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Upstate New York Power Producers, Inc.
Comments to Matter No. 14-00933
Re: In the Matter of a Technical Conference on Winter Energy Pricing and Supply

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Upstate New York Power Producers, Inc., provides the following in response to question #3 posed by the New York State Public Service Commission's (the "Commission") Notice Seeking Comments on Matter No. 14-00933 issued May 23, 2014.

Question #3 poses a number of questions that ultimately seek proposals which would encourage generating units capable of burning fuels other than natural gas to be available and remain operational. While not specifically noted in the question, coal must be included when evaluating, maintaining and improving the fuel diversity of the generation supply in New York.

As it is not a "just in time" fuel, coal generating units are able to rely upon an available and predictable fuel source that is not subject to the same volatility and price shocks observed for natural gas. Further, unlike gas or fuel oil, coal is not typically used by consumers as a fuel for heat. Therefore, there are not competing demands for this commodity during times of peak need as experienced this past winter. Coal inventory storage and restocking capabilities for existing plants are robust and substantial providing a reliable, accessible and steadily-priced fuel source during winter periods when gas prices exhibit significant volatility. In comparison to fuel oil, coal is a far less expensive source for fuel diversity. Over the past three years spot prices for fuel oil on a dollar per mmbtu basis have been seven to ten times higher than coal. Coal-fired facilities provide a buffer against even higher electricity prices during periods of high gas costs as experienced this past winter.

Question #3 seeks proposed mechanisms to encourage owners of generating facilities, which add fuel diversity to New York State, to continue to operate rather than choosing to retire or mothball. Changes which would accomplish this goal include, but are not limited to, instituting capacity market reforms, encouraging flexibility and creativity in addressing environmental requirements and promoting alternatives to mothball or retirement, such as repowering with dual fuel capabilities when a key resource is at risk of being lost.

Recent retirements and mothball filings have reduced the diversity of fuel sources utilized by generation facilities in New York. According to the 2014 NYISO Gold Book, since 2011 owners of over 2.5 GWs of coal (1.4 GWs) and oil & gas generation (1.1 GWs) capacity have provided notices of retirement or mothball. The majority of these notices were provided during 2012 at a time when pricing outlooks for the capacity market and the energy markets failed to justify continued operations. The capacity market currently treats all capacity equally. There is no mechanism currently in place to promote fuel diversity and to indicate to market participants that the availability of these fuel diverse facilities are critical and are valued by the market. This leaves New York electricity consumers more dependent on natural gas-fired power plants and subject to price spikes driven by supply issues and increases in commodity costs than they were just two years ago.

The cost of environmental compliance, particularly when it requires significant capital investment, is being seen across the country as a major driver of retirements. As discussed above, recent retirements in New York are disproportionately weighted towards coal and fuel oil facilities. While the goals of the environmental regulations should be maintained, allowing flexibility and creativity to accomplish a variety of policy goals will allow for diverse source generation facilities to remain available and provide a buffer to price shocks. Limiting availability time periods for a facility, capping emission levels or requiring certain market criteria to dictate the need for a facility can allow both goals to be accomplished while ensuring retirement or mothball of the facility is not the only option for a marginally economic facility. This can be accomplished without unfairly impacting all capacity market participants by ensuring that limited-run participants receive capacity payments which are adjusted on a pro-rata basis to reflect their run time limitations.

The New York Installed Capacity Market structure of seasonal auctions which are limited to six month time horizons results in limited visibility and certainty of capacity pricing for generator owners. To date, this structure has failed to incentivize investment in merchant power plant generation that does not require some form of financial support coming outside of the traditional market mechanisms. It is difficult for an owner to commit to a 20-year investment when there is limited certainty for capacity prices. Longer term markets exist in PJM and the New England Power Pool and these can be improved upon to provide the necessary certainty to attract investment.

Implementing a longer term market that sets forward prices for five years would allow owners to confidently assess the financial outlook for their facilities and commit to long-term investments in the facility. Further, a five-year horizon allows owners to access the capital markets and expand their ability to finance major capital projects and environmental upgrades. As a result, the ability to attract construction of new merchant generation is enhanced. For owners facing the decision as to whether or not to continue the operations of a facility, this extended price certainty can be the difference between operating and retiring or mothballing the facility. Installing a long-term market will also assist Load Serving Entities and the Commission in preparing for and responding when owners decide to retire their facilities.

Market-based reforms to the capacity market can be made to encourage fuel diversity and provide incentives to owners whose facilities provide for fuel diversity benefits to New York State customers. One example would be allowing for the carrying cost of storable fuels such as fuel oil and coal to be included in a generator's capacity price bid. This would provide the incentive and the ability to cover the carrying cost of a larger inventory stockpile heading into periods where diverse fuel sources would be required.

Other reforms could include structuring premium or bonus incentives within the capacity market for generation facilities that provide dual fuel capabilities or significantly add to the fuel diversity of the available state generation resources. A target capacity for these types of facilities could be set with needs being satisfied through an auction that would ensure qualifying participants are available to provide the required diverse fuel supply support to buffer the market from the impacts of spikes in the price of natural gas. This would also encourage generator owners to explore enhancements to their facilities with the knowledge that these improvements will provide additional opportunities in the markets.

In the event that a generation owner chooses to file a retirement or mothball notice, the full impact of such a decision, including the loss of fuel diversity, on the state and its stakeholders should be considered and valued. In the Commission's recent *Order Addressing Repowering Issues and Cost Allocation and Recovery* (Case 12-E-0577), refueling of NRG's Dunkirk facility was approved. In approving the Dunkirk refueling, the

Commission determined that the wide-ranging impacts that the plant's retirement would have at the local, regional and state levels had to be evaluated as part of their decision. The Staff Report issued on May 16, 2014 in Case 12-E-0577 highlighted the "insurance value provided by the dual-fuel capability" and cited Dunkirk's ability to run on coal during periods of time when natural gas supply is constrained or unavailable. Staff estimated the Dunkirk facility's dual fuel capability would have provided a $50 million production benefit when gas prices spiked during the three month period from January 2014 to March 2014. Maintaining fuel diversity in New York State provides an important buffer to price shocks as demonstrated in this report.

As it considers responses and next steps, the Commission should be mindful of the changes which have occurred over the past three years which place a greater reliance on natural gas-fired facilities to meet peak demand and the exposure to price spikes that accompanies this increased reliance. Maintaining existing fuel diversity and promoting the availability of alternatives to natural gas facilities should be an important consideration as policies are developed and implemented. This can be accomplished through the introduction of new pricing mechanisms in the capacity market, encouraging flexibility and creativity as environmental standards are set and promoting alternatives to retirement when key assets are at risk.

UPSTATE NEW YORK POWER PRODUCERS, INC.

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