STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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September 12, 2013

SENT VIA ELECTRONIC FILING
Kimberly D. Bose, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Room 1-A209
Washington, D.C. 20426

Re: Docket No. ER13-1380-000 - New York Independent System Operator, Inc.

Dear Secretary Bose:

For filing, please find the Request for Rehearing and Clarification of the New York State Public Service Commission in the above-entitled proceeding. The parties have also been provided with a copy of this filing, as indicated in the attached Certificate of Service. Should you have any questions, please feel free to contact me at (518) 473-8178.

Very truly yours,

David G. Drexler
Assistant Counsel

Attachment
cc: Service List

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.	))	Docket No. ER13-1380-000

REQUEST FOR REHEARING AND CLARIFICATION OF THE NEW YORK STATE PUBLIC SERVICE COMMISSION

BACKGROUND

On April 30, 2013, the New York Independent System Operator, Inc. (NYISO) filed proposed tariff revisions to establish a New Capacity Zone (NCZ) (NCZ Filing). The NCZ Filing explained that the NYISO had identified a current Highway deliverability constraint driving the need to create an NCZ in NYISO Load Zones G, H, I, and J.[1] The asserted purpose of this NCZ is to induce developers of generation to build facilities within the new zone to address the identified constraint.

The NCZ Filing also requested that the Federal Energy Regulatory Commission (FERC or Commission) accept the NYISO's previously proposed market power mitigation rules applicable to the NCZ. The NYISO plans to implement the NCZ by May 1, 2014, to coincide with the start of the 2014/2015 Capability Year.

[1] Capitalized terms that are not otherwise defined herein have the meaning set forth in the NCZ Filing, the NYISO Services Tariff, or the NYISO Open Access Transmission Tariff.

On May 21, 2013, the New York State Public Service Commission (NYPSC) submitted its timely Notice of Intervention and Protest to the NCZ Filing (NYPSC Protest). The NYPSC opposed the NCZ Filing because it did not recognize the State's ongoing competitive procurement processes that would address the same deliverability constraint identified by the NYISO, within the same period that the NYISO seeks to impose the NCZ. In light of these State processes, the NYPSC maintained that the price signal from the NCZ would not be effective in incenting new generation over the short-term, since suppliers would be looking to the price signals that result from the State's initiatives and not the short-term price spikes associated with implementing the NCZ at this time. This price spike will require ratepayers to pay hundreds of millions of dollars in unjust and unreasonable increased Installed Capacity (ICAP) costs. In addition, the NYPSC advocated for a mechanism for determining when the NCZ is no longer necessary and should be eliminated. The NYPSC further opposed the NYISO's proposed mitigation measures for any new entrants in this NCZ, which would likely have the effect of deterring new entry that the NCZ is supposedly designed to incent.

On August 13, 2013, FERC issued an Order accepting the NCZ Filing and establishing a technical conference to discuss whether or not to model Load Zone K as an export-constrained zone for a future Demand Curve reset proceeding (August 2013 Order).[2] The August 2013 Order dismissed the NYPSC's arguments related to the short-term ineffectiveness of price signals in the NCZ, and the concomitant windfall in ICAP revenues that would be extracted from ratepayers. As FERC stated, "[b]ecause the net cost of new entry in the new capacity zone is higher than in the Rest-of-State, the new capacity zone needs its own ICAP Demand Curve, reflecting its higher net cost of new entry, in order to send the necessary price signals *over the long run* and provide the higher capacity revenue over the long run needed to encourage new investment."[3]

In addition, FERC's August 2013 Order rejected the NYPSC's request to include a mechanism for determining when the NCZ is no longer necessary and should be eliminated. In rejecting this argument, FERC determined that the NYISO should work with its stakeholders to determine if a mechanism for eliminating the NCZ is "deemed necessary," and if so, "file appropriate tariff revisions with the Commission."[4] The Commission also found that the NYPSC's arguments with respect to

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[2] Docket No. ER13-1380, New York Independent System Operator, Inc., Order Accepting Proposed Tariff Revisions and Establishing a Technical Conference, 144 FERC ¶61,126 (issued August 13, 2013) (August 2013 Order).

[3] August 2013 Order, ¶26 (emphasis added).

[4] August 2013 Order, ¶82.

the NCZ mitigation measures were beyond the scope of this proceeding.

REQUEST FOR REHEARING

The NYPSC requests rehearing of the August 2013 Order pursuant to Rule 713 of the Commission's Rules of Practice and Procedure.[5] As discussed more fully below, the August 2013 Order contains numerous mischaracterizations and incorrect statements regarding the NYPSC's Protest, which led the Commission to make erroneous conclusions.

The NYPSC urges the Commission to revisit the NYPSC's arguments and to properly account for the NYPSC's on-going initiatives that carry out New York Governor Andrew Cuomo's Energy Highway Blueprint, and will address the deliverability constraint associated with the NCZ. Because these initiatives will directly impact the long-term price signals for encouraging new entry in the NCZ, implementing the NCZ at this time will result in improper and meaningless price signals to prospective developers, without any concomitant ratepayer benefits. The NYPSC estimates that these improper price signals will result in an economic windfall for incumbent generators and a significant price increase for ratepayers that may be upwards of $350 million per year. This translates to a total bill rate increase

[5] 18 C.F.R. §385.713.

of over 25% for some customers of Central Hudson Gas and Electric Corporation. The NYPSC anticipates that the bulk power transmission relief that will result from the NYPSC's initiatives will have a material impact on long term Installed Capacity prices in the NCZ. Therefore, to ensure FERC has a complete record, the Commission should direct the NYISO to analyze the long-term price signals that will result from the NYPSC's initiatives prior to implementing the NCZ. In the alternative, the Commission should phase-in the NCZ price signals to correspond with the implementation of the NYPSC's congestion relief initiatives.

The NYPSC also requests that the Commission direct the NYISO to file tariff amendments providing a process for the elimination of the NCZ when the deliverability issues that led to its formation are resolved. The Commission appears to suggest inconsistent standards by which the NCZ should be created (i.e., deliverability), and for which the NCZ should be retained (i.e., reliability and/or the cost-of-new-entry). Finally, we ask that the Commission direct the NYISO to address the need to modify the "buyer-side" mitigation measures for the NCZ, which would apply to any new entry in the NCZ and would deter the very entry that the NCZ is supposedly designed to incent. For these reasons, the Commission should grant the NYPSC's Request for Rehearing and Clarification.

I. STATEMENT OF ISSUES

A. Whether FERC's decision, which incorrectly characterized the NYPSC's Protest and failed to consider arguments that the New Capacity Zone would result in unjust and unreasonable impacts, was arbitrary, capricious, inconsistent with reasoned decision-making, an abuse of discretion, or otherwise not in accordance with law.[6]

B. Whether FERC's decision, which failed to provide tariff provisions for eliminating the New Capacity Zone that are comparable to the provisions for creating the New Capacity Zone, was arbitrary, capricious, inconsistent with reasoned decision-making, an abuse of discretion, or otherwise not in accordance with the law.[7]

C. Whether FERC's decision, which failed to address the NYPSC's Protest that the mitigation measures applied to the New Capacity Zone are unjust and unreasonable, was arbitrary, capricious, inconsistent with reasoned decision-making, an abuse of discretion, or otherwise not in accordance with law.[8]

II. DISCUSSION

A. <u>The Commission Incorrectly Characterized The NYPSC's Protest And Failed To Provide Meaningful Consideration Of Arguments That The New Capacity Zone Would Result In Unjust And Unreasonable Impacts</u>

The August 2013 Order states that the Commission "disagree[s] with the NYPSC that creating a new capacity zone would provide no economic benefits and would needlessly increase

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[6] In reviewing agency determinations, courts shall "hold unlawful and set aside agency action, findings, and conclusions found to be...arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law,...or, unsupported by substantial evidence." 5 U.S.C. §706; see also, <u>Farmers Union Cent. Exchange, Inc. v. F.E.R.C.</u>, 734 F.2d 1486 (D.C. Cir. 1984).

[7] <u>Id.</u>

[8] <u>Id.</u>

customers' bills."[9] The NYPSC did not dispute that creating an NCZ could have long-term reliability benefits, or that the creation of a new NCZ in Zones G-J may eventually incent new generation in that location,[10] but instead disputed that these benefits would accrue from establishing the NCZ "*at this time*."[11]

As the NYPSC demonstrated in its Protest, there are new State transmission initiatives underway that will address the deliverability constraint identified by the NYISO. In particular, two programs that address recommendations made by New York Governor Andrew Cuomo's Energy Highway Blueprint will result in the addition of major transmission facilities in the corridor identified in the NCZ Filing as congested.[12] The first of these seeks transmission solutions that can be constructed by the summer of 2016; the NYPSC anticipates making a decision on funding these solutions this fall.[13] The second proceeding solicits alternating current transmission proposals, with the goal of adding at least 1,000MW of transfer capability over the

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[9] August 2013 Order, ¶25.

[10] The NYPSC recognized that NCZs "have the potential to send appropriate price signals to retain existing generation resources and to encourage the entry of new resources." NYPSC Protest, p. 2.

[11] NYPSC Protest, p. 3 (emphasis added).

[12] See, Energy Highway Blueprint, pp. 37-49, http://www.nyenergyhighway.com/Content/pdf/Blueprint_FINAL.pdf

[13] Case 12-E-0503, Generation Retirement Contingency Plans, Order Instituting Proceeding and Soliciting Indian Point Contingency Plan (issued November 30, 2012).

Upstate New York/Southeast New York and Central East interfaces.[14] The Energy Highway Blueprint presented to the Governor calls for construction of the projects selected in this latter process by 2018.[15]

The progress of the State programs raises "serious doubts regarding the effectiveness of creating an NCZ *at this time*, while requiring ratepayers to pay hundreds of millions in additional Installed Capacity costs within the NCZ with no concomitant benefits to consumers."[16] The Commission either failed to consider these imminent changes "on the ground," or arbitrarily and capriciously ignored them. The Commission should not put blinders on to the State's initiatives, which should be viewed as supportive of FERC's goals.

In light of the NYPSC's ongoing proceedings, potential new entrants contemplating entry in the Lower Hudson Valley three or four years from now will not look at the prices set in the summer of 2014 as a valid and indicative "long run price signal." Implementing the NCZ in 2014 will provide a meaningless price signal and will only serve to provide an

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[14] Case 12-T-0502, <u>Alternating Current Transmission Upgrades</u>, Order Instituting Proceeding (issued November 30, 2012). Application materials are due to the NYPSC by October 1, 2013.

[15] See, Energy Highway Blueprint, p. 40.

[16] NYPSC Protest, p. 3 (emphasis added). As noted above, the NYPSC estimates the price impacts may be upwards of $350 million per year, which translates to a rate increase of over 25% for some customers.

extremely high short-term price that provides incumbent generators in the Lower Hudson Valley with an economic windfall. This skewed short-term price bears no relation to the long-term price signal the NCZ is intended to produce, and would be completely meaningless for prospective developers. The Commission failed to properly account for the NYPSC's on-going initiatives and to recognize the important distinction that the NYPSC was making between short-term and long-term benefits of the NCZ price signals.

FERC's rationale in approving the NCZ stressed the importance of a long-term price signal. The August 2013 Order indicated that "creating a new capacity zone is necessary to provide more accurate price signals over the long run to encourage new investment in the new capacity zone when it is needed."[17] The Commission's goal of creating the NCZ to provide a long-term price signal would be successfully achieved by allowing for a delay until 2017 for the capacity price increase, or a phase-in approach as advocated by the New York Transmission Owners, so that prices in the NCZ would reflect the new configuration of the transmission system. Therefore, the Commission should direct the NYISO to analyze the long-term price signals that will result from the NYPSC's initiatives prior to implementing the NCZ. Alternatively, the Commission

[17] August 2013 Order, ¶25.

should phase-in the NCZ price signals to correspond with the implementation of the NYPSC's congestion relief initiatives. Either approach would ensure the Commission establishes proper price signals, and achieves the required balance of just and reasonable rates for ratepayers and ICAP providers.[18]

In addition, the Commission incorrectly characterized the NYPSC's argument by stating that "[t]he NYPSC is concerned that prices in the new capacity zone would be higher than in the Rest-of-State, because the higher net cost of new entry in the new capacity zone would raise the new capacity zone's ICAP Demand Curve."[19] This characterization is in fact contrary to the NYPSC's position. The NYPSC maintains that even if the Cost-of-New-Entry (CONE) was equal in the different zones, prices could be higher in the new zone because of the Locational Capacity Requirement (LCR) in the NCZ and the different lengths of the Demand Curve. Under a likely scenario, the CONE in the Lower Hudson Valley could equal or approximate the CONE in the Rest-of-State market. However, because of the LCR, prices may not be allowed to equilibrate. Therefore, it is possible that

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[18] This one-sided approach fails to ensure prices to consumers are not excessive, and is impermissible. See, Farmers Union Cent. Exchange, Inc. v. F.E.R.C., 734 F.2d 1486, 1501-02 (D.C. Cir. 1984) (citing FERC v. Pennzoil Producing Co., 439 U.S. 508, 517 (1979); Permian Basin Area Rate Cases, 390 U.S. 747, 797 (1968)); see also FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 585 (1942).

[19] August 2013 Order, ¶26.

even if the deliverability issue is resolved and there is no difference in CONE, prices could remain higher in the NCZ. Because the NYISO has not included a process for determining whether to eliminate the new capacity zone if the Highway deliverability constraints are longer binding, as discussed in the following section, it further exacerbates the problem.

B. <u>The Commission Improperly Concluded That Tariff Provisions Were Not Needed To Determine When The Elimination Of The New Capacity Zone Is Warranted</u>

By failing to establish tariff provisions for determining when the NCZ may be eliminated, the Commission has inappropriately skewed prices in favor of suppliers, and left ratepayers in the position of having to bear a permanent increase in ICAP prices. While the Commission maintained that relieving the binding deliverability constraint will result in price convergence between the Rest-Of-State market and the NCZ, the NYISO's recent analysis presented at various working group meetings demonstrates that even if the deliverability constraint dissipates, prices will not be able to "equilibrate" or converge unless there is such an abundance of excess capacity in the new capacity zone that the supply approaches the zero crossing point on the Demand Curve.[20] The Commission must address this flaw in the market design by ensuring the NCZ can be eliminated when it is no longer needed.

Moreover, the NYPSC is concerned that the Commission appears to suggest a different standard may be appropriate for NCZ elimination than NCZ creation. In the separate proceeding where the NYISO originally proposed two main criteria for defining when to create an NCZ, the NYISO filed a deliverability test and a reliability test. The NYISO also proposed to include a CONE analysis to determine if the cost of entry was substantially different in a particular zone. The Commission rejected both the reliability criteria and the CONE criteria, and determined that the deliverability test should be the single threshold for creating an NCZ.[21]

While the August 2013 Order indicates that the "NYISO should work with its stakeholders, and if a mechanism for zone elimination is deemed necessary, NYISO should file appropriate

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[20] In the Consumer Impact Analysis presented at the March 28, 2013 Installed Capacity Working Group (ICAP) meeting, the NYISO projected clearing prices for 2018 under various scenarios. Even under the scenario with the largest increase of supply in the NCZ (i.e., 1,500 MW of generation and transmission additions), the forecasted clearing prices in the NCZ did not equilibrate with the Rest-of-state prices. August 2013 Order, ¶51.

[21] ER04-449, New York Independent System Operator, Inc. and New York Transmission Owners, Order on Compliance Filing, 136 FERC 61,165 (issued September 8, 2011).

tariff revisions with the Commission,"[22] the Commission prematurely and inappropriately suggests different criteria for eliminating the NCZ. The NYPSC presented evidence that the system upgrades that will result from its two ongoing proceedings "would eliminate the need to create a new capacity zone and the resulting higher prices, because the upgrades would relax the transmission constraint that has bottled generation capacity." However, the Commission's rationale for dismissing the evidence relies on the same reliability criteria that it previously rejected in the NYISO's filing to establish criteria for creating an NCZ.[23] The August 2013 Order states that "no one argues that the upgrades would eliminate the reliability need for some capacity to be located within the new capacity zone."[24] Moreover, the Commission stated that

> [i]n order to encourage new resources to be built in the new capacity zone when they are needed, capacity prices on average over time must approximate the net cost of new entry in the new capacity zone. Otherwise, developers will be reluctant to build the new capacity that will be needed as load grows and resources retire over time. Because the net cost of new entry in the new capacity zone is higher than in the Rest-of-State, the new capacity zone needs its own ICAP Demand Curve, reflecting its higher net cost of new entry, in order to send the necessary price signals over the long run and provide the higher

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[22] August 2013 Order, ¶82.

[23] ER04-449, New York Independent System Operator, Inc. and New York Transmission Owners, Order on Compliance Filing, 136 FERC 61,165 (issued September 8, 2011).

[24] August 2013 Order, ¶26.

> capacity revenue over the long run needed to encourage new investment.[25]

These statements attempt to provide a rationale for why the new zone is needed based on factors (i.e., reliability and CONE) that the Commission previously deemed irrelevant to the creation of an NCZ. As a result, New York is left with a tariff structure that allows for the creation of NCZs without allowing for their dissolution, and a sustained price separation even after the initial deliverability issue is resolved. This result is clearly unjust and unreasonable and improperly favors suppliers' interests to the detriment of ratepayers. The Commission should therefore direct the NYISO to include a process in its tariff for determining how to eliminate the new capacity zone if the Highway deliverability constraints are no longer binding. These provisions are necessary to ensure rates remain just and reasonable for ratepayers, and not just for suppliers.[26]

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[25] August 2013 Order, ¶26.

[26] According to the Commission, "the failure to create a zone where one is needed is much more significant than the impact of a failure to eliminate an existing unneeded zone." August 2013 Order, ¶82. As noted above, this one-sided approach fails to ensure prices to consumers are not excessive, and is impermissible. See, Farmers Union Cent. Exchange, Inc. v. F.E.R.C., 734 F.2d 1486, 1501-02 (D.C. Cir. 1984).

C. The Commission Improperly Rejected Arguments That The Mitigation Measures Applied To The New Capacity Zone Were Unjust And Unreasonable

The Commission summarily dismissed the NYPSC's arguments that the proposed mitigation measures were unjust and unreasonable, finding that they were "beyond the scope of this proceeding."[27] Although the Commission previously accepted market power mitigation measures for an NCZ, it was done on a generic basis. Given that the parameters of the NCZ have now been defined, the Commission should address whether such measures would be just and reasonable as applied to the specific NCZ. Moreover, the NYISO's NCZ Filing raised the issue of whether the mitigation measures were appropriate by requesting the approval of such measures.

The NYPSC's Protest maintained that the uncertainty of potential capacity earnings produced by the accompanying "buyer-side" mitigation rules in the NCZ will likely have more of a long-term adverse impact on reliability and prices in the NCZ. In particular, "[u]nder the proposed rules, even a pure merchant entrant would face the risk that it would be precluded from selling into the capacity market, thus effectively receiving a market price of $0. This risk will inevitably increase the difficulty of financing merchant projects, and potentially exclude them from the capital markets altogether. Thus, while

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[27] August 2013 Order, ¶84.

the "buyer-side mitigation" rules were intended to encourage merchant entry, their actual implementation will likely have the opposite effect. These rules would likely serve as a barrier to new entry, and act counter to the rationale stated for creating this new zone in the first place (i.e., to encourage the entry of new resources). The application of those rules to the NCZ should therefore be rejected."[28]

CONCLUSION

In accordance with the foregoing discussion, the NYPSC respectfully requests that the Commission grant the foregoing Request for Rehearing and Clarification.

Respectfully submitted,

Peter McGowan
General Counsel
Public Service Commission
of the State of New York

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Dated: September 12, 2013
Albany, New York

[28] NYPSC Protest, pp. 8-9.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated: Albany, New York
September 12, 2013

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