NEW YORK INDEPENDENT SYSTEM OPERATOR

10 Krey Boulevard ♦ Rensselaer, NY 12144

March 15, 2010

VIA ELECTRONIC MAIL

Hon. Jaclyn A. Brilling, Secretary
Public Service Commission of the State of New York
Three Empire State Plaza
Albany, New York 12223-1350

Subject: Case 03-E-0188 – Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard.

Dear Secretary Brilling:

Enclosed for filing by electronic mail in the above-entitled proceeding are the Comments of the New York Independent System Operator, Inc., together with a Certificate of Service of these comments on all parties on the Active Parties List in this proceeding. Should you have any questions, I can be reached at the above address, by phone at (518) 356-6220 or by e-mail at cpatka@nyiso.com.

Very truly yours,

/s/ Carl F. Patka
Carl F. Patka
Senior Attorney

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 03-E-0188 - Proceeding on Motion of the Commission Regarding a
Retail Renewable Portfolio Standard

COMMENTS OF
THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

I. Introduction and Background

The New York Independent System Operator, Inc. ("NYISO") respectfully offers these comments in response to the Public Service Commission's February 3, 2010 notice[1] in the present proceeding ("Notice"). The NYISO's comments, below, focus on four of the questions raised in the Notice.

The NYISO is the independent body responsible for providing open access transmission service, maintaining and planning for bulk power system reliability, and administering competitive wholesale markets for energy, capacity, and ancillary services in New York State. The NYISO has been engaged for some time in the integration of intermittent renewable resources into the State's supply portfolio and energy markets. As State policy toward incentivizing additional renewable resources evolves, the NYISO has a direct interest in ensuring that these important policy objectives are structured in ways that do not distort to the markets or exacerbate reliability concerns.

The RPS program has made significant progress towards achieving its goals, and has supported the installation of approximately 1200 MW of wind facilities in New York since 2006. The addition of substantial amounts of intermittent resources to the power system, accompanied by out-of-market financial supports, posed several challenges to the NYISO as system operator and market administrator. To date, the NYISO has successfully addressed these challenges by making changes to its market rules and operating procedures. The NYISO believes its experience managing these issues demonstrates that public policy initiatives can be compatible with the competitive markets.

The primary focus of the NYISO's response to the increase in RPS-supported resources has been to enable wind operators to respond to economic signals in the same way that other types of generation do by, among other things, reducing the incentive to run even when their energy is not needed. Responsiveness to price in real time is

[1] Notice of Proposed Rulemaking. "Possible Modifications to Renewable Portfolio Standard (RPS) Program Eligibility Rules, Budgets and Collections." NYS Register. February 3, 2010. Pg. 26

critical to the NYISO's ability to dispatch generation efficiently under changing transmission system conditions. Recent tariff revisions approved by the Federal Energy Regulatory Commission ("FERC") on May 11, 2009, have enhanced the NYISO's operational control of these wind resources.[2] Wind generators now submit economic offers that include the price at which they are willing to reduce their generation. This allows the real time dispatch software to determine the specific units and megawatts that are economically appropriate to run, or to be reduced in the presence of congestion, in the most efficient way.

The NYISO commends the Commission on considering the impacts of its evolving policies on the wholesale markets, and urges the Commission to continue to work with the NYISO to structure incentives in ways that preserve the overall benefits of competition.

II. Comments

Questions 2 and 5: Should the Commission encourage hedging contracts? Should Main Tier contracts be structured as contracts for differences?

The NYISO recognizes the fact that the commercial hedging market collapsed in the wake of the financial crisis in the fall of 2008 and applauds the Commission's efforts to respond to the difficulties developers have had in trying to raise financing for renewable projects. Private party hedging arrangements have an important role in the energy markets, and the NYISO fully expects that banks will make financing available to the market as conditions stabilize. However, the NYISO cautions the Commission against stepping into the role of hedge provider. Unless very carefully designed, either a hedge contract or a Contract for Differences ("CFD") will tend to reduce renewable generators' sensitivity to the prices in the NYISO market, leading to distortions in the system dispatch and increased costs to ratepayers. In addition, either approach risks allocating investment risk to ratepayers. By contrast, exposure to real time pricing incents generators – including renewable suppliers – to comply with NYISO dispatch instructions and to locate new projects at the highest-value locations.

For example, a wind operator's relative indifference to fuel costs – even without a hedge – could result in the generator continuing to operate at full output even when prices are low or even negative. These circumstances create two potential problems from the NYISO's perspective: First, some wind generators may self-curtail in the face of low

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[2] New York Independent System Operator, Inc., FERC Docket No. ER09-802-000. Proposed Tariff Revisions to Enhance Operational Control of Wind Resources, Amend Settlement Rules Applicable to Them and Increase

or negative prices, which could raise a potential for reliability issues and result in increased costs of regulation service. Prior to placing wind units "on dispatch," the NYISO's operators observed instances of wind self-curtailment. Second, reliance on manual and out of market directions to reduce production does not solve the constraints efficiently. These manual actions tend to take more wind offline for longer periods of time than would be achieved through an automated economic evaluation.

Under the NYISO's revised procedures, renewable generators signal through their bids the prices at which they are willing to reduce their production, just as other suppliers do, and the NYISO then directs the generators to adjust their production to resolve constraints in accordance with those economic choices. Generators who do not comply with the NYISO's basepoint signals are not paid for their excess energy and are subject to penalties based on the cost of regulation service. To the extent a hedge agreement or CFD insulates the renewable energy supplier from the NYISO's real time price signals, the supplier's incentive to comply with dispatch signals will become distorted. If a renewable generator is completely insulated by the terms of the hedge from NYISO market price signals, market and operational inefficiencies will result, and the costs of managing the system around those suppliers will be passed on to loads and ultimately to ratepayers.

The Commission has raised the possibility of using a CFD in its past deliberations on the RPS procurement program. At the time, and for similar reasons, the NYISO advised the Commission against structuring RPS incentives in this way.[3] The NYISO continues to believe that a variable Renewable Energy Credit ("REC") premium would improperly insulate the renewable resource from the normal incentives provided by market forces which, at their most basic, encourage suppliers to produce when market clearing prices are higher than the resource's incremental production costs and to cease production when prices fall below that level.

In contrast, the fixed price REC has two distinct advantages. One, it does not distort the unit's incentive to respond to the dispatch, and two, it incents developers to locate their projects at the highest-value locations. The NYISO is also concerned that either the CFD or the hedging proposal may transfer market risk from generators and investors to consumers. The NYISO submits that the Commission should continue with the fixed-price REC payment, as it is more compatible with the electricity markets and results in an efficient energy dispatch.

System Reliability. March 5, 2009.

Should the Commission determine to proceed with the CFD, the NYISO believes that the approach outlined in Staff's white paper is reasonably compatible with existing market structures and the current level of renewable generation expected to be on the system. The NYISO cautions that the Commission may need to reconsider the CFD concept at some point, if renewable generation continues to be added to the system and zonal congestion patterns change. The NYISO also suggests that the Commission consider the future availability of commercial hedges and discontinue the CFD program as the private financing markets revive.

Question 7: Should Main Tier contracts allow the sale of energy outside the NYISO spot market?

The NYISO would again caution the Commission against shifting investment risk to ratepayers through long term fixed price energy purchase contracting. However, should the Commission choose to encourage bilateral contracts for renewable energy, the NYISO is confident that its market mechanisms can accommodate such transactions. Current NYISO tariff rules would permit a wind generator to schedule such a transaction, which may or may not be priced at the spot market price, just as any other generator presently can do. The NYISO requires the supplier to make up any shortfall in energy produced by purchasing replacement power to serve the transaction at either the day ahead or real time market clearing price. The NYISO does not see any reason why it could not schedule renewable bilaterals, but would advise the Commission to ensure that RPS incentive payments were linked to the renewable megawatts scheduled and actually paid for by the NYISO, for the reasons discussed below.

Question 8: Should Main Tier contracts allow incentives at times when new renewable generation displaces a pre-existing renewable resource?

The NYISO respectfully submits that the Commission's question poses a policy issue: whether to subsidize all renewable production or only to subsidize renewable production that has value to the system. The NYISO urges the Commission to take the second approach and to structure Main Tier incentive payments to support the competitive wholesale energy markets. From the NYISO's view point, this means providing REC payments only for energy that is actually scheduled and settled through the NYISO in compliance with its real time dispatch signals.

The NYISO is not aware of any mechanism that would allow it to determine specifically when one renewable resource was "displaced" by another, as multiple factors contribute to real-time conditions. The real time dispatch

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[3] PSC Case No. 03-E-0188. Comments of the New York Independent System Operator, Inc. on Proposed Rulemaking, (December 22, 2004).

software allocates resources to meet load and resolve constraints in accordance with suppliers' economic choices, and both existing and new renewable suppliers compete for access to the transmission system on a market basis. The NYISO believes that renewable energy subsidies should be allocated in the same way, so as not to interfere with or distort suppliers' responses to NYISO dispatch signals. This can be accomplished by tying REC payments to the energy provided in response to NYISO base point signals. Under these rules the Commission would provide REC payments only for megawatts actually scheduled and settled – i.e., paid for – by the NYISO. This will limit wind generators to receiving REC payments only up to the maximum amount of renewable megawatts that the system can absorb, given the existence of transmission constraints, while allowing the NYISO's software to allocate the transmission efficiently among the competing wind resources.

III. Conclusion

The NYISO respectfully urges the Commission to consider these comments in its review of the RPS program, and to reject modifications, such as a variable REC payment, that would distort the economic incentives governing suppliers' behavior in the competitive markets.

Respectfully submitted,

/s/ Elizabeth A. Grisaru

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CERTIFICATE OF SERVICE

I hereby certify that I am over the age of eighteen years, and that on March 22, 2010 I caused to be served by electronic mail upon the persons on the Active Party List provided on the NYSDPS-DMM: Matter Master/Active Party List for the above-captioned proceeding the Comments of the New York Independent System Operator, Inc.

/s/ John C. Cutting

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Dated: March 15, 2010