

**REMARKS FOR WILLIAM M. FLYNN
CHAIRMAN
NEW YORK STATE PUBLIC SERVICE COMMISSION**

**NYSERDA 2ND BIENNIAL CONFERENCE
"CHP IN NEW YORK STATE – TWO YEARS LATER"
CROWNE PLAZA TIMES SQUARE
NEW YORK CITY**

JUNE 24, 2004

Thank you, Judge DeIorio. I want to thank NYSERDA for inviting me back to speak to this group today. I was beginning to think they had long since forgotten me because it has been about a year and a half since I left NYSERDA and this is the first time they have invited me to speak at one of their conferences.

I have not lost touch with NYSERDA at all since joining the Public Service Commission. I now sit on the Board of Directors and work closely with Peter Smith on a day-to-day basis and am pleased to see that NYSERDA has not lost a step since my departure. Peter has done an excellent job of steering the ship and I continue to be encouraged by some of the subtle changes that are regularly made at NYSERDA to continuously improve its performance and deliver more effective programs and services to New York's energy users; and for that, we all thank you Peter.

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One of the guiding principles that has always benefited NYSERDA is its belief in evolving and adapting its programs to match the ever-changing realities of the energy marketplace in order to remain effective. That was something I stressed as President and I know it is an ongoing area of emphasis under the leadership of Judge DeIorio and Peter. Government agencies can only remain effective if they are willing to adapt and evolve over time, and during this ongoing transition toward more competitive energy markets, that may be truer of energy agencies than any other. Since 1998, when the System Benefits Charge program was created by the Public Service Commission and entrusted to NYSERDA to administer it, we have seen a tremendous amount of flux in the energy landscape. The collapse of Enron, the energy crisis and

scandals in California, and last year's blackout are just a few examples of recent events that have had substantial ramifications on the energy industry. Put simply; the industry in 2004 looks nothing like it did in 1998. And, to its credit, NYSERDA and its programs have evolved to keep up with those changes. I know those of you in the CHP community can attest to that.

The SBC program was created to stimulate market-based activity in the areas of efficiency, demand reduction, distributed generation, and renewable energy deployment. The intent was to encourage the market to implement solutions and adjust NYSERDA's role as that happened. The CHP area is one where those adjustments have been substantial and effective. When the first CHP solicitation was issued a few years back, there were some 150 or so proposals that included demonstrations and product development activity. Based on the overwhelming response to the solicitation, NYSERDA made some minor modifications to its solicitation process to more narrowly focus proposals. The second round produced another 100 or so proposals leading to still more refinements in the solicitation process.

In response to a call from the industry for a more subscription-based CHP program to reduce some of the burden of developing proposals, NYSERDA, in this latest round of proposals, has offered a reduced level of incentives for projects that may be considered less innovative, but are still good examples of how and where CHP makes sense. This was not the subscription-based program many of you sought, but it may provide NYSERDA with some valuable data and feedback as to what level of support might be necessary to administer a more subscription-based approach for CHP.

Again, this latest round saw no real slow down in terms of proposals. The number of proposals continues to make NYSERDA's job difficult in terms of evaluating the best use of its funds in this area and, to the industry's credit, the quality of the proposals only seems to increase, making NYSERDA's job all that much tougher. Altogether, NYSERDA has committed roughly \$46 million toward almost 100 demonstration and technology development projects, having to turn away more proposals than it ultimately funded. If all of these projects come to fruition, the program will help to install nearly 100 megawatts of on-site generating capacity in an efficient and environmentally responsible manner.

The program has experienced its share of bumps, but between Governor Pataki's commitment to encourage the development of clean energy technologies, and the efforts of NYSERDA and the Public Service Commission, I think this audience would be hard pressed to find another state in the nation that is more committed to advancing distributed generation technologies or more effective at doing so.

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I already touched upon the financial and technical assistance that NYSERDA provides, but we have addressed regulatory issues as well. In my brief tenure at the Commission, we have established electric standby rates for all utilities in the state except for Niagara Mohawk, which were established prior to my arrival to the Commission. These rates reflect greater consistency throughout the state and include exemptions and phase-in periods for certain renewable technologies and CHP systems up to one megawatt in an effort to ensure those standby rates do not hinder DG development. We have directed gas utilities to develop rates that are tailored to the usage characteristics of industrial and commercial customers operating DG systems and encouraged gas utilities to develop programs to support DG deployment. And, we are currently discussing with the industry revisions to our standard interconnection requirements in ways that I think will only further benefit DG technologies in the state. These are just a few examples of how we are striving to level the playing field for DG and CHP technologies by lowering hurdles and eliminating disincentives.

I cannot stand here today and say our work is over. Issues continue to crop up that hinder deployment of CHP systems throughout the state and we need to reexamine some of our policies that have not produced the types of results we expected. Our requirement for utilities to examine DG alternatives to distribution system upgrades has not resulted in any projects moving forward despite two – and in some cases three – rounds of RFPs by the utilities. The network configuration in Con Edison's service territory, which is responsible for a very high level of system reliability, also presents special challenges and added safety concerns for interconnecting DG systems. There is a widespread need for substation breakers to be upgraded in Con Ed's

territory before certain types of CHP systems can be interconnected to the grid. New issues with steam use and standby rates in New York City have cropped up recently that affect the economics of proposed CHP projects. Flex rates, which benefit commercial and industrial customers through reduced utility charges and reflect the state's commitment to retaining and attracting jobs, have at times been presented as an alternative to proposed CHP projects after a great deal of ground work had already been done. And, I am sure this audience can and will list a host of other issues that should be resolved to assist you in your efforts to sell DG projects.

The point I am driving toward here is not that we as a regulator have done enough for this industry already. The potential benefits of more widespread DG and CHP deployment are too great for us to declare victory and move on at this point. The added security benefits for society and economic benefits for customers of having on-site power available during extended grid outages; the added diversity in the way the grid is utilized; and the economic development potential from growing this industry here in New York State all make compelling arguments to continue to identify and eliminate barriers to DG and CHP deployment. The point I want to make is that New York State government cannot grow this industry to its potential on its own. Just as I am confident there is more work for New York State and the PSC to do to help this industry thrive, there is also more work for the industry to do to help itself.

I have at times been frustrated by the response of the industry to certain actions the Commission has taken. The first reports I read after the standby rates were approved for Con Ed, Orange and Rockland, Rochester Gas and Electric, and New York State Electric and Gas focused on the Commission "raising rates" for DG users and the fact that the one megawatt exemption was too low. I understand that it is human nature to focus on what we don't have rather than what we do have, but there is a careful balancing act that the Commission needs to responsibly maintain as our restructuring efforts create opportunities for new technologies and new ways to use the grid; and I think very few people appreciate that fact. Sudden or dramatic policy shifts will have unintended consequences that could do more harm than good. There are certain fixed costs that utilities face when delivering power to customers, regardless of the volume of power being delivered. Standby rates are an attempt to allow utilities to recover those costs and thereby remove any disincentive for them to interconnect the systems.

In addition, customers and developers in this industry need to recognize that in many cases, DG systems should not supply on-site power 100% of the time. There are times when DG simply cannot match the economics of the grid. While some customers may have certain reasons for choosing to disconnect or eliminate purchases from the grid, those reasons are often not based on economics. Some in the DG industry try to overlook that fact and sell oversized systems that will meet all of a customer's power needs when a smaller system designed for peak demand periods would actually offer the optimum financial return to the customer.

I realize you have a tough enough job in trying to be successful. You are faced with the unenviable task of trying to market equipment to different types and sizes of customers in different utility territories – each with its own unique circumstances and characteristics. And, you are faced with that challenge in all 50 states. I can understand that there must be a certain level of frustration on your part at dealing with this patchwork of markets; but I want to challenge you today to examine ways in which you can help yourselves. There are steps you can take to improve the economics of DG systems and work toward more consistent regulatory treatment on a regional or national scale.

One approach that occurs to me is to develop and offer prepackaged DG systems that can lower the costs for customers and increase penetration of the technology. I know there are already efforts underway in this area and I applaud those of you working toward this end. Currently, DG and CHP systems are designed, sold, and operated in a piecemeal fashion customized to the unique energy needs of individual end users. While there is some value in this type of approach in terms of gaining experience and knowledge with systems under various usage characteristics, there is also inefficiency inherent in this type of approach. To reach the next level and achieve wider deployment of your technologies, it seems to me that standardized equipment packages need to come to the market. DG systems designed to run on specific fuel types like landfill gas or propane, or systems designed for the usage characteristics of supermarkets, hospitals, nursing homes, or large apartment complexes could satisfy these niches more economically and efficiently than continuing to develop site-specific designs that may not be replicable from one customer to the next. Prepackaged systems could do for the DG industry

what the assembly line did for the automotive industry. It could dramatically lower installation costs to make the technologies available to a wider range of customers.

Another area where I would specifically ask your help is in getting other states on board. New York has always strived to maintain a leadership role in the energy industry and we work closely with the industry to develop and implement policies that stimulate investments and facilitate competition. But, as much as we strive to lead, leadership has its drawbacks – and the progressive thinking of one or two states cannot sustain an industry on its own. We are at a point where from my perspective, other states have some catching up to do before we can continue much further down the path toward facilitating DG and CHP. The March/April issue of **Distributed Energy Magazine** listed the top eleven states for DG. *They must have thought that top ten lists were becoming too cliché so they decided that their list would be one better by going to eleven.* The states they listed included, in order; California, New York, Massachusetts, Ohio, Connecticut, Illinois, New Jersey, Minnesota, Michigan, Pennsylvania, and Oregon.

Notwithstanding the fact that I disagree with them in terms of which state should be ranked number one, what struck me about the list was that the rationale for including the various states varied significantly from one state to another. California was praised for the amount of money it provides to support DG installations, as well as some policies to eliminate barriers such as exit fees. New York earned good marks for the financial assistance we offer, the number of active demonstration projects we supported, and regulatory policies that differ from those in California, but are nonetheless facilitating a wide range of DG installations in the agricultural, residential, and commercial sectors. Other states were recognized specifically for their focus on fuel cells, their financial support of DG, or their commitment to research. In other words, while each state on the list was considered friendly toward DG, each had separate and distinct reasons for being on the list. And, while most states were acknowledged for offering some level of financial support to the industry, very few states were identified as addressing regulatory hurdles to greater DG deployment. If the majority of the states on the top 11 list are not acknowledged by the industry as eliminating regulatory barriers, I would not want to even think about what challenges you face in the other 39 states.

In the early stages of restructuring, it made a lot of sense for individual states to experiment a little with policies until we could identify those that work. But, now we are at a point where we can identify those states and those policies that are working for the DG community. It seems to me that it is time to build on that for the benefit of the industry by creating a little more consistency from one state to the next. That is a role that I think this industry needs to address.

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In the absence of federal direction on smaller-scale DG systems, states develop policies that they feel best meet their own needs. Some states have placed greater value on DG than others, but I think it is up to this industry to work with those states that you feel are lagging behind to identify the best practices in terms of DG policy and encourage those states that are not implementing those policies to do so. Greater consistency among state policies will help the industry in the long run by simplifying the regulatory landscape and supporting a much wider deployment of equipment. This in turn can help to further reduce costs and gain a greater understanding of the technological capabilities and limitations that would be useful in further refining policies.

While not all states have the ability to put the financial resources into supporting various technologies, they can adopt aspects of our regulatory approach, which frankly I think would be more beneficial to this industry in the long run than grants or financial assistance. Money can stimulate activity, but without the regulatory framework to back it up, the industry will never be self-sustaining. That is where I think New York's support of this industry stands head and shoulders above the rest of the states; we are committing more than just money. We have committed to transforming the market. Awarding funding through the SBC program is an important component of that market transformation effort, but equally important is the effort we undertake to review and refine our policies to ensure the money we invest through the SBC program is not ultimately wasted.

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Now, I mentioned earlier that I was confident that this group could identify the remaining barriers New York needs to address to further advance CHP and DG initiatives in the state. The reason for my confidence is simply that I know you have been developing your own Top 10 list of the remaining hurdles in New York State. As a result of a meeting held with some of my staff, the Northeast Combined Heat and Power Initiative took us up on an offer to outline the remaining challenges faced by the industry in New York. The staff of the Department is already working on many of the issues on that list, including:

- 1) The issue of utility Flex Rates and the way they have been presented to customers as an alternative to considering DG projects;
- 2) Standard interconnection requirements that will potentially apply to network distribution configurations and bring New York's standards in line with national standards;
- 3) An ongoing review of utility initiatives to examine DG alternatives to distribution system upgrades; and
- 4) A lack of awareness over gas rates for DG customers, which we are addressing through events like this, and may consider holding workshops in the future similar to those we held last year on electric standby rates. I believe Mike Scott is around here somewhere and will be on a panel following my remarks to talk about gas rates and other gas-related issues for DG developers and customers.

Some of the issues identified on your list concern public awareness and making information more widely available. Resolving those types of issues needs to be done in partnership. We do not know who your customers or prospective customers are. We will gladly work with the industry to ensure you have access to the information you need to sell your products, but our resources are limited and we need to rely on you to ensure that your prospective customers learn what they need to know when making the decision to invest in DG or not.

Likewise, the issue of real time pricing is one that this Commission has grappled with and ultimately decided to continue on a voluntary basis rather than mandating it. This audience understands that real time pricing does not necessary mean higher energy bills for customers if

they take the appropriate steps to manage their energy use. DG systems are one effective tool customers could take advantage of to potentially lower their bills under real-time prices. But, customers do not necessarily understand that and the common perception of real-time prices is that mandating them would simply equate to mandating higher bills. We need the help of this industry to make sure customers understand that real-time pricing may actually lower their costs if they proactively implement energy management strategies.

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In conclusion, I cannot promise resolutions to these issues that will make all of you 100 percent happy, but I can assure you that we are aware of your concerns and are factoring those concerns into our decision making process. At the end of the day, the decision we make on any given issue will likely be the result of that balancing act I mentioned to you earlier, where we strive to take incremental steps in the right direction to avoid drastic policy shifts and unintended consequences that may ultimately do more harm to the industry than good. But, I want to thank you for taking the time to carefully and constructively consider what challenges continue to confront you in New York State. I would only re-emphasize that while I pledge to work on your list, you need to pledge to work on it as well.

One lesson I learned in my days at NYSERDA is the value of partnerships. By working together, we can achieve more than either of us could on our own. While the role of the Commission is different than that of NYSERDA, I still believe that we can continue to work in a partnership and I know we already have a strong relationship on which to build. I want to thank the Northeast CHP Initiative once again for taking the time to visit our offices and meet with some of our staff to discuss the regulatory issues that concern you. All too often, we hear about groups that take exception to certain policies or decisions made by the Commission yet never take the time to sit down and meet with us. As I understand it, the folks from the CHP Initiative were initially reluctant to share the problems they face in New York at that meeting because they did not want the meeting to be misconstrued as a griping session. It was only after some prompting from my staff that they identified some of the remaining barriers they faced and then

went back to develop the Top Ten list. That is the kind of relationship that I want to encourage more of. Partners may not always see eye to eye on the issues, but they must always sit down together and discuss their differences. I hope to continue the partnership New York State has established with this industry and look forward to working with you as we move forward.

Thank you.