BEFORE THE
NEW YORK STATE
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission to Examine Repowering Alternatives to Utility Transmission Reinforcements	:	Case 12-E-0577

NEW YORK STATE ELECTRIC & GAS CORPORATION
RESPONSE TO NOTICE OF FILING DEADLINE

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I. INTRODUCTION

New York State Electric & Gas Corporation ("NYSEG" or the "Company") submits this Response to Notice of Filing Deadline ("Response") in accordance with the Secretary of the New York State Public Service Commission's ("Commission") September 24, 2013 Notice of Filing Deadline in the above-referenced proceeding ("Notice").[1] The Notice stated that "Cayuga and NYSEG should file . . . a revised proposal for the repowering of the Cayuga station that meets the reliability, economic development, and environmental benefits identified in the January order, *at the least cost to ratepayers*. If the parties are unable to identify such a proposal by that date, they are requested to file, either jointly or separately, their recommendations for any further action in this proceeding."[2]

[1] Case 12-E-0577 - Proceeding on Motion of the Commission to Examine Repowering Alternatives to Utility Transmission Reinforcements, Notice of Filing Deadline (Sept. 24, 2013). On October 23, 2013, the Commission's Secretary granted an extension until November 7, 2013 to Cayuga and NYSEG to file a revised repowering proposal for the Cayuga generating station. On November 7, 2013, the Secretary granted NYSEG and Cayuga an extension until November 21, 2013. NYSEG and Cayuga sought and obtained a further extension to December 23, 2013. On December 23, 2013, the filing deadline was further extended to February 28, 2014. Cayuga unilaterally filed for an additional extension on February 18, 2014. Various parties opposed Cayuga's request but it was granted on February 26, 2014, extending the filing deadline to March 31, 2014. Cayuga requested on March 24, 2014 a new filing deadline of December 1, 2014, which was granted by a One Commissioner Order on March 28, 2014. A further extension request by Cayuga was granted on November 26, 2014, thus establishing the current February 6, 2015 filing date.

[2] Id. at 1-2 (emphasis added).

Despite lengthy good faith negotiations,[3] NYSEG and Cayuga Operating Company, LLC ("Cayuga")[4] have been unable to agree upon a revised repowering proposal that meets the Commission's requirements, including "at the least cost to ratepayers," set forth in the Notice. NYSEG cannot agree with Cayuga's repowering proposal because it would require NYSEG customers to finance the repowering of Cayuga Unit 1 and Cayuga Unit 2 (collectively, the "Cayuga Facility") at a cost that is millions of dollars more expensive for customers than other available options.

Therefore, NYSEG recommends that the Commission: 1) find that further pursuit of a largely customer-subsidized Cayuga Facility repowering is not in the public interest; 2) allow NYSEG to move forward with its transmission reinforcement projects; and 3) close this proceeding.

II. EXECUTIVE SUMMARY

Cayuga and NYSEG have been unable to "identify" a repowering proposal that is consistent with the criteria specified in the Notice and in the Commission's January 18, 2013 Order Instituting Proceeding and Requiring Evaluation of Generation Repowering.[5]

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[3] Negotiations were at times encouraged and facilitated by the New York State Department of Public Service ("Staff").

[4] Cayuga Operating Company, LLC does business as Upstate New York Power Producers. According to a Petition of Cayuga Operating Company, LLC For Market Based Rate Authority and Granting of Waivers and Blanket Authorizations; Request for Expedited Treatment and Prior Notice Waiver (Docket ER12 -___-000 filed on April 18, 2012) the owners of Cayuga Operating Company include the following five entities which may own or control up to 20%: Carlyle Strategic Partners II, LP, CSP Co-Investment II, LP Standard General, J.P. Morgan Investment Management, Marathon Asset Management LP, and California Public Employees Retirement System. In addition, the following entities may own up to 10% of Cayuga Operating Company, LLC, but have no management control: MacKay Shields, Prudential Investment Management, Inc., Whitebox, Penn Mutual Life Insurance Company, Värde, Brigade Capital Management, LLC, CoveView Capital LLC, Goldman, Sachs & Co., Merrill Lynch, Shenkman Capital Management, Inc., Redwood Capital Management, Trilogy Capital, LLC and Citigroup Global Markets.

[5] Case 12-E-0577, Order Instituting Proceeding and Requiring Evaluation of Generation Repowering (Jan. 18, 2013) ("Evaluation Order").

The Company's calculation of the cost associated with the least expensive of the several repowering alternatives offered by Cayuga is set forth on Exhibit 1. Moreover, since the time the Commission issued the Notice, the customer subsidy needed for a repowering of the Cayuga Facility has increased. Given current system studies, as described below, the repowering of the Cayuga Facility will not avoid the approximately $35 million (on a net present value ("NPV") basis)[6] in transmission costs as originally contemplated by the parties.[7]

NYSEG and Cayuga have worked diligently and collectively in an extensive multi-month good faith attempt to reach an agreement to repower Cayuga at *a cost to ratepayers equal to or less than* the cost of the transmission enhancements that were expected to be needed upon the mothballing or retirement of the Cayuga Facility. NYSEG estimates that customer payments under a Cayuga Facility repowering are expected to be approximately $452.3 million on a NPV basis.[8] NYSEG has estimated market revenues from sales by a repowered Cayuga Facility of $263.7 million on a NPV basis, resulting in a net cost to customers of $188.6 million for repowering. Even in a conservative analysis where Cayuga Facility repowering is credited for potential indirect benefits associated with early termination of the existing Reliability Support Services Agreement ("RSSA")[9] and uncertain local economic benefits, the cost disadvantage to customers for the repowering option remains $160.7 million.[10]

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6 NPV is calculated for January 1, 2017, calculated at a 7.48% discount rate.

7 Transmission work by National Grid to reconductor the Clay-GE #14 line will now be required regardless of the status of the Cayuga Facility. See Case 10-E-0050 – Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation d/b/a/ National Grid for Electric Service, Five-Year Transmission and Distribution Capital Plan (Jan, 31, 2014) at 18-19.

8 All cost estimates NPV to January 1, 2017 at NYSEG's discount rate of 7.48%

9 Given the recent fire and shut down of a unit at the Cayuga Facility, the opportunity for early termination benefits of the RSSA are more speculative.

10 The cost delta presented assumes a 20-year repowering agreement. Because the plant is around 60 years old (with some upgrades) NYSEG would strongly prefer that a repowering agreement, if any, be limited to 10 years.

It should be noted that the above calculation of the required customer subsidy is conservative as it assumes that Cayuga would bear the entire risk that market revenues ultimately produce less recovery than estimated and that Cayuga would not receive any payments from NYSEG to make up for the revenue shortfall. In practice, Cayuga's repowering proposal seeks to have all risk associated with negative changes in market revenues assigned to NYSEG's customers.[11] This represents a major economic risk for customers.[12]

In short, Cayuga's repowering proposal is neither economic nor in customers' best interest. Additionally, beyond the economic costs identified by NYSEG, Cayuga's repowering proposal would obligate customers to absorb potentially significant construction, operational and reliability risks, each of which has the potential for significant associated costs to customers. Given the significant cost to customers associated with Cayuga's repowering proposal, NYSEG recommends that the Commission: 1) find that further pursuit of a largely customer-subsidized Cayuga Facility repowering is not in the public interest; 2) allow NYSEG to move forward with its transmission reinforcement projects; and 3) close this proceeding.

The Commission should not lose sight of the fact that customer-subsidized support is not the only method for repowering the Cayuga Facility. The Commission has long supported a wholesale generation marketplace that encourages competition and efficient new generation. Cayuga's owners remain free to pursue repowering the Cayuga Facility without customer subsidies via self-generated funding or by attracting other capital in the marketplace.

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[11] See Case 12-E-0577, Cayuga Repowering Proposal (Mar. 26, 2013) at page 6 of 43 ("Cayuga 2013 Repowering Proposal").

[12] See Exhibit 1. Exhibit 1 includes, among other things NYSEG's current estimate of market revenues for analysis purposes. Significant market change and fluctuation is possible. There is significant market risk in the wholesale power market. In other words, if the market price for power sold by the repowered facility falls and that risk is not assigned to Cayuga, customers would pay a lager subsidy to Cayuga's owners.

Finally, NYSEG understands if Cayuga elects to mothball the Cayuga Facility following expiration of the existing Reliability Support Services Agreement 2 ("RSSA 2") (through June 2017) there could be a negative economic impact to the Lansing area similar to when any other private employer closes for economic reasons. During this transition period, NYSEG is open to discussions with applicable state agencies to identify other development opportunities that might ease the transition for the Lansing area while further supporting New York State's Reforming the Energy Vision ("REV") goals for distributed generation, micro-grids and clean generation development.

III. BACKGROUND

This proceeding arises directly from Cayuga's filing in July 2012 of a notice of its proposed "protective lay-up" or mothballing of the Cayuga Facility effective January 16, 2013.[13] That voluntary election to mothball or retire the Cayuga Facility by its owners triggered reliability concerns for the electric network and for customers.

As the entity responsible for local reliability, NYSEG conducted an analysis of the proposed mothballing and identified adverse reliability impacts that could occur if the mothballing were effectuated. NYSEG also identified transmission system reinforcements as an alternative to remedy reliability impacts arising from a mothballing of the Cayuga Facility, but estimated that the reinforcements would not be completed until 2017, well after the proposed mothball date. As a result, the Cayuga Facility had to remain available for commitment in order to maintain system reliability on an interim basis. NYSEG negotiated the RSSA with Cayuga to ensure the continued maintenance and availability of the Cayuga Facility to avoid adverse impacts on system reliability resulting from the proposed mothballing. The terms of the RSSA

[13] Case 12-E-0400 - Petition of Cayuga Operating Company, LLC to Mothball Generating Units 1 and 2, Petition of Cayuga Operating Company, LLC to Mothball Generating Units 1 and 2 (July 20, 2012).

were approved by the Commission in the RSS Approval Order with an initial term of January 16, 2013 through January 15, 2014.[14] The parties worked diligently and efficiently to negotiate the RSSA 2, which ensured the continued maintenance and availability of the Cayuga Facility for up to four more years solely for reliability purposes. The RSSA 2 was filed with the Commission on November 4, 2013 and approved on January 16, 2014.[15]

The Commission's Evaluation Order directed NYSEG to perform certain additional tasks, including filing transmission upgrade costs and seeking repowering alternatives to NYSEG's proposed transmission upgrades. The Company, as required, solicited a bid from Cayuga for the level of out-of-market support (i.e., customer subsidies) necessary to finance the repowering of the Cayuga Facility. NYSEG transmitted to Cayuga a 19-page detailed solicitation for the repowering of the Cayuga Facility.[16] Cayuga responded on March 26, 2013 with a repowering proposal.

NYSEG completed, on an expedited basis, the required detailed evaluation of Cayuga's repowering proposal, which is set forth in the Company Report on Cayuga Repowering Analysis, filed on May 17, 2013 in the referenced docket.[17] The Company Report recommended that the Commission adopt the transmission reinforcement option since it provides the "most certainty to

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[14] See Case 12-E-0400, Order Deciding Reliability Issues and Addressing Cost Allocation and Recovery (Dec. 17, 2012) ("RSS Approval Order").

[15] See Case 12-E-0400, Order Deciding Reliability Need Issues and Addressing Cost Allocation and Recovery (Jan. 16, 2014).

[16] See Case 12-E-0577, Letter from Mr. Jeffrey M. Converse, Manager – Electric Supply NYSEG/RG&E, to Mr. Jim Mulligan, President, Cayuga Operating Company, LLC (Feb. 19, 2013).

[17] See Case 12-E-0577, Report on Cayuga Repowering Analysis (May 17, 2013) ("Company Report"). The Company respectfully incorporates by reference herein the Company Report. Please note that the redacted public version of the Company Report was revised twice pursuant to trade secret and confidential determinations of the New York State Department of Public Service Records Access Officer ("RAO") and revised documents were filed on September 10, 2013 and October 15, 2013. Cayuga filed an appeal with the Secretary of the RAO's determinations on October 23, 2013 in Case 12-E-0577.

customers with regard to cost, schedule and operational risk."[18] Cayuga responded to the Company Report on August 16, 2013.[19]

Cayuga's August 2013 filing contained extensive statements and assumptions regarding Cayuga's view of the indirect societal and market benefits associated with repowering. While the magnitude and nature of these alleged "societal and market" indirect benefits remain subject to challenge, the direct costs of repowering the Cayuga Facility remain millions of dollars higher than the transmission alternative for customers.[20]

IV. REPOWERING AGREEMENT DISCUSSIONS

A. Discussions Prior to the Notice

Even before issuance of the formal Notice directing the parties to review alternatives, NYSEG was actively engaged with Cayuga in exploring whether any repowering option existed that would be equivalent or better than NYSEG's proposed transmission enhancements. On September 16, 2013, Staff requested a meeting between Cayuga and NYSEG to discuss repowering options, with a focus on identifying an alternative that would maintain reliability for customers, provide for just and reasonable rates, and establish the lowest cost option that minimizes customer risks while addressing all stakeholder concerns. Based on that meeting and further discussions with Cayuga, NYSEG proposed, on September 18, 2013, a payment stream that would pay Cayuga for the RSSA and repowering services.[21] The parties met on

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[18] See id. at 22.

[19] See Case 12-E-0577, Comments on the NYSEG Report on Cayuga Repowering Analysis and Recommendation dated May 17, 2013 (Aug. 16, 2013) ("Cayuga Proposal"). Cayuga filed a less redacted version on October 7, 2013.

[20] Id. at 3-4. The Notice also indicated that any revised proposal for repowering meeting reliability, economic development and environmental benefits identified by the Commission at the "least cost" to ratepayers. Notice at 1-2.

[21] Cayuga has requested confidential treatment for all information exchanged during the settlement discussions regarding a repowering agreement pursuant to a written confidentiality agreement between the parties. As indicated above, these settlement discussions did not result in a binding agreement. Cayuga has neither publicly

September 18, 2013 to discuss NYSEG's proposal. At that meeting, Cayuga rejected NYSEG's proposal claiming that NYSEG had failed to recognize all of the "societal benefits" that Cayuga asserted arise from repowering.

B. Discussions Post Issuance of the Notice

After issuance of the Notice on September 24, 2013, the Company reiterated to Cayuga its willingness to participate in discussions regarding an acceptable repowering option based on NYSEG's September 18, 2013 repowering proposal. On September 27, 2013, NYSEG responded to Cayuga's request that NYSEG consider whether NYSEG taking responsibility for building a new, approximately 19-mile long, natural gas transmission pipeline needed for repowering would add any value for NYSEG. NYSEG indicated that it would review Cayuga's new gas pipeline project proposal, but NYSEG did not agree to assume responsibility for construction and/or ownership of the required new gas pipeline.

On September 30, 2013, as part of the discussions concerning RSSA 2, NYSEG explained to Cayuga the details of NYSEG's September 18, 2013 repowering proposal, including the payment amounts (equal to avoided transmission costs) NYSEG would provide to allow for the repowering of the Cayuga Facility. Despite the economic gap between the parties, NYSEG indicated its willingness to continue good faith discussions with Cayuga in an attempt to reach an agreement on an economically acceptable repowering proposal.

The parties continued to engage in multiple discussions and negotiations regarding repowering alternatives on various dates from October, 2013 through the present.[22]

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announced its last negotiation position nor authorized NYSEG to do so. As a result, the Company's comments herein are based on Cayuga's publicly provided proposals and data.

[22] While repowering discussions were occurring, the parties successfully negotiated in good faith the RSSA 2.

Notwithstanding the parties' good faith, multi-month and repeated efforts to identify a negotiated resolution, NYSEG and Cayuga have been unable to reach agreement on a repowering proposal.

V. NYSEG'S REPOWERING PAYMENT PROPOSAL

NYSEG's repowering payment proposal was consistent with the requirements outlined in the Evaluation Order and the Notice. Consistent with the Notice, NYSEG's initial repowering payment proposal to Cayuga reflected NYSEG's ability to avoid enhanced transmission costs and certain RSSA 2 payments. NYSEG also took into account the feedback it received from Staff and Cayuga during the many negotiation sessions and subsequent discussions identified above. NYSEG's repowering payment proposal was intended to be based primarily on NYSEG customers' avoided costs and payment for certain indirect societal benefits. NYSEG also included in its original repowering payment proposal the potential savings in RSSA 2 Agreement costs that might result from repowering the Cayuga Facility on an expedited basis and terminating the RSSA early. The potential avoidance of RSSA 2 payments for 2017 is now highly questionable given the passage of time. In addition to making modifications and improvements to the Cayuga Generating Facility itself, Cayuga has to permit, license and construct a natural gas pipeline necessary to operate a repowered Cayuga Station before RSSA 2 payments for 2017 can be avoided.[23]

NYSEG's proposal to Cayuga was reasonable for customers and consistent with the Commission's least-cost mandate. NYSEG's proposal was rejected by Cayuga. Based on updates for current market pricing and the lack of avoided transmission costs, NYSEG's Cayuga Repowering payment proposal, if made today, would be lower than the initial proposal that was rejected by Cayuga.

[23] Despite the low probability, the Company has conservatively given Cayuga credit in its analysis for certain avoided RSSA 2 payments.

VI. CAYUGA'S REPOWERING PROPOSAL

Under Cayuga's public repowering proposal, payments to Cayuga would result in a NPV direct cost gap of approximately $188.6 million, resulting in payment of that amount by NYSEG customers to Cayuga. Even assuming indirect avoided cost benefits of $27.8 million (for analysis purposes only) an economic gap remains of $160.7 million NPV in additional cost to customers to support Cayuga and its repowering proposal.

Moreover, as discussed in detail in Section VII below, the economic gap between what NYSEG would be willing to pay for reliability and what Cayuga seeks for its reliability services (via repowering) was calculated in a conservative fashion. The actual cost is likely greater. Specifically, the direct economic cost estimate (even if alleged offsetting indirect benefits are included in the analysis) does not account for the significant operational and business risks NYSEG's customers would bear as a result of relying, for system reliability purposes, on a generating facility (while updated in part) that contains significant components over 50 years old. In addition, the Cayuga Facility recently experienced a shutdown of one unit and a fire, which is still under investigation. See Exhibit 6.

The cost identified also does not account for the risk that Cayuga might once again mothball the Cayuga Facility (regardless of repowering or customer support provided for repowering) as a result of future negative market price developments or a failure of older, non-updated components of the Cayuga Facility. The Company's recommendation is also conservative because it does not penalize the repowering option for the cost of other risks, such as Cayuga filing for bankruptcy, suffering financial distress, or otherwise being incapable of timely completion and/or continued operation of the repowering project.

There is simply no guarantee that after seeking to shut down the Cayuga Facility once, Cayuga will not do so in the future. While these financial and operational risks could theoretically be mitigated through various financial vehicles, including parental guarantees, liquid security, etc., these guarantees would impose costs on Cayuga that have not been accounted for in Cayuga's or NYSEG's economic assessment.

VII. NYSEG'S ANALYSIS OF CAYUGA'S PROPOSAL

In the following sections, NYSEG addresses specific issues associated with Cayuga's proposal.

A. NYSEG's May 17, 2013 Company Report Concerns Are Still Valid

NYSEG notes that the significant concerns raised in the Company Report, based on its evaluation of Cayuga's initial repowering alternative, have not been resolved and are still applicable.[24] NYSEG has not reproduced each of the concerns stated in the Company Report in this response, but incorporates by reference those concerns herein.

B. Direct Cost of Repowering

Cayuga has provided a NPV cost estimate of $452.3 million to repower Cayuga. NYSEG has estimated $263.7 million in market revenues as an offset to the revenues required by Cayuga. This produces a NPV direct cost delta of $188.6 million (discounted to January 1, 2017 using NYSEG's discount rate of 7.48%).

C. Indirect Cost Comparison

NYSEG considered in its analysis two major adjustments to reflect any potential indirect cost savings that could be associated with the repowering: 1) local economic benefits; and 2)

[24] See Company Report at 8-23.

avoided 2017 RSSA 2 payments. NYSEG believes that a repowering prior to January 1, 2017 is unlikely.

1. Local Economic Benefits

NYSEG understands that should Cayuga decide to mothball the Facility, there would be a negative impact on the economy of the local community. The negative impact would be similar to when any other business or economic enterprise ceases to operate locally for a variety of reasons.[25] NYSEG remains open to discussions with applicable state agencies to identify other development opportunities that might ease the transition for the Lansing area while further supporting New York State's REV goals for distributed generation, micro-grids and clean generation development. NYSEG considered these local concerns and impacts in its analysis. Societal and local economic benefits are created when private money is spent to introduce new production or expand existing production in a region. Similarly, public money (i.e., government spending of tax dollars) can create societal and local economic benefits by funding certain projects in a region because the tax money collected broadly can be redirected to a specific geographic region. In the case of Cayuga repowering, the source of the subsidy to support a Cayuga repowering would come from all NYSEG electric customers through higher rates. As a result, while the communities surrounding the Cayuga Facility might benefit, all NYSEG electric customers and society as a whole would be worse off because the repowering, as discussed above, costs more than the value it provides.

Nevertheless, NYSEG calculated the local economic benefits associated with a Cayuga repowering based on the information provided by Cayuga in its March 26, 2013 Repowering

[25] It is worth noting that by entering into the RSSA1 and RSSA 2 NYSEG avoided a "flash-cut" impact on the local economy resulting from Cayuga's stated intent to mothball the facility. Given the remaining 2.5 years of term on the RSSA2, the local economy will have additional time to adjust to Cayuga's shut down of the facility.

Proposal submitted to NYSEG.[26] For Option 1, Cayuga estimates Annual Payroll to be $135.8 million over the term of the proposed 20 year agreement. Cayuga also estimates Regional and State Payroll Impacts to be $116.3 million. The Regional and State Payroll Impacts are not included by NYSEG because they are exactly equal to and offset by the money paid by NYSEG customers. NYSEG has included the Annual Payroll benefits associated with the repowering to recognize the fact that the repowering would be done three years in advance of the construction of the required need date of 2019 identified in the NYISO's 2014 Reliability Needs Assessment.[27] Based upon the calculation described above and included in Exhibit 3, NYSEG estimated the economic benefits of repowering Cayuga to be $20 million for analysis purposes.

2. Avoided RSSA 2 Costs

To the extent that the Cayuga Facility could be repowered and in service by January 1, 2017, there would be a reduction in RSSA 2 payments in the amount of $7.8 million by avoiding six months of RSSA 2 payments. For analytical purposes, the Company included this amount as a benefit to repowering.

D. Other Issues

1. Emissions

Cayuga is proposing to fuel existing coal boilers with natural gas, resulting in less efficient operation than new natural gas combined cycle combustion turbine generators. As a result of this configuration, NYSEG estimates the plant will have a capacity factor of less than 50%. Even at this level, the plant would produce significantly more emissions than a new combined cycle natural gas-fired generator.

Therefore, no value can be realistically attributed to re-powering the Cayuga plant for

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[26] See Cayuga 2013 Repowering Proposal at page 41 of 43.

[27] See NYISO, 2014 Reliability Needs Assessment (Sept. 26, 2014).

long-term avoided emissions.

2. No Congestion Relief

In stark contrast to the Niagara Mohawk Dunkirk station, there is no apparent congestion relief that a repowered Cayuga would offer to NYSEG's customers. Accordingly, no benefit for congestion relief is appropriate.

3. Market Impacts

Cayuga has asserted that its proposed repowering option has capacity market benefits that NYSEG should recognize. The Company disagrees with Cayuga's assertion. Cayuga used the NYISO demand curve to calculate its purported benefits to the capacity market. Cayuga assumed that there are no additional generators or demand response providers in the markets whose bid cost would fill some or any of the capacity void created by mothballing the Cayuga Facility. Cayuga has not demonstrated that this is the case. In addition, Cayuga failed to consider that this market price suppression, if real, might result in some other generator retiring or being mothballed. As shown on Exhibit 4, numerous generators have recently rescinded retirement notices that were submitted as little as 12 months ago. As also shown on Exhibit 4, a generator that has been operating at significantly derated capacity has given notice of its intent to restore to full operating capability. This demonstrates that generators react quickly to changes in capacity market prices and no value can be assigned to market price impacts.

The Affidavit of Michael Cadwalader filed in Case 12-E-0577 addresses this issue. Mr. Cadwalader notes that:

> In competitive electricity markets, such as those operated by the NYISO, the entry of new generation can have a significant impact on prices of energy and capacity. As a result, if one were to assume that this impact would be significant and long-lasting, one might reach the conclusion that economically inefficient entry was in the interest of consumers, because it would suppress the prices that consumers pay, not just for energy and capacity provided by the new generator, but for energy and capacity provided by all generators. Such a conclusion would be shortsighted, however. Economically inefficient entry is likely to lead to responses

> by the owners of competing resources that would offset the impact on energy and capacity prices resulting from the inefficient entry. As a result, if economically inefficient entry is supported by contracts that require consumers to pay above-market prices for the energy and capacity provided by a new generator, it may cause consumers to be worse off in both the short run and the long run.[28]

As stated very succinctly by Mr. Cadwalader, customers will be worse off if economically inefficient entry (via repowering or otherwise) is supported by contracts that require customers to pay above-market prices for energy and capacity provided by these new generators.

4. Commercial and Operational Risks

Commercial and operational risks associated with Cayuga's proposal fall into three categories: 1) construction costs and schedule risks associated with Cayuga Facility repowering construction and natural gas pipeline construction; 2) repowered Cayuga Facility operating costs and operating risks; and 3) repowered Cayuga Facility market revenue risks. Unexpected events in any of these categories could result in the failure of the Cayuga Facility to operate as expected and/or financial distress for the Cayuga Facility's owners. NYSEG's updated risk matrix analysis of Cayuga's current repowering proposal, provided in Exhibit 5, demonstrates that the Cayuga repowering option remains far riskier than NYSEG's proposed transmission alternative, an alternative that is now required regardless of repowering.[29]

a. Construction Cost and Schedule Risks

Another significant risk to repowering involves the need for a new approximately 19-mile long gas transmission line that Cayuga or another party would have to permit, license, and construct to provide the natural gas necessary for repowering. Potential issues associated with

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[28] Case 12-E-0577, Report and Recommendations Comparing Repowering of Dunkirk Power LLC and Transmission System Reinforcements, Exhibit 7 - Affidavit of Michael D. Cadwalader, (May 17, 2013) at 6-7.

[29] The Company would expect to get financial and other performance and operational guarantees along with related liquidated damage protection from Cayuga to protect customers. The cost of Cayuga providing these guarantees should properly be included as part of the repowering scenario costs.

the licensing of a gas transmission line in this area should not be overlooked and their impact should be considered in any analysis. By its very nature, the siting of a gas line is often an extended regulatory process that requires heavy public involvement and may be subject to frequent delays mandated by opposition and the need to address siting concerns.[30]

b. Operating Costs and Risks

The proposed repowering by Cayuga is limited to using natural gas, rather than coal, as a fuel in the existing boilers. While certain coal related equipment will no longer be in service, the balance of plant steam and water cycle equipment will still be used, including the existing turbine/generator train. At a minimum, the age and condition of the Cayuga Facility must be addressed and concerns must be ameliorated regarding the ability of the plant to operate in a reliable fashion into the future. Utilization of a 1950's vintage facility (although with specific upgrades) creates additional operational risks. In addition, the Cayuga Facility recently experienced a shutdown of one unit and a fire, which is still under investigation. See Exhibit 6.

NYSEG has not received any assurances that the Cayuga Facility is in sufficiently sound physical condition to permit repowering upgrades sufficient to reliably meet the generation need for an extended period of time. Since NYSEG and its customers would to rely upon the availability of the plant's output (and also be responsible under Cayuga's approach for levelized revenue payment streams), sufficient assurances that necessary plant upgrades can actually be made for reliable operation in the future is an important factor when assessing the relative merits of Cayuga's proposal.

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[30] The transmission option also has permitting and siting risk that can delay project completion. No project is able to move forward until appropriate permits have been granted. See Case 12-E-0400, Letter from J. Lahtinen to Secretary Burgess (Jan. 16, 2015) (setting out the transmission project schedule and expressly noting that it is dependent upon permit approval and does not reflect federal permit or PSC Certificate conditions that may restrict the Company's ability to begin construction). However, the gas line proposed by Cayuga would be a "greenfield" project making it that much more difficult to timely site and permit.

Accordingly, NYSEG recommends that, if repowering is to be pursued, a complete and thorough due diligence review of the material condition of the Cayuga Facility and an independent review of the technical and operational aspects of Cayuga's repowering plan/work scope should first be completed. If Cayuga has already secured such reviews, the information should be provided to the Company, Staff and the Commission. The Company has identified some of these due diligence risks and tasks, as set forth in Exhibit 7.

To potentially mitigate the impact associated with operational risk (assuming repowering is undertaken), the Commission should recognize that any repowering contract with Cayuga must include sufficient operational and financial protections for NYSEG's customers, including Cayuga long-term financial and performance guarantees, and sufficient penalties and damages provisions to protect NYSEG's customers.[31] NYSEG's customers should not bear such operational or financial risks and, as a result, the Commission must also provide clear identification of Cayuga's responsibilities in the event of unit or plant operational failures or other extended outages, whether for reasons within or outside of the control of Cayuga.

In the event Cayuga is permitted to pass on such operational costs to NYSEG and its customers, the Commission should provide now for NYSEG's full recovery of such costs, as well as any costs associated with replacing the services NYSEG should have received from Cayuga under the repowering proposal, but did not.

c. Market Risks

Cayuga's repowering proposal included a calculation of market revenues and NYSEG has provided an estimate of market revenues in Exhibit 1. There is substantial risk associated with the continuous movement in market prices and associated increase or decrease in available

[31] Such a situation would need to be remedied at considerable cost and potentially on an expedited basis.

market revenues. The projection of market revenues should offset, upfront, the payments required by NYSEG customers to repower Cayuga. In other words, the risk of the market movement should be on Cayuga, not NYSEG's customers. If future market revenues are not an offset to NYSEG's customers' ongoing payments to Cayuga to repower the facility, customers will bear the market revenue risk that generation deregulation was intended to remove.

If repowering is required, NYSEG would use its best efforts to provide sufficient protections for its customers should Cayuga not live up to its obligations under the repowering agreement. NYSEG remains concerned that any contractual protections: 1) cannot operate as envisioned under the repowering agreement; 2) might be subject to litigation uncertainty or bankruptcy risk; and 3) are solely within Cayuga's control to meet or breach based on its own economic interests.

5. Competitive Generation Policy Considerations

Having decided in Wallkill,[32] Carr Street[33] and their progeny to create a competitive marketplace for generation, the Commission should continue to allow the market to function as designed. If the market supported repowering, Cayuga would never have sent the notice of mothballing or retirement that triggered the reliability need in the first place. Commission intervention to "save" a generation competitor that is "out-of-market" and requires a multi-million dollar customer subsidy interferes with the basic premise that inefficient generation should be replaced with more efficient generation or enhanced transmission. The preservation of one specific generation competitor is inconsistent with the goal of fostering a broad and competitive marketplace and will have little to no benefit toward achieving the Commission's

[32] See Case 91-E-0350 - Wallkill Generating Company, L.P., Declaratory Ruling on Regulatory Policies Affecting Wallkill Generating Company & Notice Soliciting Comments (Aug. 21, 1991); Case 91-E-0350, Order Establishing Regulatory Regime (Apr. 11, 1994).

[33] Case 98-E-1670 - Carr Street Generating Station, L.P., Order Providing for Lightened Regulation (Apr. 23, 1999).

goals of reducing emissions while modernizing the State's energy infrastructure.

VIII. NYSEG'S RECOMMENDATION

NYSEG recommends that the Commission: 1) find that further pursuit of a largely customer-subsidized Cayuga Facility repowering is not in the public interest; 2) allow NYSEG to move forward with its transmission reinforcement projects; and 3) close this proceeding.

IX. CONCLUSION

For the foregoing reasons, NYSEG respectfully requests that the Commission adopt NYSEG's recommendation as set forth in Section VIII above.

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Respectfully Submitted,

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