

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
Albany on August 16, 2012

COMMISSIONERS PRESENT:

Garry A. Brown, Chairman
Patricia L. Acampora
Maureen F. Harris
James L. Larocca
Gregg C. Sayre

CASE 12-E-0136 - Petition of Dunkirk Power LLC and NRG Energy,
Inc. for Waiver of Generator Retirement
Requirements.

ORDER DECIDING RELIABILITY ISSUES
AND ADDRESSING COST ALLOCATION AND RECOVERY

(Issued and Effective August 16, 2012)

BY THE COMMISSION:

INTRODUCTION

On March 14, 2012, NRG Energy, Inc. and Dunkirk Power LLC (collectively, NRG) filed a notice, pursuant to the Commission's Order Adopting Notice Requirements for Generation Unit Retirements (Retirement Order), which stated that NRG intended to "mothball" its Dunkirk generating station by September 10, 2012.¹ NRG sought a waiver of the Commission's notice requirement adopted in the Retirement Order so that it

¹ Case 05-E-0889, Policies and Procedures Regarding Generating Unit Retirements, Order Adopting Notice Requirements for Generation Unit Retirements (issued December 20, 2005).

could proceed with the mothballing of the Dunkirk generating station prior to September 10, 2012.²

In response to NRG's Retirement Notice, Niagara Mohawk Power Corporation d/b/a National Grid (National Grid) conducted an analysis of the reliability impacts associated with the planned mothballing. The analysis identified adverse reliability impacts attending the mothballing. National Grid also identified system reinforcements needed to resolve those reliability impacts. However, because it anticipated that the reinforcements could not be completed by September 10, 2012 (i.e., the proposed mothball date for the Dunkirk generating station), National Grid determined that a portion of the Dunkirk generating station must remain available for an interim period in order to maintain system reliability.

On July 20, 2012, National Grid submitted a proposed "Term Sheet Agreement" whereby NRG would agree to provide "Reliability Support Services" (RSS) in order to maintain reliability. National Grid and NRG requested the Commission's approval of the Term Sheet Agreement before entering into a bilateral contract for RSS from the Dunkirk facility for a period beginning September 1, 2012, and ending May 31, 2013. Under the Term Sheet Agreement, RSS would be procured from two units at NRG's Dunkirk generating station until National Grid completes, as is expected by May 31, 2013, the transmission upgrades sufficient to reduce the reliability need to no more than one Dunkirk unit. In the event there are delays in National Grid's schedule for deployment of the upgrades, the

² The term "mothball" is synonymous with a "retirement" for purposes of providing notice under the Retirement Order, given that each action may result in adverse reliability impacts. However, as discussed below, "mothballing," in comparison to "retirement" may have unique implications for establishing appropriate levels of compensation.

Term Sheet Agreement provides that National Grid may obtain a 90-day extension beyond May 31, 2013, until August 31, 2013. Before agreeing that NRG should continue to operate any portion of the Dunkirk generating station beyond May 31, 2013, or, if the initial period is extended, beyond August 31, 2013, National Grid intends to evaluate potential alternative reliability solutions. National Grid indicates that its identified permanent solution to the reliability need could be implemented by June 2015.

On July 20, 2012, National Grid also proposed amendments to its tariffs that would create a mechanism for allocating and recovering the costs it will incur in procuring RSS from NRG (Tariff Amendments). The Tariff Amendments provide for the deferral of the recovery of the costs of procuring RSS from NRG from the inception of National Grid's payment obligation to NRG until lower base rates, proposed in its pending rate proceeding, Case 12-E-0201, are approved and go into effect on April 1, 2013. These costs would be recovered from all retail delivery customers in the same manner as other transmission capital and operating costs.

In this Order, we confirm that National Grid is taking the steps necessary to ensure reliability in the short-term by procuring necessary generation services from NRG, and by soliciting alternatives to meet reliability needs from market participants in the longer term. As discussed more fully below, the proposed Term Sheet Agreement is approved as necessary to ensure that adequate generation facilities have been procured to meet local reliability needs, subject to the filing of an executed contract. However, we reject the proposed Tariff Amendments and refer issues pertaining to the recovery of RSS costs from National Grid's retail customers to the utility's pending rate case, Case 12-E-0201. These actions will ensure

the provision of safe and adequate service at just and reasonable rates, and are therefore in the public interest.

BACKGROUND

The Retirement Order, in adopting requirements for providing notice of generator retirements, was intended to address the potential that a retirement of electric generating units could cause the level of generation supply to decline to a point that would threaten the reliability of electric service.³ These notification requirements were needed so that generation unit retirements that might undermine electric system reliability and render service unsafe or inadequate could be evaluated, and, if necessary, adverse impacts to reliability could be avoided. However, no specific remedies that would be used to address adverse reliability impacts attending a retirement were identified, and the process that would be used to consider such remedies was left open. Instead, the remedies would be considered on a "case-by-case basis, given the potential variety of circumstances that could be encountered." Designing a remedy would "depend upon the exact nature of those circumstances, which cannot be adequately forecast."⁴

On March 14, 2012, NRG filed a notice in Case 05-E-0089, pursuant to the Retirement Order, that stated it intended to "mothball" its Dunkirk generating station and cease operations for an undefined period, by no later than September 10, 2012 (NRG Retirement Notice). The Dunkirk generating station consists of four units with a combined nameplate rating of over 635 MW. Dunkirk units 1 and 2 are each rated at 100 MW and interconnect to the transmission system at 115 kV, while

³ Retirement Order, p. 13. For units 80 MW or larger, a 180-day notice requirement was adopted.

⁴ Retirement Order, p. 20.

Dunkirk units 3 and 4 are each rated 217.6 MW and interconnect to the transmission system at 230 kV. NRG also sought a waiver of the retirement notification requirement so that its units could be mothballed prior to September 10, 2012.

The NRG Retirement Notice explained that the proposed mothballing was due to the disparity between current and forecasted wholesale electric prices in Western New York and the underlying cost of operation of the Dunkirk facility, leading to a net loss for NRG if operations continued. Thus, NRG indicated that the facility would be mothballed "until such time as market conditions improve."⁵

In conformance with the State Administrative Procedure Act (SAPA) §202(1), notice of the NRG Retirement Notice was published in the State Register on April 11, 2012. The SAPA §202(1)(a) period for submitting comments in response to the notice expired on May 29, 2012. No comments were received by that date.

Subsequent to the filing of the NRG Retirement Notice, National Grid conducted analyses to determine the system reliability impacts of permanently removing all four Dunkirk units from the electric system. In a letter dated March 30, 2012, National Grid advised Staff of the New York State Department of Public Service (DPS Staff) that "the proposed mothballing of Dunkirk units 1-4 will result in significant impacts to transmission system reliability in western NY."⁶

National Grid's preliminary analyses suggested that three Dunkirk units (one 230 kV unit and the two 115 kV units) would be required to meet reliability needs, with two of these

⁵ NRG Retirement Notice, p 2.

⁶ Letter from Christopher E. Root, National Grid Senior Vice President, Network Strategy, to Thomas Dvorsky, Department of Public Service (dated March 30, 2012).

three units required all year and all three operating in the 2013 summer season. National Grid subsequently revised its need assessment, and on June 29, 2012, indicated to NRG that only two 115 kV units were required from September 2012, until May 31, 2013, when certain transmission system reinforcements would be completed. Further, National Grid thought that a single unit would likely be required from June 1, 2013, until June 1, 2015, when critical substation and line projects would be completed. National Grid noted that it was continuing to examine whether it is possible to avoid the need for the single Dunkirk unit after May 31, 2013.⁷

In a letter dated June 11, 2012, our Counsel advised National Grid and NRG that we could exercise our authority to ensure that adequate generation facilities have been procured to meet local reliability needs, and that the parties should pursue an agreement to ensure adequate generation resources were available during the proposed mothballing period. The letter directed National Grid and NRG to advise the Commission by July 12, 2012 whether such an agreement was negotiated or, alternatively, to submit proposed term sheets individually for our consideration.

On July 12, 2012, National Grid and NRG responded that they were continuing to negotiate, and that they believed additional time could be beneficial in their efforts to reach agreement. The parties asserted that submitting respective proposed terms at that time would be counterproductive. On the same date, NRG filed a proposed, but unexecuted, reliability must-run (RMR) agreement with the Federal Energy Regulatory Commission (FERC). The RMR applied to Dunkirk Units 1 and 2 for the period ending May 31, 2013, and to one of the two units for

⁷ Case 12-E-0201, National Grid Response to Information Request DPS-464 (dated August 2, 2012).

an additional two-year period ending June 1, 2015. Pursuant to the proposed RMR, National Grid would compensate NRG through a monthly fixed-cost charge of \$5,607,513 for keeping Units 1 and 2 in service through May 31, 2013, and \$4,450,332/month to keep a single unit in service between June 1, 2013, and June 1, 2015. NRG characterized these amounts as based on its "cost-of-service" (COS).

On July 18, 2012, a Notice was issued by the Secretary directing National Grid and NRG to file either an agreement, or proposed terms recommended by each party for consideration by no later than July 20, 2012, so that the filings could be acted upon at our August 16, 2012 session. The Notice solicited comments from interested parties on the National Grid and NRG filings by July 30, 2012.

On July 20, 2012, National Grid submitted a proposed Term Sheet Agreement for which it and NRG sought approval. The Term Sheet Agreement was intended to supersede NRG's RMR filing with FERC. National Grid also proposed Tariff Amendments to provide a mechanism for allocating and recovering the costs it would incur in procuring RSS from NRG (Petition).⁸ On July 30, 2012, comments were filed on the Term Sheet Agreement and Tariff Amendments by National Grid, Independent Power Producers of New York (IPPNY), Sierra Club, and Multiple Intervenors (MI). The parties' comments are summarized below.

⁸ NRG subsequently filed a motion to hold the FERC proceeding in abeyance pending the possible approval by the Commission of the proposed Term Sheet Agreement. In the event the Term Sheet Agreement is approved, without modification, and becomes final, NRG plans to withdraw its RMR filing at FERC.

THE PETITION

Term Sheet Agreement

The Term Sheet Agreement provides that NRG shall defer mothballing actions on Dunkirk Units 1 and 2, which are interconnected to the 115 kV transmission system, and keep them available to support reliability. The length of the contract would cover the period from September 1, 2012, until May 31, 2013, although it may be extended by National Grid for up to an additional 90 days beyond May 31, 2013, in the event there are delays in the planned in-service dates of the transmission reinforcements. Under the Term Sheet Agreement, National Grid would pay NRG a monthly fixed-price charge of \$2,924,324, plus true-ups for "verified expenses" supporting NRG's property tax payments (i.e., payment in-lieu of taxes (PILOT)) and coal delivery charges.⁹

The Term Sheet Agreement provides for the crediting of any Installed Capacity (Capacity) revenues earned in New York Independent System Operator, Inc. (NYISO) markets against the costs of the contract, while NRG would retain any Energy and Ancillary Services market revenues. In the event that the Dunkirk generating station exceeds certain earnings thresholds in the five-year period following the termination of the contract, a portion of such earnings would be credited to National Grid for the benefit of customers. In addition, monies may also be credited to National Grid in the event NRG's generating units fail to meet certain performance standards.

National Grid's preliminary evaluation indicates that there may be a need for RSS beyond May 31, 2013. However, National Grid believes that it is premature, at this time, to

⁹ For the nine month period of the contract, taxes/PILOT expenses would be paid up to \$6,681,084, and "take or pay" coal contract true-up expenses would be paid up to \$4,342,985.

contract for continued RSS from Dunkirk beyond the period(s) that are specified in the Term Sheet Agreement, pending an evaluation of other potential reliability solutions that may become available in the future.

Tariff Amendments

National Grid proposes that the costs of procuring the RSS be deferred from the start of the payment obligation until lower base rates, which are proposed in Case 12-E-0201, go into effect on April 1, 2013. National Grid believes the deferred amounts should accrue carrying charges at the customer deposit rate (currently 1.65%). These costs would be recovered from retail delivery customers in the same manner as other transmission capital and operating costs.

Beginning with the effective date of new base rates, it proposes to commence recovery from retail customers of the current RSS costs as well as deferred RSS amounts inclusive of accumulated carrying charges. National Grid maintains that because the rate proposal in Case 12-E-0201 is expected to result in a rate decrease, deferring cost recovery until that time helps promote "rate stability."

National Grid proposes to recover RSS costs through service class specific surcharges over a period to be identified.¹⁰ As proposed, the costs of the RSS would be recovered from all delivery customers regardless of supplier, except for Empire Zone qualifying load, Excelsior Jobs Program

¹⁰ National Grid stated that "[t]he Company did not propose a specific period over which to recover the RSS costs; however, the Company's filing modeled recovery of the forecast RSS amounts over 12 months beginning April 1, 2013;" and "[a]lthough the 12-month period modeled in the filing appears reasonable given the nine-month term of the contract, the Company anticipates proposing an appropriate surcharge recovery period in the future when additional cost information will be available." Case 12-E-0136, National Grid Response to Information Request MI-4 (dated July 27, 2012).

qualifying load, and certain S.C. 12 customers with individually negotiated contracts that disallow surcharges.

National Grid proposes to allocate the costs of the RSS charges in the same manner as other transmission capital and operating costs. The allocation is based on the respective contribution of each service class to the coincident peak demand, and the proposed methodology will recover costs from each service class on either a demand or kilowatt-hour basis.

COMMENTS

National Grid

In its Statement in Support of the Term Sheet Agreement, National Grid reiterates that Dunkirk Units 1 and 2 must remain in operation through at least May 2013 in order to maintain reliability. National Grid asserts that the Term Sheet Agreement addresses the reliability need at far less cost, and under more favorable terms, than those NRG proposed to FERC.

In its filing with FERC on July 12, 2012, NRG requested recovery of a monthly fixed-cost charge of \$5,607,513 (or \$50,467,617 for nine months), based on "cost-of-service" rates, for keeping Dunkirk Units 1 and 2 available. National Grid points out that this amount is significantly more than the fixed-price charges and tax-related payments of \$33,000,000, plus actual coal contract costs of up to \$4,342,985, over the nine months under the Term Sheet Agreement. Neither the coal contract adjustment clause, the provision for refunds to ratepayers if the Dunkirk plant exceeds a certain earnings threshold within five years, or the unit performance standards were included in NRG's filing with FERC.

National Grid asserts that the deferral of the RSS surcharges would help promote rate stability for customers. Even with the implementation of the surcharge, National Grid

estimates that most typical customers' delivery bills will be lower beginning April 1, 2013 than they are currently.

In sum, National Grid maintains that the Term Sheet Agreement is reasonable, fair to customers, consistent with public policy, and is in the public interest. National Grid contends that the Term Sheet Agreement is the product of agreement among normally adversarial parties, and reflects a reasonable compromise position that is within the range of results that may have arisen from litigation.

Sierra Club

Sierra Club argues that the reasonable term of the agreement should coincide with the period for which a reliability need has been demonstrated, which it maintains is only September 10, 2012, to May 31, 2013. Limiting the term of the agreement would also minimize the potential for effects that would distort the market. Sierra Club cites FERC orders stating that "RMR contracts suppress market-clearing prices, increase uplift payments, and make it difficult for new generators to profitably enter the market."¹¹

According to Sierra Club, a process is needed for selecting competitive bids to provide any needed reliability services beyond June 1, 2013, and prior to June 1, 2015. Such a solicitation, Sierra Club maintains, may identify a less expensive alternative to operating the Dunkirk facility and will ensure that National Grid customers are not forced to make unjust and unreasonable payments to NRG.

Sierra Club takes issue with the provision in the Term Sheet Agreement that provides a refund to National Grid for a portion of the \$4.2 million debt-related allowance in the event NRG's profits exceed certain thresholds. Rather, Sierra Club

¹¹ Sierra Club comments, p. 4 (citing Devon Power, LLC, 103 FERC ¶61,082 at 9, ¶ 29) (issued April 25, 2003).

suggests that refunds should be triggered by any profits NRG obtains beyond the termination of the agreement.

Finally, Sierra Club notes the various examples where upstate New York coal plants are facing challenges to remaining in operation because of aging plant and adverse financial circumstances. To forestall future out-of-market reliability payments, Sierra Club requests that an analysis of the need for transmission upgrades be undertaken to protect ratepayers from unjust and unreasonable increases in their rates.

Multiple Intervenors (MI)

Although MI generally supports the procurement of RSS from NRG to the extent needed to ensure reliability, it opposes several aspects of National Grid's filing. In particular, MI objects to the Tariff Amendment for recovering the RSS costs, which it argues are exorbitant and unnecessary. MI notes that National Grid has identified, in its current Case 12-E-0201 rate proceeding, approximately \$128.349 million in deferrals owed to customers, and MI requests that a portion of that deferral be used to pay for RSS costs incurred to support RSS operations of two Dunkirk units. Such an approach would obviate any need to institute an RSS surcharge. Alternatively, MI proposes that the Commission refer issues pertaining to the recovery of RSS costs from National Grid's retail customers to the utility's pending rate case, Case 12-E-0201. MI states that if the RSS surcharge is allowed to go into effect as National Grid proposes, S.C. 3 and S.C. 3-A customers would experience a demand rate increase of between 4.37% and 12.74%, not including the delivery rate increase being sought by the utility in Case 12-E-0201.

If the imposition of an RSS surcharge is authorized, MI suggests that the RSS costs should be recovered over a time period consistent with transmission system investments (i.e., by extending the recovery period over multiple decades), rather

than the proposed 12-month period for recovering deferred costs. Treating the RSS costs in a manner comparable to transmission system investments for amortization and recovery purposes, if a surcharge is allowed, would reduce the amount of the surcharge, and its impact on customers. Further, MI contends that, in addition to the proposed recovery from retail customers, RSS costs should also be recovered on an equitable basis from wholesale customers, other investor-owned utilities, and municipal utilities that would similarly benefit from the RSS. However, MI supports National Grid's proposed allocation of any such surcharge to service classes based on their contribution to coincident peak demand, and recovery based on a per kW basis.

MI does not take a position on the amount of financial compensation provided for under the Term Sheet Agreement, and maintains that the process in this proceeding precluded it from meaningful participation. MI notes that it was not notified of any settlement discussions, had no opportunity to participate in the negotiations, and did not have access to the facts and data relied upon in negotiating the Term Sheet Agreement. MI requests that under this process, no precedential value should be attached to this proceeding.

Notwithstanding the constraints on its ability to participate, MI contends that the compensation provided to NRG for the RSS should not begin prior to the expiration of the 180-day notice period, which is September 10, 2012. In its view, NRG should not be entitled to any compensation prior to that date because NRG is precluded, by operation of the Retirement Order, from mothballing the Dunkirk generating station prior to that date. MI is further concerned that the amount of the monthly fixed-price charge refunded to National Grid, if one or both Dunkirk units are unavailable due to a forced outage, is unreasonably low.

Independent Power Producers of New York (IPPNY)

IPPNY takes no position on the provisions of the Term Sheet Agreement or Tariff Amendments, but requests that the waivers of the Retirement Order notice requirements be granted with respect to Dunkirk Units 3 and 4. IPPNY argues that these units have not been identified as needed for reliability.

IPPNY points out that the Retirement Order found that remedies should be considered on a case-by-case basis, given the varied circumstances that could be encountered, and requests that the Term Sheet Agreement should not be considered precedential to the resolution of any other reliability situations that may arise. IPPNY seeks to ensure that approval of the Term Sheet Agreement will not be interpreted as a waiver of what it deems a generation owner's rights under the Federal Power Act to file with FERC proposed rates, terms, and conditions for the provision of service needed to ensure reliability within New York.¹²

DISCUSSION

As discussed in prior orders, the movement to competitive electricity markets requires that new approaches be taken to maintaining the adequate generation resources needed to ensure reliability.¹³ If independent owners of lightly regulated generation units can discontinue or abandon a service needed for reliability without sufficient regulatory oversight, it is possible that the reliability of electric service would be threatened. Accordingly, policies and procedures were developed

¹² In a comment filed late on August 9, 2012, the "Indicated Transmission Owners" discuss issues raised by other parties; as a result, its comment need not be considered further.

¹³ Case 05-E-0889, supra, Order Instituting Proceeding and Notice Soliciting Comments (issued July 27, 2005)(Retirement Notice Order), p. 1.

in the Retirement Order to ensure regulatory review of generation retirements in order to prevent or mitigate any adverse impacts a retirement may have on system reliability.

It is in this context that NRG filed its notice of generation retirement and National Grid identified a potential adverse reliability impact associated with the retirement. The Term Sheet Agreement between NRG and National Grid for the provision of RSS on an interim basis is proposed for the purpose of ensuring the maintenance of adequate generation resources necessary for safe, adequate, and reliable service. While various notices of other planned generation retirements have been received, this is the first instance where a generation unit slated to close operations must instead remain available beyond the end of the notice period prescribed in the Retirement Order.

RSS Jurisdiction

Article 4 of the Public Service Law (PSL) establishes the scope of our jurisdiction over electric generation facilities. That jurisdiction extends to the abandonment of service by wholesale electric generation companies, which may pose the potential for a significant adverse impact to system reliability, thereby threatening the provision of "safe and adequate" service. Moreover, the retirement of a generating unit subject to a lightened regulatory regime under the PSL, or operated as an Exempt Wholesale Generator (EWG) under federal law, could raise public interest considerations analogous to a franchised utility's abandonment of service to an identifiable group of customers. Since the RSS is a remedy for NRG's proposal to abandon service by mothballing the Dunkirk generating station, the RSS falls within the ambit of jurisdiction over abandonments.

The issue of regulating a large-scale independent generator first arose in the 1994 Wallkill Order, where a regulatory regime was established for such a generation facility.¹⁴ That generator was exempted from provisions of the PSL where feasible, such as those provisions explicitly applicable only to retail service. It was also decided that some provisions of Article 4 would be flexibly applied to the generator, by reducing filing requirements and the level of scrutiny applied upon review of those filings. Flexible application of Article 4, however, did not carry with it a general exemption from all of the substantive provisions of that Article, leaving the generator subject to certain PSL Article 4 regulation of its activities.

In the AES and Carr Street Orders, the Wallkill regulatory regime was updated and applied to EWGs generally,¹⁵ including those, like NRG Dunkirk, formed out of the divestiture of generation by formerly integrated electric utilities. While those Orders continue to provide for lightened Article 4 regulation, they explicitly provide that EWGs remain subject to PSL jurisdiction with respect to matters like safety, reliability and system improvement.¹⁶ All EWGs requesting lightened regulation have been held to similar requirements.

¹⁴ See Case 91-E-0350, Wallkill Generating Company, L.P., Order Establishing Regulatory Regime (issued April 11, 1994) (Wallkill Order) and Declaratory Ruling on Regulatory Policies Affecting Wallkill Generating Company and Notice Soliciting Comments (issued August 21, 1991).

¹⁵ Case 99-E-0148, AES Eastern Energy, L.P., Declaratory Ruling on Lightened Regulation (issued March 23, 1999) and Order Providing For Lightened Regulation (issued April 23, 1999) (AES Order); Case 98-E-1670, Carr Street Generating Station, L.P., Order Providing For Lightened Regulation (issued April 23, 1999) (Carr Street Order).

¹⁶ AES Order, p. 9; Carr Street Order, p. 10.

Recent orders similarly provide that EWGs remain subject to the PSL "with respect to matters such as enforcement, investigation, safety, reliability, and system improvement, and the other requirements of PSL Articles 1 and 4," to the extent not specifically exempted from those Articles elsewhere in the orders.¹⁷ This jurisdiction extends to EWG abandonment of service.

Moreover, our role in establishing the compensation due generation owners whose facilities are needed for reliability is explicitly recognized in the FERC-approved NYISO tariff. In particular, Attachment Y of the NYISO's Open Access Transmission Tariff provides that the "[c]osts related to regulated non-transmission reliability projects will be recovered by Responsible Transmission Owners, Transmission Owners and Other Developers in accordance with the provisions of New York Public Service Law, New York Public Authorities Law, or other applicable state law."¹⁸ Although this provision of the NYISO tariff is not implicated under these circumstances, given that the reliability need arose due to local, and not bulk system, reliability issues, it is instructive on the jurisdictional responsibilities we assume in situations similar to those present here.

Reliability Needs

In response to NRG's notice of intent to mothball its Dunkirk generating station, National Grid performed reliability

¹⁷ See, e.g., Case 11-E-0351, Stony Creek Energy LLC, Order Granting Certificate of Public Convenience and Necessity, Providing for Lightened Ratemaking Regulation and Approving Financing (issued December 15, 2011).

¹⁸ OATT, Attachment Y, §31.4.1.6. Policies and procedures for addressing the need for a reliability backstop solution were implemented in Case 07-E-1507, Long-Range Electric Resource Plan and Infrastructure Planning Process, Policy Statement on Backstop Project Approval Process (issued February 18, 2009).

studies that showed the mothballing, after September 10, 2012, of Dunkirk Units 3 and 4, which are interconnected to the 230 kV transmission system, would not result in reliability criteria violations. However, these studies also indicated that mothballing Dunkirk Units 1 and 2, interconnected at 115 kV, would result in reliability criteria violations on the local 115 kV transmission system in the Southwestern New York Area, absent transmission reinforcements. The NYISO found no reliability issues on the Bulk Power System caused by the mothballing of Dunkirk, but concurred with National Grid with respect to reliability violations on the local transmission system.¹⁹

National Grid plans several system reinforcements to reduce the dependence upon the NRG Dunkirk generating station. The reinforcements to address the identified reliability needs are scheduled to be in service by May 31, 2013. It is extremely important that these facilities be completed in a timely manner in order to minimize the extent of the reliability need and to avoid imposing on ratepayers costs beyond those necessary to support NRG Dunkirk operations for the shortest possible period of time. National Grid shall proceed expeditiously with its planned reinforcements, and shall alert DPS Staff to any developments that may jeopardize their timely completion.

Until the anticipated completion of the planned system reinforcements by May 31, 2013, National Grid has determined that Dunkirk Units 1 and 2 must be available to avoid violating post-contingency reliability criteria and to help ensure the reliability of the local transmission system. Once the appropriate system reinforcements are in place, National Grid expects that one of the Dunkirk 115 kV units may continue to be

¹⁹ Letter from Wesley Yeomans, NYISO Vice President of Operations, to Thomas Dvorsky, Department of Public Service (dated July 30, 2012).

needed until longer-term system reinforcements can be installed. National Grid's approach is designed to minimize the amount and duration of the RSS that must be procured from NRG.

NRG requests a waiver of the Retirement Order notice requirement so that the Dunkirk generating station could be mothballed prior to the expiration of the notice period. A waiver of the notice period may be granted only where it is demonstrated that there is no reliability need prior to the end of the notice period. Regarding Dunkirk Units 1 and 2, National Grid in its analyses examined the reliability impacts of mothballing the Dunkirk generating station as of September 10, 2012. There is no reason to believe, however, that the Dunkirk capacity would be any less needed before that date than it is afterwards. The Term Sheet Agreement recognizes that such a need does exist by procuring RSS prior to September 10, 2012. Similarly, the absence of a reliability need for Dunkirk Units 3 and 4, prior to September 10, 2012, has not been demonstrated. Moreover, granting the waiver could allow the mothballing to occur during the summer Capability Period, when the Dunkirk facility is most needed to ensure that high peak loads can be met. Therefore, there is no basis for granting NRG's request for waiver of the Retirement Order notice requirement and its request is denied.

Sierra Club and MI take issue with the September 1, 2012 commencement date for the bilateral RSS contract between National Grid and NRG, given that NRG cannot mothball its units any sooner than September 10, 2012, due to the 180-day notice requirement under our Retirement Order. Under the provisions of the Term Sheet Agreement, the date for commencement of the RSS is just one part of an overall agreement that resolves a multitude of matters by balancing the interests of the parties. Moreover, we note that the proposed start date is only nine days

prior to the date suggested by Sierra Club and MI. Under these circumstances, the proposed commencement date of September 1, 2012, which the parties arrived at in balancing their interests, is a reasonable term that addresses the procurement of adequate generation facilities for reliability needs while providing a sufficient level of compensation to the owner of the needed facilities.

We do, however, agree with Sierra Club that a process is needed to determine whether alternatives can solve reliability needs beyond the expiration of the Term Sheet Agreement (i.e., May 31, 2013 or August 31, 2013, depending on the optional extension tied to National Grid's completion of system reinforcements). This is an important step to ensure that ratepayers are contributing no more than necessary to keep the Dunkirk generating station available, and to evaluate whether reliability needs can be met more cost-effectively and efficiently than through continued reliance on NRG's Dunkirk facility. Moreover, a solicitation of alternatives is comparable to the NYISO tariff means for addressing reliability backstop solutions. Therefore, we direct National Grid to consult with DPS Staff and to file a proposed schedule and process for soliciting alternative solutions to any remaining reliability needs that may exist after completing the planned reinforcements.

Term Sheet Agreement

In reviewing whether the costs incurred under the Term Sheet Agreement are just and reasonable, it is appropriate to begin with an inquiry into the economic impacts of a temporary shut-down of a generating facility (i.e., mothballing) as an efficient market response to currently unfavorable economic conditions. In such circumstances, it is arguable that an appropriate level of compensation would meet the costs that a

generation owner could avoid by mothballing a generation unit. There are several costs that an owner may "avoid" or minimize by mothballing a generating unit, including: 1) labor and other operating and maintenance (O&M) costs; 2) capital expenditures; 3) taxes or PILOT; 4) operating risks (e.g., risks of equipment failures during operation); and, 5) corporate overhead costs.

These "avoidable" costs do not include "sunk" costs, such as past investments in environmental controls. Similarly, debt and equity costs are considered sunk costs. While depreciation costs begin as sunk costs, they reflect expected service life of the plant. By mothballing a unit, the owner can avoid operating risks and thereby extend the remaining service life of that unit once more favorable economic conditions exist (e.g., higher natural gas prices relative to coal) and the plant can return to profitability. Thus, depreciation costs could be regarded as a proxy for the operating risks avoidable through mothballing.

In the case of a "take-or-pay" coal transportation contract where payments are required for shipment, even if no fuel is actually delivered, the costs may be considered sunk and unavoidable. However, it is possible that these costs may be avoided through bankruptcy, or renegotiation of the contract with the coal transporter, although those outcomes are speculative. Taking all these factors into account, we estimate that avoidable costs for procuring NRG's Dunkirk Units 1 and 2 over nine months would be between approximately \$24 million and \$40 million, depending on the treatment of Administrative &

General (A&G) corporate expenses, the take-or-pay coal contract, and depreciation.²⁰

NRG's filing at FERC, which was characterized as a "Cost of Service" (COS) rate, provides another means for measuring the reasonableness of the costs incurred under the RSS Term Sheet Agreement. In the COS filing at FERC, NRG claimed the compensation for continuing two Dunkirk units in service for nine months should be set at a rate of \$50.5 million. This rate includes recovery of sunk costs on the same basis as if NRG were a regulated supplier.

However, a COS rate yields poor operating incentives because, under that approach, NRG would lack the incentive to operate its units efficiently. Moreover, a COS approach is problematic from our perspective of promoting competitive markets, as it allows a generation owner such as NRG to earn market-based returns (potentially in excess of a COS rate) when market conditions are favorable, and to obtain a regulated COS rate, including profits, when market conditions are not favorable. If market conditions improve, as NRG hopes they will by mothballing instead of retiring its Dunkirk facility, then the generation unit could return to a more lucrative market-based rate. By taking this approach, some merchant generation owners could thereby avoid market risks and shift the risks of higher costs to ratepayers.

²⁰ Based on the costs identified by NRG in its RMR filing with FERC, the upper bound of the avoidable costs for nine months (\$40.1 million) could be estimated by reducing the fully embedded COS amount (\$50.5 million) by cost of capital (\$7.5 million) and related income taxes (\$2.8 million). The lower bound of the avoidable costs (\$24.2 million) could be estimated by further reducing from the upper bound by potentially sunk costs associated with depreciation (\$7.0 million), A&G (\$4.6 million), and the coal take-or-pay contract (\$4.2 million).

The proposed condition in the Term Sheet Agreement, whereby NRG would be required to refund a portion of its profits above a certain threshold amount, reduces this concern to some degree. While, as Sierra Club suggests, a provision requiring NRG to refund any profits to National Grid may be preferable from a ratepayer perspective, the proposed condition balances the interests of ratepayers and generation owners, and is reasonable under the circumstances.

The Term Sheet Agreement covers a term of nine months, at a cost of \$33 million, plus coal delivery costs. The costs are less than what NRG sought in its COS filing at FERC, and are within the range of estimates of avoidable costs.

Allowing NRG to retain energy revenues is reasonable since it creates an incentive for operating efficiently. Under the proposed Term Sheet Agreement, capacity revenues are credited to ratepayers. This is reasonable, as the capacity revenues will help to reduce the burden on ratepayers of the contract payments. However, because NRG will not retain the capacity revenues, this provision could vitiate NRG's incentive to offer Dunkirk Units 1 and 2 competitively into the capacity market. Indeed, NRG might profit from offering them at a price so high they would fail to clear the capacity market, effectively withholding that capacity in order to increase the market price of capacity received by its other generating units remaining in the market. The Term Sheet Agreement addresses this concern by committing NRG to offer its units into the capacity market at a price no higher than their going-forward costs. However, the Term Sheet Agreement does not define the term "going-forward costs".

We note that the Term Sheet Agreement provides sufficient revenues to keep Dunkirk Units 1 and 2 in operation for local reliability, and requires the units be bid into the

NYISO's day-ahead energy market, except for outages. Therefore, the incremental costs (i.e., the costs above those set in the RSS Term Sheet Agreement, which establishes the costs NRG will incur in providing the local reliability service itself) of Dunkirk Units 1 and 2 supplying capacity (i.e., bidding into the capacity market) appear de minimus. Thus, the parties should have expected and we would expect that the capacity associated with Dunkirk Units 1 and 2 will be bid into the capacity market at a correspondingly de minimus price. The Term Sheet Agreement appears to be reasonable based on these expectations. When the final executed copy of the contract implementing the Term Sheet Agreement is filed as discussed below, National Grid and NRG shall describe how the bid prices reflecting these expectations will be set.

Tariff Amendments/Cost Allocation and Recovery

Upon consideration, we agree with MI's recommendation that we refer issues pertaining to the recovery of RSS costs from National Grid's retail customers to the utility's pending rate case, Case 12-E-0201. Determining the appropriate cost recovery mechanism in the context of the ongoing rate case will allow us to fully understand the rate implications of the various cost recovery approaches advanced by the parties. Therefore, the proposed RSS surcharge tariffs are rejected. National Grid is directed to defer the RSS costs and accrue carrying charges at the other customer provided capital rate, which is appropriately applied in circumstances such as these when it is expected that the duration of the deferral will be short. If, however, the recovery period for the RSS costs determined in Case 12-E-0201 extends beyond the rate year in that proceeding, accrual of interest on the RSS costs will be increased to the allowed pre-tax rate of return starting on April 1, 2013.

With regard to MI's concerns about the allocation of the RSS costs, we concur with MI that it would be inequitable for retail customers to be solely responsible for paying the RSS costs. National Grid acknowledges that wholesale transmission customers, as well as customers of New York State Electric & Gas (NYSEG), will benefit from the RSS agreement. We estimate that approximately 7.5% of the RSS costs could be recovered from National Grid's wholesale transmission customers. However, we do not expect National Grid to seek recovery from NYSEG. It is National Grid's customers that will realize the vast majority of the RSS benefits; in comparison, NYSEG's customers will experience only comparatively de minimus benefits.

National Grid is expected to include in its transmission revenue requirement filing, due to FERC next June, the costs associated with the executed RSS agreement, as allocated between retail and wholesale customers. The wholesale customers' share of the costs, expected to be recovered through the FERC Transmission Service Charge, would be credited to retail customers through National Grid's Transmission Revenue Adjustment mechanism.

MI and National Grid misapprehend our settlement guidelines and their relevance to this proceeding. Entry into the RSS term sheet was not a settlement of issues in this proceeding pursuant to the settlement guidelines. Instead, it was a decision made by National Grid in furtherance of its responsibilities as a fully-regulated electric retail utility. In so doing, National Grid proceeded in accordance with the usual PSL regulatory process, where decisions a regulated utility makes are subject to subsequent review. Therefore, the settlement guidelines are not applicable in this situation, and arguments to the contrary are rejected.

Several parties question the precedential value of the decisions reached here. We note that the facts involved in the review of each notice submitted in compliance with the Retirement Notice Order are unique, and may warrant different treatment on a case-by-case basis.

CONCLUSION

It is essential that the mothballing or retirement of generation units that are subject to a lightened regulatory regime do not jeopardize the reliability of the electric system. We have taken the necessary steps herein to ensure that National Grid procures sufficient generation facilities necessary for its provision of safe and adequate service, as required under the PSL. The Term Sheet Agreement governing National Grid's procurement of RSS from NRG represents a reasonable balance of the interests of electric consumers and the generation owner, and is in the public interest.

The Commission orders:

1. The request of NRG Energy, Inc. and Dunkirk Power LLC for waiver of generator retirement notification requirements is denied.

2. National Grid shall procure Reliability Support Services from Dunkirk Power LLC, and Dunkirk Power LLC shall provide Reliability Support Services to National Grid, in accordance with the Term Sheet Agreement, which is approved, as discussed in the body of this Order.

3. National Grid and NRG Power Marketing LLC shall file a final executed copy of the contract implementing the Term Sheet Agreement at least five days prior to the commencement of Reliability Support Services.

4. National Grid shall consult with Department of Public Service Staff and file, within 30 days of the date of

this Order, a schedule and process for soliciting alternative solutions to any remaining reliability needs that may exist after completing the facility improvements scheduled for completion by May 31, 2013.

5. The Tariff Amendments filed by National Grid are rejected.

6. National Grid shall file a supplement, on not less than one day's notice, to become effective August 31, 2012, canceling the tariff amendments listed in the Appendix.

7. The requirement of Section 66(12)(b) of the Public Service Law regarding newspaper publication of the cancellation supplement in Clause No. 5 is waived.

8. National Grid shall defer the costs of procuring Reliability Support Services from Dunkirk Power LLC and accrue carrying charges at the other customer provided capital rate. If the recovery period for the Reliability Support Service costs decided in Case 12-E-0201 extends beyond the rate year in that proceeding, accrual of interest on the Reliability Support Service costs will be increased to the allowed pre tax rate of return starting on April 1, 2013.

9. Issues pertaining to the recovery of costs associated with procuring Reliability Support Services from Dunkirk Power LLC from National Grid's retail customers are referred to the utility's pending rate case, Case 12-E-0201.

10. The deadlines provided for in this Order may be extended by the Secretary in her discretion.

11. This proceeding is continued.

By the Commission,

(SIGNED)

JACLYN A. BRILLING
Secretary

SUBJECT: Filing by NIAGARA MOHAWK POWER CORPORATION D/B/A
NATIONAL GRID

Amendments to Schedule P.S.C. No. 6 - Electricity

Original Leaf No. 235.0.1

Sixth Revised Leaf No. 235

Ninth Revised Leaf No. 3

Issued: July 20, 2012 Effective: September 1, 2012

NEWSPAPER PUBLICATION: Waived.