# Withholding of Carbon Pricing from REC Contract Holders

NYISO INTEGRATING PUBLIC POLICY TASK FORCE

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MARK REEDER

ALLIANCE FOR CLEAN ENERGY NEW YORK (ACE NY)

# Overview

On July 16, 2018 NYISO put forward a proposal to create a class of generators- renewable generators holding REC contracts that were signed on or before January 1, 2020 - and make that class of generators ineligible for the carbon pricing portion of wholesale market energy prices.

The proposal has one primary advantage – a reduction in the customer impact of carbon pricing.

The proposal has many disadvantages. The disadvantages far outweigh the advantages.

On balance, the proposal should not be adopted.

Importantly, this is a matter of public policy, not market design. It should be decided by the NYPSC.

# Customer Impacts is a Legitimate Issue

The goal of avoiding excessive customer impacts caused by the implementation of carbon pricing is a legitimate one, and much work should be done in pursuit of this goal.

Yet, it is not the only goal. Improving the financial motivation of market players to pursue actions that lower carbon emissions is also an important goal, and carbon pricing accomplishes this.

Other goals, such as preserving a favorable climate in New York for private investment, are also important.

A final proposal will have to strike a balance between these goals– no one goal is absolute.

# The NYISO and the Integrity of the Market

A fundamental principle of commodity markets is one price for the product, for all buyers and sellers.

It would be a mistake for the NYISO to deny the market price to one class of sellers. Doing so would create two prices for the same product – one for the carved-out class of sellers and another for all other sellers. The NYISO will have created a flawed market design.

Better for the NYISO to leave this policy decision to the NYPSC. This is a policy decision that, if decided as is being suggested, goes against the NYISO's market principles.

The NYPSC can order the redesign of REC contracts for use in future REC solicitations.

# The Proposal Will Undermine Business Environment

Denying a part of the market price to REC Contract holders will send a very bad signal to potential future investors in green energy in New York.

It will demonstrate a regulatory willingness to, in essence, go back on the assumed contractual deal.

This would be the first time the NYISO has taken an action that goes against existing contracts.

It will increase uncertainty and will decrease the willingness of future investors to invest in New York.

# REC Contract Holders Agreed to Bear the Market Price Risk

REC Contract Holders took on the market price risk, up or down, just like any other generation investor.

Market price risk has many components. For example, the trajectory of natural gas prices has turned out to be much lower than forecast at the time many REC contracts were signed. This loss was borne by renewable generation investors.

One upside factor was always the possibility – a real one – that carbon policy would eventually raise market prices significantly: strengthening RGGI; a national carbon price/tax; a national cap and trade program; a NY carbon price/tax.

It would be wrong to, years after the fact, pick out a piece of the upside risk and take it away.

# A REC Price and a Carbon Price Are Not the Same

REC price is just an amount of money that developers need, over and above their expectations of the future market price, to get a renewable project built.

Renewable generation owner receives 2 revenue streams

- Market
- REC Contract

The combination must be enough, given the risks, to convince investors to put capital at risk.

# Hybrid Pricing Scenario Negatively Impacts Important Hedging Activity

In order to secure project financing it is often necessary for renewable projects to enter into long term hedge contracts for their energy revenue. Beyond the initial term, hedging continues to be a valuable tool for reducing energy price risk. A hybrid market structure will not only majorly disrupt existing hedge agreements, it will significantly curtail access to this financial tool, used broadly by generators and load, in a discriminatory fashion.

A typical energy price hedge contract is a fixed for floating swap, where:

- The fixed (strike) price is agreed to by both parties and is usually representative of expectations of average energy price
- The floating price is the actual energy price at a particular pricing point (typically a zonal node)

For existing contracts, the strike price would have been set without a carbon adder, while the floating price would now include the carbon adder. If left unamended, the project owner would wind up paying the hedge counterparty the carbon adder, but not actually receive it themselves. Furthermore, if the contract were to be reopened, it would be at a significantly weakened negotiating position for the project owner.

For both reopened and new contracts, hedge counterparties are unlikely to want to offer a product that only settles against the carbon-less LBMP (the product renewable owners would need) as there will be a very limited and illiquid market  for such a product.

# Consumer Impacts Need to be Quantified in Detail

The NYISO's estimation of the consumer impacts from carbon pricing should isolate the consumer impact from various components of the market to put a perspective on the consumer impact issue.

The following isolated impacts should, at a minimum, be separately estimated.

- The consumer impact of existing REC Contract Holders receiving the carbon price (under various definitions of "existing")
- The consumer impact of NY's nuclear plants under the ZEC regime receiving the carbon price
- The consumer impact of combined cycle gas turbines receiving the carbon price (net of their carbon payments)
- The consumer impact of NYPA's hydro generation receiving the carbon price

# How Does NYISO Choose the Classes of Generators to Whom Carbon Pricing is Denied?

Holders of ZEC contracts? They received attractive contracts tied to their zero emissions. Should they be denied carbon prices? What is the policy call the NYISO will make? (ACE NY believes no one should be denied carbon prices)

Renewable energy generators not under REC contracts? They will receive the carbon price under the NYISO proposal. Does NYISO now own the RECs? Can those generators sell RECs into New England?

NYISO not the right entity to make policy calls like the above, NYPSC is the right entity.

# A Proposal for Consideration

Existing REC Contract Holders receive the full market price including carbon price effects.

Holders of REC contracts signed pursuant to 2018 solicitations receive the full market price including carbon price effects.

REC contracts for 2019 solicitations and beyond be designed to comport to the indexed price approach that the NYPSC just approved for use in offshore wind REC contracts (ORECs). Such a contract prevents the contract holder from gaining when market prices unexpectedly rise faster than forecast and from losing when market prices unexpectedly fall below forecast.

ACE NY believes a reasonable balancing of consumer impacts with other important goals can be achieved with approaches that don’t go so far as the extreme of denying the full upside of carbon prices to existing REC contract holders.

In this way, NYISO is treating all market participants equally, and NYPSC is solving public policy issues.