

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
Albany on August 24, 2005

COMMISSIONERS PRESENT:

William M. Flynn, Chairman
Thomas J. Dunleavy
Leonard A. Weiss
Neal N. Galvin
Patricia L. Acampora

CASE 03-E-0188 – Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard. (Lyonsdale Biomass Facility - Request for Renewable Portfolio Standard Support as a Maintenance Resource.)

ORDER APPROVING REQUEST FOR RPS PROGRAM
FUNDING AS A MAINTENANCE RESOURCE

(Issued and Effective August 31, 2005)

BY THE COMMISSION:

INTRODUCTION

By Order issued April 14, 2005 (April Order), the Public Service Commission approved an Implementation Plan for the Renewable Portfolio Standard (RPS) Program.¹ On April 15, 2005, NGP Power Corporation (NGP Power), on behalf of its subsidiary, Lyonsdale Biomass, LLC (Lyonsdale), submitted an application for a

¹ Case 03-E-0188, Retail Renewable Portfolio Standard, Order Approving Implementation Plan, Adopting Clarifications, and Modifying the Environmental Disclosure Program (issued April 15, 2005).

determination that its Lyonsdale biomass facility is eligible for RPS Program funding as a maintenance resource. After review and consideration of the application, the Director of Electricity and Environment (OEE Director) determined, in a letter to NGP Power dated April 23, 2005, that the facility is eligible to participate in the RPS Program as a maintenance resource. In this Order, we provide Lyonsdale options for obtaining RPS Program financial support.

BACKGROUND

By Order issued September 24, 2004 (September Order), we established a maintenance resource category eligible for RPS Program support as a subset of the Main Tier² to assist certain existing renewable resource facilities to remain financially viable.³ The maintenance resource category is an important component of the RPS Program, designed to avoid losing valuable baseline renewable resources, not otherwise eligible for RPS Program support because they may be financially unable to continue operations.

The April Order established a process for a case-by-case review and analysis to determine the level of funding for a maintenance resource. The case-by-case approach was intended to ensure that the amount of support provided is sufficiently tailored to meet the needs of each project, while reserving the largest possible portion of RPS Program funds to encourage the development of additional renewable resources. Eligibility criteria includes consideration of operating costs, financial records, effect of market rules, potential for capital improvements, and relationship with a parent company.

² The Main Tier is generally comprised of specified renewable resources that were not in operation before January 1, 2003 and sell wholesale power into the spot market.

³ Case 03-E-0188, supra, Order Regarding Retail Renewable Portfolio Standard (issued September 24, 2004).

A notice of this pending action was published, pursuant to the State Administrative Procedure Act (SAPA) on May 11, 2005 in the State Register. The only comments received were provided by the owners of the Lyonsdale facility.

APPLICATION

The Lyonsdale facility is a 19 megawatt (MW) wood-fired cogeneration plant selling energy and capacity through the New York Independent System Operator, Inc. (NYISO) day-ahead and real-time markets. The facility, located in Lyons Falls, New York, began commercial operation in August 1992. NGP Power purchased the facility on June 1, 2003 and transferred it to Catalyst Renewables Corporation on June 13, 2005.⁴

Lyonsdale states that the facility provides significant economic benefits for the State of New York. The facility itself directly employs 20 people, with a payroll in excess of \$1 million per year. In addition, Lyonsdale supports over 100 loggers as suppliers, which infuses more than \$5 million per year into the upstate economy, providing landowners and sawmills with a stable, year round market for their low-valued wood products. Lyonsdale also has a contract for steam sales through 2006 with the Burrows Paper Corporation. The arrangement helps minimize Burrows' use of higher-priced natural gas imported from Canada, thereby enhancing the economic viability of the paper plant that employs approximately 40 people.

In the application for RPS Program support, Lyonsdale reports that its facility has been unable to operate profitably on a sustained basis since the 1999 buyout of Lyonsdale's previous owners' Public Utility Regulatory Policy Act (PURPA) contract

⁴ By letter dated August 10, 2005, the Commission was advised that effective June 13, 2005, ownership of the Lyonsdale facility was transferred from NGP Power to Catalyst Renewables Corporation. For the purposes of this Order, the entities of NGP Power, Catalyst Renewables Corporation, and Lyonsdale, LLC will be collectively referred to as "Lyonsdale."

by Niagara Mohawk Power Corporation. Additionally, Lyonsdale asserts that additional investments are needed to improve the plant and its fuel supply. It requests funding under the RPS Program to stabilize operations and provide incentives for investors to commit capital necessary to complete plant improvements and fund local fuel infrastructure programs. Finally, Lyonsdale says that, while the facility, as a biomass plant, is entitled to federal tax credits, it has not earned sufficient revenues to become a taxpayer and does not obtain value from the project's tax attributes. In support of the application, Lyonsdale submitted two years of financial data⁵ and its income tax return for 2003. The 2004 return is not yet available.

COMMENTS

Lyonsdale submitted comments in support of its application. In its comments, it raised three issues: the distinction between base period output and additional output of the facility; the appropriate approach for calculation of maintenance resource support; and inclusion of all of a facility's output for resources that split their output between the maintenance resource category and the Main Tier. Those issues are discussed below.

Distinction Between Base Period Output and Additional Output

Lyonsdale observes that the April Order assumes the possibility that existing resources may be able to increase their output over the base levels and that such additional output should be considered as a Main Tier resource eligible for RPS Program support. Lyonsdale raises the concern that the letter from the OEE Director to Lyonsdale, dated April 25, 2005 determining its eligibility as a maintenance resource, did not discuss this base period issue. Accordingly, Lyonsdale requests assurances that the base period for its biomass facility is the 12 months ending December 31, 2002 and that all output

⁵ Three years of financial data are generally required for an application. Lyonsdale was permitted to submit two years of data because the owners have operated the plant for less than three years.

from the facility in excess of this base period output is considered a new Main Tier resource eligible to participate in Main Tier procurements.

Calculation of Maintenance Resource Support

Lyonsdale warns that use of the case-by-case approach to evaluate the amount of RPS Program support for maintenance resources may lead to utility style rate-of-return regulation on its own facility as well as on other maintenance resources requesting support. Lyonsdale asserts that this form of regulation is incompatible with the objectives of fostering the development of renewable resources in a competitively sound manner because cost-based pricing would suppress the incentives for innovation and efficiency provided by unregulated markets for generation services. Lyonsdale further argues that using such a method would discourage investors from considering more risky investments such as the Lyonsdale biomass facility. The alternative, Lyonsdale suggests, would be for the Commission to employ a discount, applied to the average RPS Program benefit extended to Main Tier resources in the prior RPS solicitation. Specifically, Lyonsdale proposes that the Commission award an amount equivalent to a ten percent discount from the average Main Tier awards. Lyonsdale asserts that this award formula would reduce the cost to retail customers of meeting the Commission's RPS Program objectives while enabling Lyonsdale and any future investors to continue operation of their facilities.

Resources Splitting Output Between the Maintenance Category and the Main Tier

Based on the assumption that maintenance resources with output in excess of their base period outputs would be considered, with respect to the excess output, as Main Tier resources in the RPS Program, Lyonsdale submits two suggestions. First, Lyonsdale recommends that, in these circumstances, all of the output from the facility should be covered under a single agreement, with separate benefits levels applying to the facility's base period output and to the full incremental output. Lyonsdale explains that this contract formation would recognize the policies of the New York State Energy Research and Development Authority (NYSERDA) regarding energy production above

or below contract quantities and ensure that these policies are not unfairly applied to only part of the output of the facility. Second, Lyonsdale requests that the Commission direct NYSERDA to provide Lyonsdale with the maintenance resource benefits for its incremental output until this output is selected pursuant to NYSERDA's next procurement solicitation.

DISCUSSION

Options for RPS Support

The continuation of Lyonsdale's operation would improve the diversity of the State's energy supply, result in economic development, and provide environmental benefits. The State would benefit from maintaining Lyonsdale as a base line renewable resource. The information provided by Lyonsdale supports the conclusion that the facility incurs significant net losses and requires financial assistance to continue its operation. The Department of Public Service (DPS) Staff calculated the level of funding that Lyonsdale requires to remain financially viable and continue its operation. The Staff's recommendations are reasonable and would balance the objectives of providing support and minimizing costs to the RPS Program.

Two options would provide a reasonable level of support to Lyonsdale.⁶ The options provide different benefits, along with varying levels of risk. Because

⁶ Both options would allow Lyonsdale to opt out of the RPS Program for all or part of its output at any time and for 12-month periods during the contract term if it should decide to sell energy into the New York State green market or pursuant to an Executive Order (EO) 111 procurement.

Lyonsdale is in the best position to decide how much risk it is able to assume and when it needs support to minimize its risks, the options are provided to Lyonsdale for its consideration. Lyonsdale shall select one of the options or, alternatively, none of them and provide written notice of its decision to the Secretary to the Commission within 30 days after the date of the issuance of this Order or on another date established by the Secretary, upon Lyonsdale's request for additional time to file such notice. Failure to do so within 30 days from the date this Order is issued, unless this deadline is otherwise extended at the discretion of the Secretary, will be deemed a rejection of the two options for RPS Program support. If Lyonsdale does not select one of the options, it may bid its output into the next procurement for which it qualifies.

If Lyonsdale selects one of the options and notifies the Secretary to the Commission, it will need to work with NYSERDA to execute a contract to effectuate the terms of the option selected. We direct NYSERDA to include in its contract with Lyonsdale reasonable provisions as discussed herein and similar to those contained in existing RPS Program contracts to ensure performance by Lyonsdale as an eligible biomass generation resource under the terms of the RPS Program.

Under Option 1, Lyonsdale would receive payments for each megawatt-hour (MWh) of energy produced at the plant and sold into the wholesale spot market administered by the NYISO, up to a baseline amount of 82,948 MWh, which is consistent with the plant's actual 2002 year production. This option offers RPS Program payments, based on up to 82,948 MWh of production, at \$8.20 per MWh adjusted according to the changes in the price of energy,⁷ over a ten year period beginning January 1, 2006. Option 1 would suffice, under the current assumptions, to permit continued operation.

⁷ Lyonsdale would receive RPS Program payments though NYSERDA and energy payments though the NYISO. If the price of energy increases above the forecasted amount, the RPS Program payment would decline proportionately. On the other hand, if the wholesale price of energy decreases below the forecast, the RPS Program payment would be increased monthly proportionally up to a cap of \$15.00 per MWh.

Option 1 is consistent with Lyonsdale's proposal that the facility's output above its base period level (82,948 MWh) be treated as a new resource eligible for all future Main Tier RPS Program benefits. To receive those benefits, Lyonsdale must participate in a bidding process and be selected for Main Tier benefits. The next Main Tier procurement is currently expected to take place in 2006 for deliveries to begin in 2007; the Commission may extend these dates, depending on the availability of funding resources. Alternatively, if the Lyonsdale facility is able to produce more than 82,948 MWh each year, the excess could be offered in the New York State green market or in an EO 111 procurement.

Under Option 2, Lyonsdale would receive \$11.50 per MWh, adjusted monthly according to changes in the price of energy up to a \$15 cap, for all energy produced and sold into the NYISO spot market, up to 133,152 MWh per year over a ten year period starting January 1, 2006. Under Option 2, Lyonsdale would not have to wait until 2007, or thereafter, for payments on the incremental energy (as it would for Option 1, assuming the Lyonsdale facility is selected in the Main Tier procurement), but would instead receive payments to reflect all energy produced beginning January 1, 2006, up to 133,152 MWh per year. Option 2 is based on the assumption that investments will have been made and work will have begun to enable incremental generation to commence on January 1, 2006. Any production above 133,152 MWh can be offered in the New York green market or in an EO 111 procurement.

The recently enacted Energy Policy Act of 2005 provides for grants of up to \$20/ton for biomass fuel. The Lyonsdale facility may qualify for such a grant, subject to meeting criteria that will be established by the Secretary of Energy. If a Federal grant should be obtained, it would be appropriate that it offset the RPS Program payments made to Lyonsdale by NYSERDA. Because the Federal grant program has not been designed and implemented, it is impossible to forecast if or when Lyonsdale might receive such a grant. Therefore, as a condition for maintaining its eligibility as a maintenance resource under the RPS Program, the RPS Program contract must require that Lyonsdale apply for any Federal grants for which it may be eligible, and any such

grants awarded should offset the RPS Program maintenance resource payments provided by NYSERDA.

Other Matters

Lyonsdale urges us to determine a standard level of funding by applying a discount to the average benefits provided in the most recent Main Tier solicitation, instead of conducting a case-by-case financial analysis. Lyonsdale's suggested approach would necessarily tie RPS Program funding to past performance; a determination of the appropriate discount would have to be made without a structured analysis of projected revenues and costs. A standard level of funding without reference to a facility's specific financial situation would not ensure careful use of ratepayer money and maximize renewable energy benefits obtained from a limited amount of RPS Program funds. Therefore, we decline to adopt Lyonsdale's suggestions.

Lyonsdale requests a single agreement applicable to its entire output because NYSERDA's initial procurement proposed to make payments for output up to 115% of the bid quantity. In effect, this could result in payments for MWhs produced in excess of the 133,152 MWh, on which Option 2 is based, and so it is rejected with respect to that option. RPS Program funds are limited. With reference to Option 1, we reject the request for the reason stated in the next paragraph.

Finally, Lyonsdale requested that we direct NYSERDA to provide maintenance resource benefits for its incremental output until RPS Program benefits are provided pursuant to NYSERDA's next solicitation. If Lyonsdale selects Option 2, RPS Program benefits will be provided beginning in 2006. It is not possible to satisfy the request regarding Option 1 because we are unable to predict whether Lyonsdale would, in fact, be a winning bidder in the next procurement. We cannot make such a guarantee and, accordingly, reject the proposal with respect to Option 1.

CONCLUSION

Lyonsdale is provided with two funding options, both of which present a level of support that will allow Lyonsdale--which we agree is an important component of the upstate economy--to maintain and increase its current level of production and

continue to make a valuable contribution to the baseline level of renewable generation resources.

The Commission orders:

1. The application of Lyonsdale Biomass, LLC for RPS Program funding as a maintenance resource is approved, subject to receipt of the written notice required in ordering clause 2, and shall be administered by New York State Energy Research and Development Authority in accordance with the discussion in the body of this Order; all other requests are denied.

2. Lyonsdale Biomass, LLC is provided a choice of selecting one of the two options for RPS Program support, or none of them, as described in the body of this Order, and shall provide written notice of its decision to the Secretary to the Commission within 30 days after the date of issuance of this Order, or another date established by the Secretary upon Lyonsdale's request for additional time to file such notice. Failure to timely file the notice shall be deemed a decision by Lyonsdale to decline the two options for RPS Program support. If Lyonsdale does not select one of the two options, it will be permitted to bid its output into the next procurement for which it qualifies.

3. This proceeding is continued.

By the Commission,

(SIGNED)

JACLYN A. BRILLING
Secretary