

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Joint Petition of Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation for Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A.

Case 07-M-0906

**BRIEF OPPOSING EXCEPTIONS OF
INDEPENDENT POWER PRODUCERS OF NEW YORK, INC.**

David B. Johnson
READ AND LANIADO, LLP
Attorneys for Independent Power
Producers of New York, Inc.
25 Eagle Street
Albany, New York 12207
Phone: (518) 465-9313
Facsimile: (518) 465-9315
dbj@readlaniado.com

Dated: July 3, 2008
Albany, New York

TABLE OF CONTENTS

INTRODUCTION	1
I. THE JOINT PETITIONERS' AND OTHER PARTIES' CRITICISMS OF THE RD'S MEASURES TO PREVENT THE EXERCISE OF VERTICAL MARKET POWER LACK MERIT.	3
A. Prohibiting the Joint Petitioners From Owning Any Generation Interconnected to T&D Facilities in Their Own Service Territories Is Consistent With This Commission's VMP Policy Statement.....	4
B. This Restriction Does Not Affect the Economic Feasibility of Wind Generation Investment by Iberdrola's Unregulated Affiliate.....	7
II. THE NYISO AND FERC MARKET RULES DO NOT SUFFICIENTLY ADDRESS THE JOINT PETITIONERS' ABILITY TO EXERCISE MARKET POWER IN THEIR OWN SERVICE TERRITORIES.....	9
III. JOINT PETITIONERS MUST BE DIRECTED TO DIVEST NYSEG'S AND RG&E'S HYDRO FACILITIES AS A PRE-CONDITION OF TRANSACTION APPROVAL...14	
IV. IF THE COMMISSION ALLOWS JOINT PETITIONERS TO OWN WIND GENERATION CONNECTED TO NYSEG'S AND RG&E'S T&D SYSTEMS SUBJECT TO MITIGATION MEASURES ADDRESSING THE ABILITY TO EXERCISE VERTICAL MARKET POWER, STAFF'S AND SPM'S PROPOSED MITIGATION MEASURES ARE INADEQUATE AND SHOULD BE MODIFIED OR REJECTED.....	16
V. JOINT PETITIONERS MUST BE DIRECTED TO COMPLETE THE SALE OF ALL OF NYSEG's AND RG&E'S GENERATION WITHIN NINE MONTHS OF ISSUANCE OF AN ORDER IN THIS PROCEEDING.....	22
VI. CONCLUSION.....	23

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Joint Petition of Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation for Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A.

Case 07-M-0906

**BRIEF OPPOSING EXCEPTIONS OF
INDEPENDENT POWER PRODUCERS OF NEW YORK, INC.**

INTRODUCTION

In accordance with the Notice of Schedule for Filing Exceptions issued by the New York State Public Service Commission (“Commission”) on June 16, 2008, as amended by a Notice of Revised Briefing Schedule issued on June 18, 2008, in the above-captioned proceeding, Independent Power Producers of New York, Inc. (“IPPNY”) hereby submits its Brief Opposing Exceptions (“Reply Brief”) to the Commission. This Reply Brief addresses arguments put forth by other parties on their exceptions, filed June 26, 2008, in response to Administrative Law Judge (“ALJ”) Rafael Epstein’s Recommended Decision issued in this proceeding on June 16, 2008 (“RD”).¹

As noted in its Brief on Exceptions, IPPNY strongly supports the ALJ’s recommendation that, if the Commission approves the acquisition of Energy East Corporation by Iberdrola, S.A. (“Iberdrola”) (the “Transaction”), Iberdrola must not be permitted to own any generation in its

¹ Parenthetical references to the recommended Decision are preceded by the notation “RD”; parenthetical references to the transcript in this proceeding are preceded by the notation “Tr.”; references to the exhibits admitted into evidence during the hearings are preceded by the notation “Exh;” and references to the Briefs on Exceptions of other parties are preceded by the notation “BOE.”

own service territories, and thus, Energy East’s affiliates, New York State Electric & Gas Corporation (“NYSEG”) and Rochester Gas and Electric Corporation (“RG&E”) must be required to divest all of their electric generating facilities to adequately address the vertical market power issues. (RD at 1). In their Brief on Exceptions, the Joint Petitioners oppose any divestiture requirement beyond the divestiture of the Joint Petitioners’ fossil generation facilities, as agreed to by Joint Petitioners in their Partial Acceptance Document (“PAD”), submitted March 14, 2008. They continue to take the position that there are no vertical market power concerns.² They then argue that, to the extent that such concerns do exist, they have rebutted the presumption by claiming that New York Independent System Operator (“NYISO”) and Federal Energy Regulatory Commission (“FERC”) market rules sufficiently address any vertical market power issues.³ Finally, they continue to threaten that significant renewable resources development would be lost if their position is not accepted and, as a result, the State’s renewable energy goals will be dashed.⁴

As both IPPNY and Staff of the New York State Department of Public Service (“DPS Staff”)⁵ demonstrated on the record and in briefs, and as the ALJ correctly found in the RD, the threat of exercise of vertical market power can only be fully eliminated by total divestiture of generation. (RD at 59-81). Guarding against vertical market power is a hallmark to ensuring a

² Joint Petitioners BOE at 35-45.

³ *Id.* at 39-42.

⁴ *Id.* at 23-27. Throughout this proceeding, the Joint Petitioners have opposed an outright prohibition against Iberdrola’s unregulated affiliates constructing wind facilities in New York State. The Joint Petitioners have never claimed that they should be permitted to use their regulated dollars to construct these projects. The Renewable Portfolio Standard (“RPS”) program has been structured to provide a level playing field whereby merchant projects must compete with each other to secure RPS awards. As such, the Commission must emphasize that Iberdrola will not be permitted to use regulated dollars for any wind projects.

⁵ In its Brief on Exceptions, DPS Staff continues to strongly favor total divestiture and a ban on Joint Petitioners’ constructing or owning any new generation facilities in New York State.

competitive energy market and the benefits of such a market. Further, a prohibition against generation ownership in the NYSEG and RG&E service territories is a modest condition, particularly in light of Iberdrola's publicly announced plans to build over 800 MW of wind generation in other service territories in New York State that would foster, not impede, the development of renewable resources in New York State.

Moreover, as set forth at length herein, and as further demonstrated in the DPS Staff Brief on Exceptions, the NYISO and FERC market rules upon which the Joint Petitioners summarily rely do not, in fact, adequately address vertical market power issues associated with an unregulated Iberdrola affiliate owning wind generation interconnected to the NYSEG and RG&E service territories. Nor are the mitigation measures that were proposed by either Strategic Power Management ("SPM") or DPS Staff very late in the proceeding sufficient to address these concerns.⁶ Thus, the ALJ's finding that the Joint Petitioners must be prohibited from owning generation in their own service territories should be adopted.

I. THE JOINT PETITIONERS' AND OTHER PARTIES' CRITICISMS OF THE RD'S MEASURES TO PREVENT THE EXERCISE OF VERTICAL MARKET POWER LACK MERIT.

The RD expressly found that, if the Commission approves the Transaction, it should impose a precondition that "Iberdrola and its affiliates should not be allowed to own electric generating plants (whether wind powered, fossil fueled, or hydropower) interconnected with NYSEG's or RG&E's transmission or distribution systems." (RD at 1). In their exceptions, Joint Petitioners contend, among other things, that their affiliated wind and hydro facilities are intermittent resources located on the low cost side of the most significant transmission constraint

⁶ As noted by IPPNY in its Brief on Exceptions (at 7-9), SPM's proposed mitigation measures were not introduced until its Reply Brief. Thus, they were not subject to discovery or cross-examination. In addition, while DPS Staff continues to take the position that only divestiture will fully address the vertical market power issues, it has proposed mitigation measures in its Brief on Exceptions in an attempt to ameliorate the ability of the Joint Petitioners to exercise market power to some degree. (Staff BOE at 20-26).

in New York, ill-suited to the exercise of vertical market power, and that market rules put in place by FERC and NYISO would prevent the exercise of vertical market power.⁷ Joint Petitioners further argue that the mitigation measures set forth in the PAD are sufficient. Thus, they allege that, to the extent any vertical market power concerns exist, they have rebutted the presumption of vertical market power established by the Commission's Vertical Market Power Policy Statement ("VMP Policy Statement").⁸

Before addressing Joint Petitioners' arguments that their proposed wind projects raise no vertical market power concerns, it is important to note that Joint Petitioners have not argued that they have rebutted the VMP Policy Statement's presumption with respect to generation technologies other than wind and hydroelectric generation that may be interconnected to RG&E's or NYSEG's T&D systems in the future. Having failed to attempt to address -- much less rebut -- this presumption in this proceeding, the Commission should prohibit Joint Petitioners and their affiliates from owning any fossil or nuclear generation interconnected to NYSEG's or RG&E's T&D systems or anywhere else where Energy East could use control of the T&D systems to raise the revenues from its investment.⁹

- A. Prohibiting the Joint Petitioners From Owning Any Generation Interconnected to T&D Facilities in their Own Service Territories Is Consistent With This Commission's VMP Policy Statement.

Granting Joint Petitioners an outright exemption from the VMP Policy Statement would reverse more than a decade of consistent Commission policy favoring competitive electric generation markets. As summarized in the RD,

⁷ Joint Petitioners' BOE at 36-45.

⁸ Cases 96-E-0900 *et. al.*, *Orange & Rockland Utilities, Inc. – Rate Restructuring*, App. I, Statement of Policy Regarding Vertical Market Power (July 17, 1998).

⁹ Pursuant to § 4.10(d)(2) of the Commission's Rules, "[a] party's failure to except with respect to any issue shall constitute a waiver of any objection to the recommended decision's resolution of that issue."

[F]or about 13 years the Commission has pursued an effort to separate generation from T&D in the expectation that competitive generation moderates energy prices, encourages efficient choices among energy resources, enhances customer choice, and relieves customers of risks of generation investment that should be borne by investors. (RD at 64, fn. omitted).

The Commission has consistently favored divestiture as the surest means to prevent market power abuses, and it should do so again here.

In 1996, the Commission issued its seminal policy statement endorsing the creation of a competitive wholesale generation market.¹⁰ The Commission found that in a wholesale or retail competitive model, generation and energy service functions should be separated from T&D to prevent the exercise of vertical market power. The Commission determined that total divestiture of generation was a clear way to allay concerns about vertical market power and avoid anti-competitive behavior (such as cross-subsidies among affiliates in both competitive and monopoly environments, and favored treatment of affiliates).¹¹

The Commission also recognized in its Opinion 96-12 that the most efficient means of selecting new resources is via the competitive market. Indeed, as expressly stated by the Commission, one of the primary benefits of competitive electricity markets is that investment risks are shifted from captive utility ratepayers to private investors.¹² The Commission

¹⁰ Cases 94-E-0952 *et. al.*, *In the Matter of Competitive Opportunities Regarding Electric Service*, Opinion and Order Regarding Competitive Opportunities for Electric Service, Opinion 96-12 (May 20, 1996) at 32 (“Opinion 96-12”).

¹¹ *Id.*, at 65.

¹² Ratepayers would not be required to pay the more than \$350 million of cost overruns incurred by Consolidated Edison Company of New York, Inc. (“Con Edison”) in its construction of its East River Repowering Project (“ERRP”) had the project been developed by an independent power producer. *See*, Case 05-S-1376, *Proceeding on Motion of the Commission as to the Rates, Changes, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Steam Service*, Direct Testimony of Con Edison witness Victor Gonnella, Exhibit VG-2 (testifying that at the time Con Edison submitted its Article X application, Con Edison estimated the cost of the ERRP to be \$406 million) and Order Determining Revenue Requirement and Rate Design (September 22, 2006) at 6 (capping cost recovery for ERRP at \$788.3 million) (Tr. 903).

determined that competitors would have a greater incentive to lower costs than utilities under a cost of service regulatory regime, which would inure to the benefit of New York's consumers.¹³

The Commission therefore strongly encouraged the T&D utilities to divest their generation facilities. The Commission also stated that divestiture would help create a larger number of competing generating companies, which would result in a dynamic and aggressive market.¹⁴

Since opening the electric market to competition in New York State more than a decade ago, the T&D utilities within the State have divested essentially all of their generation.¹⁵ As recently as last fall, the Commission reaffirmed its policy favoring divestiture:

For more than 12 years, this Commission has taken numerous actions to develop competitive markets for generation products in New York. The long-term goal is that customers should be able to obtain generation products by paying prices resulting from a fully competitive generation market in lieu of regulated prices (or rates) based on the costs of generation.¹⁶

¹³ Opinion 96-12 at 30.

¹⁴ In its 2006 report reviewing New York's competitive markets, DPS Staff found, "An evaluation of New York's wholesale electricity markets under several metrics (*i.e.*, price, robustness of spot and forward markets, generation and transmission infrastructure, demand side response programs, and generator performance) indicates that New York's wholesale markets are among the most advanced in the nation and that wholesale competition has led to significant efficiencies." See New York State Department of Public Service, "Staff Report on the State of Competitive Energy Markets: Progress to Date and Future Opportunities" (issued March 2, 2006) at 1-2. As a result of the movement to competitive markets, generators are achieving availability rates at their facilities at unprecedented levels. See, *e.g.*, NYISO 2007 Power Trends Report at 1, 13 (noting that, "The performance of New York power plants, as measured by their availability to sell energy into the State's wholesale electricity markets, continues to change for the better, and has made a significant contribution to the reliability of the New York bulk electricity grid."); see also, Tierney and Kahn, "A Cost-Benefit Analysis of the New York Independent System Operator: The Initial Years" (issued March, 2007). In addition, merchant generators have taken steps to maximize the output of their facilities, by, for example, uprating them to increase their overall capacity.

¹⁵ The one notable exception is Con Edison, which has been permitted to retain a small subset of its generation portfolio solely because it was needed to serve its steam system needs in New York City.

¹⁶ See, Case 06-M-0878, *Joint Petition of National Grid PLC and KeySpan Corporation for Approval of Stock Acquisition and Other Regulatory Approvals*, Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island (September 17, 2007) (hereinafter "Grid/KS Merger Long Order"), at 128.

Indeed, the Commission has recently put forward a process to develop a long-range plan for electric resources in the state. The ERP Order¹⁷ continues the Commission's previous policies supporting competitive markets and market mechanisms as the most efficient means to serve the public and to fulfill the Commission's mission to provide "safe and adequate service at just and reasonable rates."¹⁸

Thus, the Commission has consistently maintained - - and market participants have been on notice for more than a decade - - that structural separation of generation from transmission and distribution through divestiture is the best means to prevent the opportunity for, and exercise of, vertical market power. As the RD states, "it is axiomatic that an effectively functioning market will better serve the State's environmental and economic growth objectives than one in which the Commission allows inefficiencies to occur through the exercise of market power." (RD at 62).

B. This Restriction Does Not Affect the Economic Feasibility of Wind Generation Investment by Iberdrola's Unregulated Affiliate.

Joint Petitioners threaten to "redirect resources from New York to other locations wherever economically feasible" if the proposed Transaction is not approved with "reasonable" conditions.¹⁹ At no point, however, have they ever stated that they will carry out this threat if they are prohibited from only developing wind generation that is connected to NYSEG's and RG&E's T&D systems. The Joint Petitioners acknowledge that only 166 MW of their planned

¹⁷ Case 07-E-1507 *et. al.*, *Proceeding on Motion of the Commission to Establish a Long-Range Electric Resource Plan and Infrastructure Planning Process*, Order Initiating Electricity Reliability And Infrastructure Planning (December 24, 2007) (hereinafter "ERP Order").

¹⁸ *See, Id.*, at pp. 4-5.

¹⁹ Joint Petitioners BOE at 24.

wind projects would be interconnected with the NYSEG and RG&E transmission systems²⁰ and only 112 MW of existing hydroelectric facilities are in those service territories. In contrast, they propose to add 832 MW of new wind projects in New York State outside these territories and they have ownership interests in 320 MW of operating wind facilities outside these territories.²¹ Thus, Iberdrola should be capable of deploying its expertise in other service territories in the State. IPPNY's (and the RD's) recommendation that Joint Petitioners not build or own generation in these service territories is a modest, narrowly drawn pre-condition of Transaction approval, designed to remove the incentive to exercise vertical market power, and would not inhibit Joint Petitioners' plans outside these areas.

Further, as the RD correctly found, in light of the generous subsidies offered to wind developers by the State, it is unlikely that Iberdrola would forego economically viable projects in New York if the Transaction were not approved with conditions acceptable to Joint Petitioners. (RD at 46-47).²² There are strong grounds for the Commission to treat with skepticism Iberdrola's threats of withdrawal of its investment in New York.²³ As the RD explained, Iberdrola stated in press announcements that it would invest \$2 billion over five years, and then restated as \$10 billion over an unspecified period, if the Commission approves the Transaction. (RD at 46-47). Yet despite the RD's express invitation to the parties to address on exceptions whether "these statements represent a commitment different from the \$100 million originally

²⁰ *Id.* at 35, 42-45.

²¹ Exh. 57 (IBER-0008 S).

²² Staff also correctly notes the lack of a link between Iberdrola's wind investment in the State and its ownership of NYSEG and RG&E. Staff BOE at 5.

²³ As DPS Staff demonstrated, there has been no connection in the past between where Iberdrola will own transmission and distribution facilities and where it is actively pursuing wind generation investment. Iberdrola is actively pursuing wind projects in Pennsylvania and Ohio where it owns no T&D assets. Conversely, it is not publicly pursuing wind projects in Maine where it does own T&D assets (*see*, DPS Staff BOE at 13.)

promised or whether the revised figures would affect the parties' positions," Joint Petitioners do not even mention --much less support -- their "commitment" of \$2 billion, let alone \$10 billion, anywhere in their brief on exceptions. As Staff states regarding Iberdrola's press announcements, "Iberdrola dodges making a binding commitment to invest \$2.0 billion, or any other amount, whether or not the transaction is approved."²⁴ The Commission should not fear these threats.²⁵

II. THE NYISO AND FERC MARKET RULES DO NOT SUFFICIENTLY ADDRESS THE JOINT PETITIONERS' ABILITY TO EXERCISE MARKET POWER IN THEIR OWN SERVICE TERRITORIES.

With respect to wind generation, Joint Petitioners contend that these facilities could not influence market clearing prices or congestion in the NYISO markets.²⁶ The Joint Petitioners further contend that FERC and NYISO market rules should allay any vertical market power concerns.²⁷ The Joint Petitioners' arguments, however, are seriously flawed in both respects.

First, Joint Petitioners' arguments address only one potential way to exercise vertical market power and wholly ignore the fact that there is intensive competition in New York to secure RPS dollars for these projects. As IPPNY witness Mark Younger demonstrated in his testimony, there are other ways that Joint Petitioners can exercise vertical market power that are unrelated to influencing clearing prices or congestion. Mr. Younger testified:

For example, [the Joint Petitioners] could make it easier for their own facilities to interconnect to their transmission systems while making it harder for their competitors to do so. The operation of

²⁴ DPS Staff BOE at 5.

²⁵ Finally, assuming Joint Petitioners make good on their threat to withdraw investment from the State, "the presence of other firms adequately ensures that Iberdrola's withdrawal from this market would not deter such investments and therefore would not be inimical to the public interest" (RD at 47).

²⁶ Joint Petitioners BOE, at 37-39.

²⁷ Joint Petitioners BOE at 39-41.

the generating facilities requires ongoing interaction between the generators and the local T&D company to resolve issues related to operation and delivery. If the T&D company also owns generation, there will always be the potential that issues related to its own generators are resolved faster than the same issue for merchant generators and/or that the T&D company finds cheaper ways of resolving issues for the company's own generation than for its competitors. Since each issue with each generator is unique, it will be virtually impossible to determine whether the T&D company is treating all generation in a fair and equivalent manner (Tr. 917).

Further, as Mr. Younger testified, although transmission owners must schedule maintenance outages with the NYISO, the NYISO has no control over the maintenance projects that the transmission owners either propose in the first instance or actually perform (Tr. 917).

Additionally, there are significant amounts of lower voltage transmission or sub-transmission over which the NYISO does not exercise control, for which the transmission owner is solely responsible for the scheduling and performance of maintenance. Thus, there exists an incentive to use transmission outages to financially harm competitors or delay competitors' projects while benefiting their own facilities.²⁸

Mr. Younger also testified that Joint Petitioners could use the NYISO planning process to give their own proposed generation development favored treatment (Tr. 918). Currently, there are almost 8,000 MW of operating or proposed wind generation listed in the NYISO Interconnection Queue.²⁹ There is fierce competition among a multitude of merchant developers to design, construct and interconnect new wind facilities, particularly in the upstate areas,

²⁸ *Id.*, see, also, RD at 68.

²⁹ See, NYISO Interconnection Queue, dated June 17, 2008 at http://www.nyiso.com/public/webdocs/services/planning/nyiso_interconnection_queue/nyiso_interconnection_queue.xls.

including NYSEG's service territory.³⁰ Currently, the NYISO is in the process of updating its original study of wind generation that is to be interconnected to the New York Control Area ("NYCA"), in part because of the larger than expected projected development of wind facilities in New York State: 3,266 MW in 2010 and 4,747 MW in 2011.³¹ The NYISO cautions that "SRIS [System Reliability Impact Studies] studies, preliminary operating experience and simulation results have revealed potential constraints for some wind generators in localities in NYCA."³² Further, in a recent order, the Commission observed "There will likely be some offset of other renewable generation due to operation of the new facility, including hydro-electric, other wind, and biomass units. The reductions at other sites are likely to occur at low-load conditions in the project area for limited periods when there is insufficient local load to consume all of the power generated and insufficient transmission capacity to export the balance."³³ Thus, the likelihood that wind generation will at times be curtailed due to insufficient load and transmission capacity to absorb all the potential generation creates another opportunity for NYSEG and RG&E to favor affiliated projects by moving quickly to resolve transmission constraints that affect their affiliated projects while dragging their feet on upgrades that affect competitors.

If the Joint Petitioners are permitted to develop wind projects in NYSEG's and RG&E's service territories through an unregulated affiliate, there will be a powerful incentive to favor

³⁰ The increasing levels of wind development are not surprising, given the incentives created by the federal Production Tax Credit ("PTC") and the Commission's RPS initiative.

³¹ www.nyiso.com/public/webdocs/committees/mc_sector_meetings/meeting_materials/2008-04-28/Wind_Integration_Slides_2008_Sector_Meetings.pdf. By 2011, the amount of wind generation would far exceed the level (3,300 MW) previously studied by the NYISO as being capable of being added to the NYCA.

³² *Id.*

³³ Case 07-E-1343, *Marble River, LLC*, Order Granting Certificate of Public Convenience and Necessity and Providing for Lightened Regulation (June 19, 2008), at 5.

their own projects over those of other merchant generators in the interconnection process. There is a lot of “give-and-take” in the interconnection process, including the need for multiple study agreements, performance of the studies themselves, engineering, design, construction, testing and the like.³⁴ Even a short delay in any of the stages of these processes could result in a wind project missing its milestones and being forced to be examined in the following year’s Class Year Study. Delays could also extend proposed in-service dates and may box out a project from running for an RPS solicitation. Only the modest remedy of precluding Joint Petitioners from developing wind projects in the NYSEG and RG&E service territories will remove the incentive entirely to favor their own generation to the detriment of others.

The Commission in its VMP Statement emphasized the importance of structural separation of generation from transmission and distribution:

In creating a competitive electric market, the Commission has viewed divestiture as a key means of achieving an environment where the incentives to abuse market power are minimized. Recognizing that vigilant regulatory oversight cannot timely identify and remedy all abuses, it is preferable to properly align incentives in the first instance.³⁵

The Commission recently reaffirmed its VMP policy when it conditioned the approval of the merger of National grid PLC (“National Grid”) and KeySpan Corporation (“KeySpan”) on National Grid’s agreement to divest KeySpan’s 2,450 MW Ravenswood generating facility. Finding other alternatives insufficient to adequately address VMP concerns, the Commission held: “We agree with IPPNY and others that a decision by us to rely solely on regulatory

³⁴ NYISO Open Access Transmission Tariff, Attachments S and X.

³⁵ VMP Statement p. 1; *see also*, VMP Order p. 3.

solutions would signal and in fact would amount to a weakening of our resolve to ensure a competitive generation market and its attendant benefits.”³⁶

The Commission also rejected the argument that regulatory measures available to the NYISO and FERC, which were not in place when the VMP Policy Statement was issued in 1998, are adequate to mitigate vertical market power concerns.³⁷ In the National Grid/KeySpan proceeding, the Commission reaffirmed its long-standing policy that divestiture, not regulation, is the best means to minimize market power abuse because vigilant regulatory oversight cannot timely identify and remedy all abuses.³⁸ Joint Petitioners have failed to offer any sound reasons why the Commission should depart from its long-standing policy in this case.

A blanket prohibition, rather than a case-by-case prohibition, on the ownership of generation interconnected to NYSEG or RG&E is the best means to ensure that there are no incentives to exercise vertical market power. Regulatory oversight is extremely difficult, costly and inefficient to apply on a case-by-case basis. Contrary to the suggestion of Joint Petitioners,³⁹ the threat of a NYISO or FERC imposed sanction may not be adequate to prevent future market power abuse, and, in any event, it would not cure the effects of the market power abuse.

³⁶ Grid/KS Merger Long Order at 134.

³⁷ *Id.* IPPNY notes that there have not been any significant changes to vertical market power rules, interconnection requirements (except the approval of new deliverability requirements which makes the exercise of vertical market power potentially even more lucrative) or transmission outage and maintenance procedure rules since the Commission found these rules to be insufficient to counter vertical market power concerns in this decision.

³⁸ *Id.* at 129.

³⁹ Joint Petitioners BOE at 39-41.

III. JOINT PETITIONERS MUST BE DIRECTED TO DIVEST NYSEG’S AND RG&E’S HYDRO FACILITIES AS A PRE-CONDITION OF TRANSACTION APPROVAL.

Joint Petitioners (and certain other parties) except to the RD’s recommendation that NYSEG and RG&E divest their hydro generation facilities. Joint Petitioners claim these facilities are intermittent and unpredictable and thus not conducive to the exercise of market power; that sufficient FERC and NYISO mechanisms exist to prevent abuse; and that the amount of hydro facilities (112 MW) is *de minimis*.⁴⁰ They also claim that the Commission did not require divestiture when it approved NYSEG’s and RG&E’s restructuring plans and there is no reason to believe that they constitute a VMP problem because of the merger.

IPPNY demonstrated above that regardless of the intermittent nature of certain renewables, ownership of such generation and T&D offers strong incentives, beyond affecting market clearing prices and congestion, to exercise vertical market power. And IPPNY also demonstrated above that regulatory oversight, as opposed to structural separation, is no panacea for effective restraint on the exercise of market power. The RD also spells out numerous reasons why divestiture of hydro facilities should be required. (RD at 78-81).

Further, DPS Staff’s Policy Panel testified:

[Should the hydro and gas peaking facilities owned by RG&E and NYSEG be sold?] Yes. There is a market for even small hydro and gas peaking facilities. Other utilities like Niagara Mohawk and Orange and Rockland sold such facilities when divesting their other generation facilities. More recently, Orange and Rockland’s former hydro and gas peaking facilities were sold to a new owner, Central Hudson successfully sold a small hydro facility, and there have been other similar transactions. With the sale of these facilities, Energy East would exit the generation market entirely, eliminating incentives to exercise VMP to the detriment of ratepayers and ending disputes over VMP issues (Tr. 1420-1421).

⁴⁰ Joint Petitioners BOE at 36, 43-45.

After divesting the hydroelectric facilities to an unaffiliated entity, NYSEG and RG&E can still maintain the benefits to customers of low-cost renewable resources by executing a long-term contract with the new owner of the hydroelectric facilities, as the Joint Petitioners have proposed to do with the new owners of divested fossil plants (Tr. 609-610; 692-693). Additional benefits could also accrue to ratepayers if the new owner redeveloped or enlarged the hydroelectric facilities (Tr. 694). Divestiture will ensure that the facilities are upgraded with private investment dollars rather than captive ratepayer dollars. The viability of a new owner of RG&E's hydroelectric facilities increasing their capacity is demonstrated by RG&E's announcement on April 4, 2007 that it "plans to invest more than \$20 million over the next three years in its . . . hydroelectric plants on the Genesee River in the City of Rochester [which] will result in additional generating capacity of 9 MW at the two plants that currently have a combined generating capacity of approximately 49 MW."⁴¹ Ratepayers would ultimately be put at risk of shouldering any cost overruns of such projects if RG&E or NYSEG perform the upgrades. In the case of a merchant developer performing the upgrades on a project it owns, the developer shoulders the risks and the cost overruns, not consumers. Further, because a merchant developer must rely on the market to cover its costs and produce revenue, it is forced to be more efficient (Tr. 903). Finally, Joint Petitioners have not demonstrated that their continued ownership of the hydroelectric facilities results in "substantial ratepayer benefits," as required to overcome the vertical market power rebuttable presumption against generation ownership.⁴²

The fact that the Commission has not previously required divestiture is not a rational basis for the Commission to ignore the potential harm Joint Petitioners could inflict on

⁴¹ See RG&E press release, April 4, 2007, "RG&E to Invest Millions in Upgrading Hydroelectric Plants," *available at*, <http://www.rge.com/OurCompany/News/news04042007.html> (last visited July 3, 2008).

⁴² VMP Policy Statement at 2.

consumers by favoring their hydroelectric facilities over their competitors' generation. As discussed above, Iberdrola is proposing to develop generation that would interconnect with NYSEG's T&D system. The Commission should review Joint Petitioners' existing generation portfolio and the potential ownership of new generation to determine how best to mitigate the potential exercise of vertical market power. In that regard, the Commission can best ensure that consumers will realize the benefits of competition through divestiture.

Finally, the *de minimis* amount of hydro facilities supports IPPNY's position. To the extent Joint Petitioners own any generation, together with T&D, the incentive to exercise market power exists. As the RD notes, the Commission has moved incrementally to achieve its goal of a competitive generation market, free of incentives to exercise market power. (RD at 79-80). It should do so here by requiring the divestiture of Joint Petitioners 112 MW of hydro facilities.

IV. IF THE COMMISSION ALLOWS JOINT PETITIONERS TO OWN WIND GENERATION CONNECTED TO NYSEG'S AND RG&E'S T&D SYSTEMS SUBJECT TO MITIGATION MEASURES ADDRESSING THE ABILITY TO EXERCISE VERTICAL MARKET POWER, STAFF'S AND SPM'S PROPOSED MITIGATION MEASURES ARE INADEQUATE AND SHOULD BE MODIFIED OR REJECTED.

In its Reply Brief in this proceeding, SPM for the first time offered three alternatives to requiring the divestiture of wind assets, two of which were focused on long term contracts, and a third which would have mandated divestiture of NYSEG and RG&E's transmission and distribution systems instead. The RD took note of these three alternatives, summarizing them as follows:

(1) The Iberdrola affiliate (Renewables) could enter a long-term contract with NYSEG or RG&E for each wind project at a fixed per-kWh rate (subject to operating and maintenance expense adjustments) calculated to compensate investors for the special risks of wind investment; the rate would be negotiated or determined by the Commission for individual projects in the permit process; the rate would be offered to other developers unaffiliated with Iberdrola, unless they opted for a market based rate; and the non-Iberdrola developers could interconnect with petitioners' T&D grids under the supervision of a "special

monitor” or the NYISO; (2) Renewables could enter such a contract with a third party rather than the T&D companies; and (3) petitioners could be required to divest the RG&E and NYSEG transmission assets (RD at 74.).

For its part, in its Brief on Exceptions, DPS Staff continues to strongly support the complete prohibition on ownership of wind facilities anywhere in the State.⁴³ However, it offers for the first time in its Brief on Exceptions certain conditions that it believes could ameliorate to some degree the Joint Petitioners’ ability to exercise vertical market power should the Commission come short of mandating full divestiture. These proposals are as follows:

1. conduct a project-by-project vertical market power review upon each Iberdrola proposal to build a wind project;
2. establish an independent transmission planning process whereby Iberdrola would fund a study, conducted by an independent analyst at least once every three years, of the transmission upgrades and reinforcements needed within the NYSEG and RG&E service territories to interconnect all wind power projects that are proposed. The study would also encompass transmission additions that would increase transfer capacity between adjoining states and regions, to prevent the “line that isn’t built” from escaping detection;
3. apparently somewhat akin to the first two SPM proposals,⁴⁴ require Iberdrola to enter into a contract for each wind facility that divorces the profit from the market price. These contracts could be structured as a contract for differences (CFD), which are financial devices that sets the prices that will be received for the generation independently of the market prices by providing for payments that balance to a pre-determined level the revenues generators receive from the NYISO. The term of any such contract should be at least ten years, to adequately address the incentive to raise to market prices. Iberdrola affiliates should be excluded as counterparties, and contracts for existing facilities should be executed promptly.⁴⁵

As demonstrated herein, Staff’s and SPM’s proposals fail to adequately address the Joint Petitioners’ ability to exercise vertical market power and, in fact, demonstrate the inherent problems with trying to piece together remedies when the only complete solution is full divestiture.

⁴³ Staff BOE, at 15-16, 19-20 and 26.

⁴⁴ IPPNY concurs with the argument set forth by DPS Staff in its Brief on Exceptions that SPM’s third alternative raises many issues and should not be pursued further. (*See* DPS Staff Brief on Exceptions at 20-21.)

⁴⁵ Staff BOE, at 20-26.

Initially, it must be noted that both of these proposals came very late in this process. As a result, they could not have been, and were not, offered in testimony, made subject to cross-examination or discovery, and could not have been addressed in rebuttal. The parties to this proceeding put forth their positions in testimony, responded to information requests, made witnesses available for cross-examination and fully briefed their positions. It would be manifestly unjust to allow consideration of unsupported and ill-defined alternatives previously not offered to the parties for review, much less subject to discovery and cross-examination, at this late date.

Moreover, these vague and ill-defined measures raise numerous substantive problems. Following below, IPPNY addresses the flaws with Staff's and SPM's proposed remedies and proposes alternative approaches to mitigate vertical market power. However, even these approaches still fall far short of the protection from vertical market power that complete divestiture would provide.

First, DPS Staff's proposed project-by-project review of Iberdrola's investment decisions will not be able to identify the impediments that Iberdrola may be erecting against entry by its competitors. This could only be addressed by requiring that NYSEG and RG&E publicly disclose information pertaining to their interactions on every development proposal that would interconnect with their T&D systems so that competitors could determine whether there was a pattern of Iberdrola frustrating competition. Even with this information, however, it would be a burdensome process that raises the costs of Iberdrola's competitors. Therefore, it would be far more preferable to provide the limited relief of not allowing Joint Petitioners to own generation connected to NYSEG's and RG&E's T&D systems.

Second, SPM's and DPS Staff's proposals to require Iberdrola's unregulated affiliates to enter into long term contracts unnecessarily may have adverse consequences on the competitive wholesale markets and the competitive solicitations conducted by the New York State Energy Research and Development Authority ("NYSERDA") to implement the RPS. SPM's first alternative -- to require long term contracts with NYSEG and RG&E -- may be interpreted to effectively provide cost-of-service cost recovery for all wind developers that interconnect with NYSEG's and RG&E's transmission system. Alternatively, SPM's proposal could be interpreted to require NYSEG and RG&E to execute standard offer contracts with all developers that propose wind projects.⁴⁶ Either alternative would require NYSEG's and RG&E's ratepayers to bear the above-market costs of renewable generation. This proposal would radically alter the Commission's RPS policy that was carefully crafted to ensure State incentives were provided to only the most efficient resources. The RPS is designed to evaluate projects on the basis of their need for an explicit premium above the market clearing price. By structuring the RPS in terms of paying the premium, NYSERDA can evaluate the relative costs of competing projects with different underlying energy values and execute contracts for renewable energy attributes with those that meet the RPS targets at the lowest cost to the State. SPM's proposal would take competition out of the process by requiring NYSEG and RG&E to execute contracts with all developers.

Staff's long-term contract proposal could be interpreted to have the Iberdrola projects be evaluated on the basis of a CFD payment arrangement. If so, it will be impossible for NYSERDA to conduct a fair comparison of Iberdrola's projects with competing projects unless NYSERDA makes numerous assumptions about the underlying value of the energy. To address

⁴⁶ Without the opportunity to conduct either discovery or cross-examination on these eleventh hour proposals, it is impossible to understand their full scope or intended effect.

this concern, Iberdrola projects should not be eligible for any RPS incentives. Alternatively, Iberdrola's projects should compete with other projects on an equal footing for the RPS premium and any projects that were chosen would then be required to enter into CFDs with unaffiliated third parties for the value of the projects' generation.

The proposal to use CFDs, or for that matter any long-term fixed-price contract, to address the vertical market power concerns provides the potential for reliability impacts as well. Since the payments under the CFD would be unrelated to the value of the energy at the time it is produced, this creates an incentive for the project to continue operating even at times that additional generation from the projects threatens to overload the transmission system. In the absence of a CFD this is a self correcting problem because the market clearing price during these periods becomes negative and the wind generator is incented to reduce its generation to relieve the constraint. This feedback loop is broken with the use of a CFD. If CFDs are to be used as a method of ameliorating the potential for vertical market power, the contracts must provide that penalties associated with generating more energy than the transmission system can handle are borne by the project. In addition, the penalties need to be sufficiently high to override the payment the project receives through the CFD.

Moreover, Staff's and SPM's "remedy," by definition, could only address the exercise of market power intended by the Joint Petitioners to increase market prices. It does nothing to assure that NYSEG and RG&E do not continue to have an incentive to enter into favorable contracts with their affiliates and then pass those costs through regulated rates to their customers. Instead, if the CFD approach is going to be used to ameliorate market power then the Iberdrola projects should be required to enter into the CFDs with unaffiliated parties. Further, none of the CFD proposals do anything to address concerns that market power will be used to hamper

competitors from obtaining RPS dollars and getting their projects built. As noted above, this could be accomplished either by Iberdrola frustrating their competitors' interconnection process or by allowing transmission limitations to affect their competitor's projects more than their own projects. This strategy, as demonstrated both in Mr. Younger's testimony and IPPNY's briefs, presents a significant threat to competitive markets and the success of this Commission's RPS and renewable energy efforts.

Third, turning to DPS Staff's second proposal, it is equally deficient in many respects. For example, given that RPS solicitations are generally held on an annual basis, requiring an independent study to be done every three years will make the Commission many days (perhaps years) too late and millions of squandered RPS dollars too short. As Mr. Younger demonstrated in his testimony in this proceeding, the ability to exercise vertical market power goes well beyond increasing prices to cutting out competitors. Thus, to have any value – which, by definition, falls far short of complete divestiture -- such studies must be conducted on a semi-annual basis and remedies must be enforced quickly enough to ensure that competitors are not thwarted from meaningful participation in the RPS process.

Nor can such studies be limited to just receiving and reviewing information on transmission additions and reinforcements. Maintenance schedules and any revisions thereto must be carefully monitored. The amount of energy curtailment that wind projects (both unaffiliated and affiliated with Iberdrola) experience within the NYSEG and RG&E service territories must to be tracked to assure that Iberdrola's competitors are not being disadvantaged by NYSEG's and RG&E's operation of their transmission systems and their investment decisions. In addition, Joint Petitioners' involvement in, and impact on, interconnection studies

must be carefully overseen, including the independent monitoring of such things as time to provide system data, time to complete reviews and many other factors.

V. JOINT PETITIONERS MUST BE DIRECTED TO COMPLETE THE SALE OF ALL OF NYSEG’S AND RG&E’S GENERATION WITHIN NINE MONTHS OF ISSUANCE OF AN ORDER IN THIS PROCEEDING.

Arguing that divestiture of the Russell Station should count as a benefit in this Transaction, the Joint Petitioners reveal publicly for the first time in their Brief on Exceptions that RG&E had been planning to have this Commission “revisit” their longstanding obligation to divest this facility.⁴⁷ Much later in their Brief on Exceptions, the Joint Petitioners attempt to duck in as a “given” that such divestiture could take a year or even longer.⁴⁸ As demonstrated by IPPNY in its testimony and briefs in this proceeding, these delay tactics must no longer be countenanced. Thus, if the Commission elects to approve this Transaction, the Commission should include the condition that the divestiture of all of NYSEG’s and RG&E’s generation must be completed within nine months of the Commission’s Order in this proceeding.⁴⁹

Since December 2004, the divestiture of the Russell Station has effectively been mandated. Indeed, the only condition to such divestiture was that the actual sale -- as opposed to, e.g., developing auction protocols, holding the auction, etc -- could not be completed until the Rochester Transmission Project went into service.⁵⁰ While RG&E should have been developing protocols and taking the other steps necessary to auction this facility over the past year given the expected RTP in-service date, it apparently has not done so. Rather, notwithstanding its clear

⁴⁷ Joint Petitioners BOE at 22-23.

⁴⁸ *Id.* at 86.

⁴⁹ IPPNY’s BOE sets forth the reasons supporting this nine-month restriction.

⁵⁰ *See* IPPNY Boe at 3-5.

and unequivocal obligations to divest Russell, RG&E instead was issuing press releases advising the public of its intentions to repower the facility.

Absent a firm deadline to divest this facility and all other fossil and hydro facilities, there will be no effective deterrent to prevent such tactics from continuing in the future.⁵¹ As the Joint Petitioners themselves acknowledged on cross-examination, a nine-month period to complete the divestiture of these units is not an “unreasonable goals” (Tr. 693).⁵² Thus, if this Commission elects to approve this Transaction, it should include the condition that the Joint Petitioners must complete the divestiture of all of NYSEG’s and RG&E’s generation within nine months of the Commission’s Order in this proceeding.

⁵¹ Concerns have been raised by Multiple Intervenors and others concerning the allocation of proceeds from this sale. However, holding the auction and allocating the proceeds therefrom and are not inextricably linked. Nothing prevents addressing this issue on a separate track. The auction protocols and the auction and even the sale itself can go forward without making a final determination on the allocation of such proceeds (IPPNY BOE at 4).

⁵² As IPPNY noted in its Brief on Exceptions, RG&E’s sister company, NYSEG, previously developed auction protocols which were approved by this Commission and were used to sell its fossil-fueled facilities. Thus, a strong framework already exists to develop the necessary protocols and documents for the Russell divestiture.

VI. CONCLUSION

For the reasons set forth herein, if the Commission elects to approve this Transaction, the Commission should adopt the ALJ's recommendation and prohibit the Joint Petitioners -- through either unregulated or regulated affiliates -- from owning any generation connected to NYSEG and RG&E's T&D systems. In addition, if the Commission elects to approve this Transaction, it should condition such approval on the requirement that the Joint Petitioners complete divestiture of all of NYSEG's and RG&E's generation within nine months of the issuance of the Commission's order in this proceeding.

Respectfully submitted,

READ AND LANIADO, LLP
Attorneys for Independent Power
Producers of New York, Inc.

By: _____
David B. Johnson
25 Eagle Street
Albany, New York 12207
Phone: (518) 465-9313
Facsimile: (518) 465-9315
dbj@readlaniado.com

Dated: July 3, 2008
Albany, New York