated that "[m]arkets will thrive best where there is both the perception and the reality of a level playing field, and that is best accomplished by restricting the ability of utilities to participate."[32]

Contrary to Staff's statement in its White Paper that the Commission found in its REV Framework Order that EDC ownership of DER "would impose market power concerns,"[33] the Commission determined that the VMP concerns identified in the context of the restructuring of wholesale markets are not currently present with respect to DER because DER will be valued through the use of tariffs rather than bid-based auctions.[34] The Commission's primary reason that it generally prohibited EDC ownership of DER was that it would chill private investment because EDCs would be guaranteed cost recovery while private investors would have no such guarantee. Based on its findings in its REV Framework Order, the Commission adopted certain exceptions to the Commission's policy prohibiting EDC ownership of generation. The Commission ruled that EDC ownership of DER will be allowed under the following circumstances:

> 1) procurement of DER has been solicited to meet a system need, and a utility has demonstrated that competitive alternatives proposed by nonutility parties are clearly inadequate or more costly than a traditional utility infrastructure alternative;
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> 2) a project consists of energy storage integrated into distribution system architecture;
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> 3) a project will enable low or moderate income residential customers to benefit from DER where markets are not likely to satisfy the need; or

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[32] REV Framework Order at 67.

[33] White Paper at 43.

[34] REV Framework Order at 66.

4) a project is being sponsored for demonstration purposes.[35]

The Commission should make clear in its order adopting a CES that EDC and EDC-affiliate ownership of LSRs raises significant threats of VMP that requires the Commission to impose tighter restrictions on such ownership than it did for EDC ownership of DER. Most of the renewable generation that will likely be developed to meet the CES goals will be LSRs that will participate in the competitive wholesale markets. Nowhere in its White Paper does Staff address the extensive discussion in the IPPNY August Comments that demonstrated that UOG is contrary to the Commission's long-standing, pro-competition policies implemented and reaffirmed over the past twenty years to protect the market from the exercise of VMP. As IPPNY discussed in the IPPNY August Comments and addresses more fully below, a crucially important aspect of the Commission's pro-competition policies is that transmission and distribution ("T&D") should be separated from generation to eliminate the potential that EDCs that own generation could exercise VMP to the detriment of wholesale competitive electricity markets and consumers.

The Commission's VMP Policy "established a rebuttable presumption that ownership of generation by an affiliate of a utility would unacceptably exacerbate the potential for vertical market power."[36] The Commission stated:

> 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[n] [EDC] with an affiliate owning generation may, in certain

[35] *Id.* at 70.

[36] Cases 96-E-0900 et al., *In the Matter of Orange & Rockland Utilities, Inc.'s Plans for Electric Rate Restructuring Pursuant to Opinion 96-12*, Statement of Policy Regarding Vertical Market Power (July 17, 1998), App. I, at 1–2 ("VMP Policy Statement").

> circumstances, be able to adversely influence prices in that generator's market to the advantage of the combined operation.[37]

The Commission identified the potential for VMP in two instances. First, VMP could be exercised when an EDC owns generation in its own service territory. The Commission was concerned that the EDC could use its control of the T&D system to favor its own generation or thwart its competition by either lowering competitors' revenues or raising their costs. Second, VMP could be exercised when an EDC owns generation that is located on the exporting side of a transmission constraint. The Commission was concerned that the T&D utility could use its control of the transmission system to increase constraints and raise the value of its generating assets.

The Commission found that, in a wholesale or retail competitive model, generation and energy service functions should be separated from T&D, wherever feasible, to eliminate concerns related to the exercise of VMP and best meet the interests of ratepayers. The Commission determined that total divestiture of generation was the clearest way to allay concerns about VMP and avoid anti-competitive behavior (such as favored treatment of affiliates and cross-subsidies among affiliates in both competitive and monopoly environments).[38] Finding that separating ownership of generation from T&D was preferable to relying on regulatory controls and enforcement mechanisms, because the latter was incapable of timely identifying and remedying the potential for abuse, the Commission established a rebuttable

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[37] *Id.* App. I, at 1.

[38] Cases 94-E-0952 et al., *In the Matter of Competitive Opportunities Regarding Electric Service*, Opinion 96-12 (May 20, 1996), at 64–65 ("Opinion 96-12").

presumption that separation of these functions was required.[39] The first paragraph of the VMP Statement summarizes the Commission's findings:

> 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 place.[40]

In addition, the Commission stated that divestiture would help create a larger number of competing generating companies, which would result in a more dynamic market.[41]

The Commission, therefore, strongly encouraged the EDCs to divest their generation. It adopted its VMP policy, a step which ultimately occurred and was sanctioned by the Commission in orders issued in the utility-specific rate and restructuring cases. To avoid the adverse impacts that would result from the exercise of VMP on both the continued development of competitive markets and, concomitantly, consumers, the Commission established strict VMP guidelines in the VMP Policy Statement that expressly provide that the proponent of a proposal to own both transmission and generation would face a very high hurdle in its Public Service Law ("PSL") Section 70 proceeding, namely, it must overcome the rebuttable presumption that such dual ownership would unacceptably exacerbate the potential for VMP. The Commission ruled:

> To guard against undesirable incentives, a rebuttal [sic] 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

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[39] VMP Policy Statement, App. I at 1.

[40] *Id.* (emphasis added).

[41] Opinion 96-12 at 65.

> 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.[42]

The Commission reaffirmed its VMP Policy Statement when it conditioned its approval of Iberdrola's acquisition of Rochester Gas and Electric Corporation ("RGE") and New York State Electric and Gas Corporation ("NYSEG") on the divestment of any and all fossil-fueled generating assets in New York State and the prohibition of the future construction or acquisition of any fossil-fueled generation in New York owned by Iberdrola and its affiliates.[43] While the Commission directed NYSEG and RGE to develop a limited amount of wind generation in their service territories or pay money into a fund for the benefit of ratepayers, such action was specific to the facts and circumstances of the merger at hand. It was also required to support the merger's approval (*i.e.*, by mandating that Iberdrola foot the bill to construct renewable generation which provided substantial ratepayer benefits of $275 million) and was contingent upon the generation being owned by affiliates separate from the EDC and the imposition of VMP mitigation measures.

The Commission should continue to prohibit EDCs from owning any generation facilities in New York State, including LSRs, to guard against the exercise of VMP so long as private investors are willing and able to develop projects in New York. Indeed, the very purpose of this proceeding is to design a CES structure that would foster efficient and cost-effective investment by private parties. Unlike the case in Iberdrola, where Iberdrola was mandated to incur costs to

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[42] VMP Policy Statement, App. I at 1–2.

[43] Case 07-M-0906, *Joint Petition of Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation for Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A.*, Order Authorizing Acquisition Subject to Conditions (Jan. 6, 2009).

construct renewable resources that provided $275 million in ratepayer benefits, which were needed for the Commission to find the proposal was in the public interest, and, thus, to secure the Commission's merger approval, there are no significant ratepayer benefits being offered by any EDCs (*i.e.*, the EDCs will seek to rate base any new projects) that could not be provided by private investors to offset the harm that will be caused by the EDCs' potential exercise of VMP if they own LSRs. Indeed, NYSERDA stated in the NYSERDA Report that its analysis shows that privately-owned projects are the lowest cost solutions.[44]

Staff does not demonstrate in its White Paper how its recommendations could be read in harmony with the Commission's VMP policy, attempting instead to rely on the principles articulated in the REV Framework Order permitting EDC ownership of DER. Yet, allowing EDCs to own generation if the private market does not develop "sufficient levels of instate resources" would give the EDCs a perverse incentive to limit development of renewable resources by merchant developers in New York. As the Commission correctly anticipated, the mechanisms employed to achieve these results could be quite varied, including contracting with resources out-of-State or obstructing in-State development through uneven administration of interconnection studies, contract negotiations, or otherwise so that the Commission will be more inclined to declare a market failure and turn to the EDCs to develop and own new renewable projects in-State. If the Commission adopts an "exceptional circumstances" exception to its policy prohibiting UOG, it should be limited to circumstances where private developers do not submit proposals in response to competitive solicitations. It is not sufficient to claim "market failure" without demonstrating that private developers were given a clear and defined

[44] NYSERDA Report at 126.

opportunity to meet the need for generation.[45] If the Commission determines exceptional circumstances may exist, no determination should be made without first triggering a close inspection of the solicitation and related market design to understand why competitive entities did not respond. This examination step is key to identifying and correcting for any design failures rather than simply "band-aiding" the situation.

Staff's proposal that EDCs be permitted to invest in renewable projects in partnership with private developers is unclear as to whether EDCs would take an ownership role. The Commission should reject this proposal if the EDCs' return of, and on, such investment depends on the success of the projects because EDCs will have an incentive to exercise market power to provide an unfair advantage to projects in which they have invested. The Commission should also make clear that an EDC's affiliates are prohibited from owning generation in the EDC's electric service territory because EDCs have a strong incentive to favor their unregulated affiliates' projects due to their ability to earn unregulated returns.

Finally, the argument that UOG may be advantageous because utilities have a lower cost of capital than merchant developers is flawed. It is impossible to fairly compare the costs and benefits of a proposed project that will obtain cost-of-service, rate-based recovery with a private developer's proposed project that must rely on REC payments and market revenues for cost recovery. EDCs' revenue requirements are largely guaranteed by the Commission, and the

[45] The Commission should examine the status of interconnection requests at the NYISO and applications under Article 10 of the PSL to ensure that Staff's proposed CES targets are realistic in light of the time it is taking for applicants to complete these processes. Article 10 applies to all facilities that are 25 MW or larger, including renewable facilities, and has a minimum process timeframe of one year; however, the first CES target is in 2017. Unrealistic targets should not be grounds for declaring "market failure" which would allow the EDCs to reenter the generation business. In addition to completing the Article 10 process, power plant developers would need to obtain project financing and complete the construction of the facility, which could take approximately five years. All of these needed steps call into question the appropriateness of the 2017 and 2020 CES targets. In addition, the Commission should confirm the statements made by DPS Staff during the February 26 technical conference that projects awarded contracts by NYSERDA in the 2016 solicitation would be included in the 2017 calculations.

Commission allows EDCs to recover cost overruns of projects so long as they are prudently incurred. If EDCs are allowed to develop or acquire an interest in cost-of-service, rate-regulated LSR, ratepayers ultimately will be put back in the position of being at risk of shouldering the cost overruns of such projects. As history demonstrates, the risk of such cost overruns is very real. For example, Consolidated Edison Company of New York, Inc.'s ("Con Edison") East River Repowering Project, prompted by needs on Con Edison's steam system, had an initial estimated cost of $406 million. However, by project completion, the costs had skyrocketed to nearly twice as high as Con Edison's estimate and ratepayers were required to bear final costs of $788.3 million, almost a 100% overrun of original cost estimates.[46] Similarly, RGE's construction of its Rochester Transmission Project (albeit a transmission project) was projected to cost approximately $75.4 million when initially authorized.[47] The estimates subsequently ballooned to $125 million, a 60% increase. In the case of a merchant LSR facility, private investors bear the risk of cost overruns and loss, not consumers. Merchant companies bear operation and maintenance risk and performance risk, and are incented to maximize the value of a project's output. Because they do not have the luxury of an assured regulated revenue stream to cover their costs, they are forced to be more efficient, due to the very structure—competitive markets and risk-based capital to finance development—for which the Commission advocated in the REV Proceeding. UOG, with its regulated returns, does not have the same incentives. Problems such as cost overruns and negative impacts on the competitive markets can be avoided by continuing to prohibit EDCs from owning cost-of-service, rate-regulated generation assets.

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[46] Case 05-S-1376, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of the Consolidated Edison Company of New York. Inc. for Steam Service*, Order Determining Revenue Requirement and Rate Design (Sept. 22, 2006), at 6.

[47] Case 03-T-1385, *Rochester Gas and Electric Corporation,* Order Granting Certificate of Environmental Compatibility and Public Need (Dec. 16, 2004), at 6.

UOG indisputably will skew the playing field against merchant developers. A project that is willing to cap the total cost exposure to consumers to a REC payment and otherwise rely on market revenues to recoup its investment would ultimately be more beneficial to customers than a cost-based solution that may have a lower initial cost estimate (making it appear to be the better choice) but also retains the ability to seek recovery of all costs without limitation. Allowing UOG would provide EDCs the perverse incentive to underbid their projects and have them selected, only to later recover any cost overruns through rates. This structure does not allow for true competition between private developers and UOG because the former would be bound by their bids whereas the latter would not guarantee a price or shoulder permitting, development, and construction risk.

The Commission's determination that merchant companies can build and operate generation more efficiently than utilities was one of the main reasons the Commission decided to restructure the electric utility industry in New York two decades ago. Private investors have developed and operated projects more efficiently than the EDCs did in the pre-restructuring era. It would be a complete reversal of two decades of Commission policy if the Commission were to ignore the sound bases for its determinations and instead find that utilities can build renewable facilities at a lower cost than merchant companies without taking into account the risk factors and actual all-in costs.

Merchant development of renewable resources has been effective. Nothing has changed in the intervening two decades since the Commission issued Opinion 96-12 that has altered the balance of the basic economics and other factors relating to merchant versus UOG projects. Thus, the Commission should stay the course.

Respectfully submitted,

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