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ACE NY Comments on NYISO Carbon Pricing Proposal
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The Alliance for Clean Energy New York (ACE NY) respectfully submits the following comments to the New York Independent System Operator (NYISO) regarding the NYISO's proposal to implement carbon pricing within the New York wholesale energy market. These comments are accompanied by a joint ACE NY and American Wind Energy Association (AWEA) white paper that explains why a proposal to claw back the effects of carbon pricing from holders of existing REC contracts is unwise and should be dropped from the NYISO's carbon pricing proposal.

ACE NY is a nonprofit membership organization whose mission is to promote clean energy, energy efficiency, a healthy environment and a strong economy for New York State. This diverse coalition includes private renewable energy and energy efficiency companies, environmental and economic development organizations, academic institutions, and consultants to the energy sector. The clean energy technologies represented by ACE NY members include land-based wind, offshore wind, hydropower, biomass, fuel cells, energy efficiency, energy storage, distributed wind, and solar.

ACE NY thanks the NYISO and the parties for recognizing the importance of examining the future of a New York electric system that contains renewable generation at a level of 50% of total New York electricity usage. Implementing policies and procedures that best accommodate this increase in renewable generation can greatly improve the efficiency and cost to New York of achieving its important clean energy goals. Further, we want to reiterate our support for NY's Renewable Energy Standard and underscore its importance in getting new renewable capacity financed and developed. In that context, we want to state that any initiative to integrate a carbon price into NY's wholesale electric markets should complement and supplement the Renewable Energy Standard (RES), not replace it.

Carbon Pricing Should be Implemented in New York

A market price for energy that fully reflects the social cost of carbon dioxide emissions is an essential part of a comprehensive long run policy for environmentally responsible production and consumption of electricity. ACE NY supports carbon pricing, in general. The details do matter, however. ACE NY's ultimate support for any proposal will depend on the specifics of the proposal. This is a very complicated subject, especially when implemented at a time when New York's neighboring markets do not reflect the full social cost of carbon and when implemented alongside New York's other clean energy policies that support and promote clean energy resources. In particular, ACE NY opposes the component of the

current NYISO proposal that calls for the clawing back of carbon pricing from existing Renewable Energy Credit (REC) contract holders.

The Clawback Proposal Should Be Eliminated

The NYISO has proposed that the energy market price effects of carbon pricing should be calculated and clawed back from all renewable facilities that have existing REC contracts. This aspect of the proposal was contained in a NYISO statement that was posted for the July 16, 2018 meeting of the Integrating Public Policy Task Force (IPPTF) and is as follows:

The NYISO, therefore, proposes as part of the Carbon Pricing market design that wholesale market suppliers with active REC contracts dated prior to January 1, 2020 would not be eligible to receive the carbon pricing portion of the wholesale market LBMP as part of their payment from the NYISO for supplying energy. The NYISO believes that this would largely eliminate the potential for double payment to suppliers whose carbon dioxide emissions reductions are already captured by REC contracts entered into before the approval of Carbon Pricing market rules by NYISO stakeholders.

Since the time of the proposal, ACE NY and others have analyzed the proposal and have concluded that it is unwise, highly flawed, and will make existing REC contract holders worse off than they would be in a future marketplace with no carbon pricing at all. It makes no sense to implement carbon pricing, and in so doing punish the very entities that have been at the heart of the State's renewable energy progress, when to do so is completely unnecessary. The clawback proposal must be dropped from the overall carbon pricing proposal.

ACE NY and AWEA worked together to produce a paper titled *Comments of the American Wind Energy Association and the Alliance for Clean Energy New York on the Carbon Price Clawback Proposal* ("White Paper"). It is attached. Rather than reiterate all of the arguments in opposition to the clawback proposal in these comments, we will summarize them here and direct the reader to the white paper for additional details.

1. New York State's Renewable Portfolio Standard and Renewable Energy Standard programs used a contract that placed the market price risk on the renewable generators. Renewable generators have borne declining energy prices. It is unfair to take away the upside of future carbon mitigation policies, such as carbon pricing, after the fact.
2. The clawback proposal will chill the NY business environment for renewables investment. Re-casting of contracts is always chilling.
3. This is a policy decision that should not be made by the NYISO. Rather it is the New York Public Service Commission (PSC) that should address any policy decisions about REC contract holders.

4. The clawback proposal will significantly affect operating projects with hedging contracts. Existing (already constructed) projects will suffer significant financial harm; recent solicitation winners (not yet constructed) may be disrupted/cancelled. Bankers will experience the same chill that developers get.
5. The clawback proposal will make existing REC contract holders worse off than under the status quo because of (1) the dynamic effects of carbon pricing that lower wholesale energy and capacity prices and (2) the mismatch between the actual carbon content at the generator's bus and the NYISO's estimate of carbon content at the zonal level. These impacts are in addition to the financial hit associated with the hedging contracts mentioned above.
6. A market with two prices creates unintended problems. For example, it will distort incentives to retrofit existing renewable generators to include storage.
7. The customer benefit of the clawback proposal is small and does not justify a clawback proposal that suffers from and creates so many problems. For example, the customer benefit in the year 2025 is just 2 hundredths of a cent per kWh (0.02 cents/kWh). This compares to the overall carbon pricing-induced increase in the market price of 175 hundredths of a cent, the customer benefit associated with Zero Emissions Credits (ZECs) of 25 hundredths of a cent, and the customer benefit of future REC price reductions of 18 hundredths of a cent.
8. And, at a more fundamental level, we maintain our position that carbon pricing will not create a double payment for existing REC contract holders because a REC is not the same as a social cost of carbon payment. NY's REC price is the minimum payment necessary to make an otherwise unbuildable project become buildable, as revealed through competitive solicitations. The bids in these solicitations consider the upside and downside risks of future market prices. This does not equate to the social cost of carbon abatement, i.e., the value to society of the abated carbon emissions resulting from that project's electricity generation.

It is clear that the flaws in the clawback proposal that have been revealed and discussed by the parties since the date that the proposal was made are so extensive as to make the proposal unacceptable. Moreover, the NYISO's lead consultant on carbon pricing, Sam Newell of the Brattle Group, appeared to agree when he stated that there are "compelling arguments" for why such a proposal should not be adopted. Ultimately, the decision on whether to implement the clawback proposal is a balancing of the benefits of the proposal (the two hundredths of a cent decrease in electricity prices) versus the drawbacks of the proposal. Any objective balancing of these considerations yields a decision to drop the clawback component from the NYISO's overall carbon pricing proposal.

<u>A Better Method Must be Developed to Estimate the Carbon Component of Energy Prices</u>

Late in the process the NYISO presented its proposal for estimating the carbon component of the market price of energy. It suffers from two important flaws. First, the proposed estimation method yields

estimates only at the zonal level. A more granular estimation is needed that produces estimates down to the generator bus level. Transmission congestion can and does occur within a zone. In such situations, the carbon content on the margin will vary, sometimes significantly, between some parts of the zone and other parts of the zone. Policy makers and market participants will need to know the carbon content avoided by generators. Having only a zonal estimation method, and knowing that it fails, sometimes badly, as an estimate of the carbon content at a given generator's bus, is inadequate and must be improved upon.

Second, the NYISO's proposal for estimating the carbon content at times when a clean energy resource is on the margin is flawed. The NYISO's proposal sets the carbon content to zero when a clean energy resource is on the margin. In some situations that is correct, but in others it is not. When the clean energy resource is pondage hydro, or some other energy storage resource, the marginal cost to the system often takes the form of an opportunity cost, and that opportunity cost typically is tied to the running cost, including the carbon cost, of a carbon-emitting fossil unit. At such times, the correct estimate should produce a carbon content that is not zero. The NYISO should develop an improved method that corrects this error.

The Carbon Price Risk That Faces Future REC Contract Holders Must Be Addressed

One of the largest consumer benefits of carbon pricing identified in the Brattle analysis is the projected reduction in future REC contract prices that will occur once carbon pricing is implemented and its effect on forecasts of market prices are considered. The Brattle analysis estimates this benefit to be 0.18 cents per kWh in 2025. This estimate is based on the assumption that for every dollar per MWh that the market price forecast increases, there will be a dollar per MWh decrease in REC contract prices. The dollar for dollar offset in REC contract prices is based on the assumption that REC contracts will be redesigned to provide REC contract holders protection against the risk of uncertain future carbon prices. If REC contracts remain as they are today, with no risk protection whatsoever for future market prices, the dollar for dollar benefit is lost and consumers will lose otherwise achievable benefits. It should be noted that the Brattle Group, when analyzing the future likely impacts of the carbon pricing proposal for the NYISO assumed that future REC contracts would be modified to provide this risk protection. This was a sound decision that reflected the imperative to provide revenue stability for new projects.

Once carbon pricing is in place, renewable generation projects will rely more heavily on market price revenues and less on REC revenues. This represents a shift from the relatively risk-free revenue stream of REC payments to the much more risky revenue stream of market prices. Moreover, the carbon price component of the market price is especially risky because it is a governmental/regulatory risk subject to sudden reversal via policy changes of future government leaders. If investors in future renewable generation projects are asked to bear this risk without a change in REC contract design, much of the

forecasted carbon price-based revenue will be heavily discounted leading to a consumer benefit that falls well short of the values estimated by the Brattle analysis. Failing to make the needed changes in REC contracts to provide risk protection against future market prices would be a missed opportunity.

ACE NY recommends that the change that is needed is to redesign REC contracts so that they are adjustable payments that net periodically against a reference price expressed in a market index. This is the same as the "Index OREC" approach adopted by the New York Public Service Commission (NYPSC) in its recent offshore wind order. (*Order Establishing Offshore Wind Standard and Framework for Phase I Procurement*, Case 18-E-0071, July 12, 2018). Such a REC contract would provide revenue certainty for the market price component of a project's revenue stream including protection from carbon price risk. If adopted, the indexing approach will allow consumers to receive the full benefit of carbon pricing that the Brattle analysis has estimated. At the end of the day, this contract change is a normal transitional adjustment that is needed as New York improves its policies by adding full carbon pricing to the electricity market. We further suggest that the customer savings that would result from this change from Fixed REC contracts to Indexed REC contracts for the entirety of the Clean Energy Standard will substantially reduce any customer costs of eliminating the clawback proposal during the period of transition to carbon pricing in the wholesale markets.

It is acknowledged that the NYISO is not in a position to make changes in REC contract design. Such a change must come from the NYPSC and the New York State Energy Research and Development Authority (NYSERDA). Nonetheless, it is important for the NYISO and the parties to acknowledge that one of the largest benefits identified in the NYISO's carbon pricing analysis has, as a prerequisite, timely action on REC contract redesign by the NYPSC and NYSERDA.

Respectfully submitted,

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