STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on January 23, 2002

COMMISSIONERS PRESENT:

Maureen O. Helmer, Chairman
Thomas J. Dunleavy
James D. Bennett
Leonard A. Weiss
Neal N. Galvin

CASE 01-E-0929 - Petition of Bayswater Peaking Facility, LLC for a Declaratory Ruling on Regulatory Regime; Petition for a Certificate of Public Convenience and Necessity; and Petition for Approval of Financing.

ORDER PROVIDING FOR LIGHTENED REGULATION AND APPROVAL OF FINANCING

(Issued and Effective January 31, 2002)

BY THE COMMISSION:

BACKGROUND

On July 3, 2001, Bayswater Peaking Facility, LLC (Bayswater or the company) filed a petition requesting that it be lightly regulated as an electric corporation under the Public Service Law (PSL), that we grant it a Certificate of Public Convenience and Necessity (CPCN) pursuant to PSL §68 and 16 NYCRR §21.10, and approve financing for its project pursuant to PSL §69. By order issued September 4, 2001, we granted the company a CPCN authorizing it to construct and operate its generating facility and to perform the functions of an electric corporation within New York State. This order only addresses Bayswater's petition for lightened regulation and approval of financing pursuant to PSL §69.

Bayswater, a subsidiary of FPL Energy, LLC plans to construct and operate a 44 MW natural gas fired peaking facility located in Far Rockaway, New York (Facility). Bayswater reports that its parent, FPL Energy, LLC (FPLE) responded in February

2001 to a Request for Proposal (RFP) issued by the Long Island Power Authority (LIPA). LIPA selected FPLE among competitive bidders to own and operate a gas fired peaking unit at a site under option by LIPA, adjacent to the Keyspan Far Rockaway generating facility. LIPA issued the RFP to satisfy the growing need for generating capacity on Long Island and to serve a load pocket in Far Rockaway.

THE PETITION

Bayswater asserts that the Commission has determined that others like it that propose to operate as wholesale generators qualify for lightened regulation.[1] Bayswater is a Delaware Corporation that is a wholly owned subsidiary of FPL Energy, LLC. The petition states that FPL Energy, LLC is one of the nation's largest providers of energy-related services and that it owns and operates domestic power plants representing more than 4,100 megawatts.

According to the petition, the company will operate the Facility solely as a merchant plant, selling all electric capacity, energy and ancillary products only in the competitive wholesale generation market and not to the retail market. Bayswater further asserts in its petition that it will not be affiliated with a power marketer and expects to sell all of its output to LIPA pursuant to a Power Purchase Agreement (PPA). Bayswater also seeks our authorization pursuant to PSL § 69 to enter into indebtedness payable at periods of more than 12 months. Bayswater indicates that construction for the Facility may be financed with non-recourse project debt and that the total financing raised for the Facility will not exceed $50 million. According to the petition, the finance term is expected to be no more than 18 years and interest is expected to accrue at a negotiated spread over LIBOR (London Inter Bank Offering Rate) or

[1] Case 99-E-0148, AES Eastern Energy, L.P., Order Providing for Lightened Regulation (issued April 23, 1999); Case 98-E-1670, Carr Street Generating Station, Order Providing for Lightened Regulation (issued April 23, 1999).

some other published index agreed to with lenders. Bayswater further explains that any financing it obtains will cover the all-in capital costs of the Facility and that any financing vehicle will be funded with equity provided by FPL Energy, LLC and collateralized by the Facility.

In its petition, Bayswater also requests that we grant it the flexibility to substitute financing entities and change payment terms and the amounts of its financing without having to seek new approval from us as long as the total financing amount is less than or equal to the $50 million originally sought and approved by us. Bayswater seeks flexibility to quickly modify its financing to take advantage of changing market conditions so it may avoid unnecessary financing expenses and higher ongoing costs. Bayswater asserts that without such flexibility, its competitive position may be compromised.

In accordance with the State Administrative Procedure Act (SAPA), the petition was properly noticed in the State Register on July 18, 2001. The comment period has expired and no comments have been received.

SUPPLEMENTS TO THE PETITION

Pursuant to the requests of staff of the Department of Public Service (Staff) for more information regarding the possibility of Bayswater and its parent exercising market power, Bayswater supplemented its petition with a letter dated September 26, 2001. In its letter, FPL Energy, LLC asserts that it has no significant generation assets in the Northeast and no transmission assets in the Northeast. FPLE further asserts that it presently does not own any generation or transmission assets in New York State.

Bayswater also responded to Staff’s request that it review two load pocket studies performed by Long Island Lighting Company (LILCO) dated February 1, 1996 and October 1, 1996. These studies identify a load pocket situation on the Far Rockaway peninsula where the Bayswater Facility is to be located. In its September 26, 2001 response, Bayswater asserts that its

Facility will reduce the demand for imported power in Far Rockaway, which must be transmitted on a single existing transmission line. Bayswater claims that LIPA, successor to LILCO, selected FPLE to build the Bayswater Facility to relieve the load pocket condition. Bayswater further asserts that it is unable to exercise market power regardless of supply and demand conditions in the Far Rockaway load pocket because LIPA will purchase all of the Facility's output under a long-term PPA. Further, Bayswater claims that pursuant to the PPA, LIPA will have full dispatch rights and Bayswater will not be able to set the price for its output, but will be paid pursuant to the terms of the PPA.

Staff thereafter requested a copy of the PPA so it could review the terms of the agreement. On December 13, 2001, Bayswater provided Staff with a redacted copy of the PPA between Bayswater and LIPA, to protect confidential trade secret information, and an unredacted copy of the PPA for Staff to review and return to Bayswater's attorneys. Bayswater requested trade secret protection of this contract pursuant to 15 NYCRR § 6-1.3. Staff agreed to not make copies of the unredacted contract or disclose it to third parties.

DISCUSSION AND CONCLUSION

Lightened Regulation

Under the realistic appraisal test in the AES and Carr Street Orders,[2] it was concluded that new forms of electric service providers participating in wholesale markets would be lightly regulated. Under this approach, PSL Article 1 applies to Bayswater because it meets the definition of an electric corporation set forth in PSL §2(13) and it is engaged in the manufacture of electricity described in PSL §5(1)(b). Bayswater is therefore subject to provisions, such as PSL §§ 11, 19, 24, 25

[2] Case 99-E-0148, supra and Case 98-E-1670, supra.

and 26 that prevent producers of electricity from taking actions that are contrary to the public interest.[3]

All of Article 2 is restricted by its terms to the provision of service to retail residential customers, and so is inapplicable to wholesale generators like Bayswater. Certain provisions of Article 4 are also restricted to retail service.[4]

It was decided in the AES and Carr Street Orders that other provisions of Article 4 pertain to wholesale generators.[5] Application of these provisions was deemed necessary in light of obstacles to entry into the generation market. The Article 4 provisions, however, were implemented in a fashion that limited their impact in a competitive market, with the extent of scrutiny afforded a particular transaction reduced to the level the public interest required. Moreover, wholesale generators were allowed to fulfill their PSL §66(6) obligation to file an annual report by duplicating the report they were required to file under federal law.

Regarding PSL §70, it was presumed in the AES Order that regulation would not "adhere to transfer of ownership interests in entities upstream from the parents of a New York competitive electric generation subsidiary, unless there is a potential for harm to the interests of captive utility ratepayers

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[3] The PSL §18-a assessment is applied against gross retail revenues. As long as Bayswater remains exclusively a wholesaler, there are no retail revenues and no assessment is collected.

[4] E.g., PSL §§ 66(12), regarding the filing of tariffs, required at our option; 66(21), regarding storm plans submitted by retail service electric corporations; 67, regarding inspection of meters; 72, regarding hearings and rate proceedings; 75, regarding excessive charges; and 76, regarding rates charged religious bodies and others.

[5] PSL §68 provides for certification of construction of new electric plant, unless such plant is reviewed pursuant to PSL Articles VII or X or to electricity sales made via direct interconnection with retail customers. PSL §§ 69, 69-a and 70 provide for the review of security issuances, reorganizations, and transfers of securities, works or systems.

sufficient to override the presumption."[6] Wholesale generators were also advised that the potential for the exercise of market power arising out of an upstream transfer would be sufficient to defeat the presumption and trigger PSL §70 review.[7]

In our Order applicable to competitive entities, it was decided to initiate a proceeding to revisit the regulatory requirements applicable to wholesale generators and other competitive entities.[8] As a result of the proceeding, the Article 4 requirements imposed in the Carr Street Order and similar orders could be revised. Any further requirements adopted in that proceeding that are applicable to wholesale generators generally will be applicable prospectively to Bayswater as well.

Turning to PSL Article 6, several of its provisions that adhere to the rendition of retail service do not pertain to Bayswater because it is engaged solely in the generation of electricity for the wholesale market.[9] Application of PSL §115, relating to requirements for the competitive bidding of utility purchases, is discretionary and will not be imposed on wholesale generators. In contrast, PSL §119-b, relating to the protection of underground facilities from damage by excavators, adheres to all persons, including wholesale generators.

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[6] Case 99-E-0148, supra, p. 7.

[7] In this context, under PSL §66(9) and (10), we may require access to records sufficient to ascertain whether the presumption remains valid.

[8] Case 99-M-1722, Proceeding to Consider the Applicability of Public Service Law Provisions to Competitive Entities, Order Instituting Proceeding (issued December 17, 1999).

[9] E.g., PSL §§ 112, regarding enforcement of rate orders; 113, regarding reparations and refunds; 114, regarding temporary rates; 114-a, regarding exclusion of lobbying costs from rates; 116, regarding discontinuance of water service; 117, regarding consumer deposits; 118, regarding payment to an authorized agency; 119-a, regarding use of utility poles and conduits; and, 119-c, regarding recognition of tax reductions in rates.

Most of the remaining provisions of Article 6 need not be imposed generally on wholesale generators.[10] These provisions were intended to prevent financial manipulation or unwise financial decisions that could adversely impact rates charged by monopoly providers. So long as the wholesale generation market is effectively competitive, wholesale generators cannot raise prices even if their costs rise due to poor management. Moreover, imposing these requirements could interfere with wholesale generators' plans for structuring the financing and ownership of their facilities. This could discourage entry into the wholesale market, adversely affecting its operation to the detriment of the public interest.

As discussed in the Carr Street Order, market power issues may be addressed under PSL §110(1) and (2), which afford us jurisdiction over affiliated interests.[11] Bayswater and LIPA have entered into a PPA for the purchase of all the output of the Facility. The term of the PPA is 18 years and the PPA does not provide for renewal. The PPA also contains numerous provisions that allow a party to terminate the agreement prior to the 18-year term. For example, the LIPA may terminate the agreement if Bayswater does not meet certain milestones, such as the Facility’s commercial operation date (PPA, Article 8.2). The PPA also, provides for termination of the agreement should a default occur (PPA, Article 15.3).

At this time, since Bayswater is not entering into an affiliation with a marketer to market the Facility’s output, we will not impose the requirements of § 110(1) and (2). In the unlikely event such issues arise as a result of Bayswater or its successors entering into an affiliation with a marketer for the sale of the Facility’s production, PSL §110(1), on the reporting

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[10] These requirements include approval of: loans under §106; the use of utility revenues for non-utility purposes under §107; corporate merger and dissolution certificates under §108; contracts between affiliated interests under §110(3); and, electric, gas, and water purchase contracts under §110(4).

[11] Case 98-E-1670, supra, pp. 9-10.

of stock ownership, and PSL §110(2), on access to books and records and the filing of reports, shall pertain to Bayswater and its successors and marketing affiliate.

Consequently, we will not impose the requirements of Article 6 on Bayswater, except for §119-b and conditionally impose the requirements of § 110(1) and (2) as discussed above. Bayswater is reminded, however, that it remains subject to PSL jurisdiction 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 discussed above.

Financing Approval

In this Order, we have decided that Bayswater is a competitive wholesale provider of electricity that will be lightly regulated, and that the scrutiny applicable to monopoly utilities may be reduced when a company operates in a competitive environment. As a lightly regulated wholesale provider, Bayswater remains subject to PSL §69 jurisdiction. Under the reduced scrutiny standard applicable to lightly regulated generators, however, approval of indebtedness in the amount of $50 million is appropriate.

As a result, we need not make an in-depth analysis of the proposed financing transactions. Instead, by relying on the representations made in the petition, swift action may be taken, avoiding constraints to financing flexibility that might hinder the development of the competitive electric market.

The proposed transactions are for a statutory purpose and are in the public interest. Since Bayswater's proposals do not raise objections, they are approved as appropriate under light regulation. As discussed in the AES Clarification Order,[12] this approval extends to all financing arrangements of the same

[12] Case 01-E-0357 et al., AES Eastern Energy, L.P. – Petition on Financing, Order Clarifying Prior Order (issued April 4, 2001).

type described in the petition, for an amount no more than $50 million.

The Commission orders:

1. Bayswater Peaking Facility, LLC shall comply with the Public Service Law in conformance with the requirements set forth in the body of this Order.

2. Bayswater Peaking Facility, LLC is authorized to borrow up to $50,000,000 as described in its petition and as discussed in the body of this Order.

3. Within 60 days after the transaction described in Ordering Clause 2 has occurred, Bayswater Peaking Facility, LLC shall inform the Secretary to the Commission thereof in writing.

4. If the transaction described in Ordering Clause 2 is not consummated within one year after issuance of this Order, the authorization granted herein may be rescinded.

5. This proceeding is continued.

By the Commission,

(SIGNED) JANET HAND DEIXLER
Secretary