STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case No. 06-M-1017 - Proceeding on Motion of the Commission as to Policies, Practices, and Procedures for Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers

COMMENTS OF HESS CORPORATION

INTRODUCTION

Hess Corporation ("Hess") submits these comments in response to the Commission's Order, issued on April 19, 2007, instituting a Phase II of this proceeding ("Phase II Order").[1] In Phase II, the Commission is examining whether it should mandate the use of long-term supply contracts between utilities or other load-serving entities ("LSEs") and electric generation entities.[2] The Commission is also exploring in Phase II whether the State should re-institute a centralized, integrated resource planning ("IRP") process that was a hallmark of New York's electric regulation policy prior to the restructuring of the State's electric industry.[3] Hess, one of the largest competitive energy service company ("ESCO") marketers of electricity and natural gas in New York, appreciates the opportunity to address the issues and questions raised in the Phase II Order.

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[1] Case No. 06-M-1017, *Order Requiring Development of Utility-Specific Guidelines For Electric Commodity Supply Portfolios and Instituting A Phase II To Address Longer-Term Issues* (Apr. 19, 2007) ("Phase II Order").

[2] Phase II Order at 38.

[3] *Id.*

PRELIMINARY STATEMENT

The Commission should not re-institute an IRP process in New York nor should it mandate or otherwise require utilities or other LSEs to enter into long-term supply contracts with generation resources. First, with respect to IRP, it is both unnecessary and dangerous for the Commission to reinstitute what was essentially a failed policy in the pre-restructuring era. As discussed in greater detail herein, institution of an IRP process in the current market structure would be duplicative of processes already implemented by the New York Independent System Operator ("NYISO"). In addition, reinstitution of the IRP process in the restructuring era will expose a new generation of customers to the same core harm suffered by customers in the pre-restructuring era, which is the imposition of substantial stranded costs.

Furthermore, IRP and long-term contracts cannot remove immediate barriers to electric infrastructure development. To this point, Hess can speak from its experience as a participant in New York's competitive energy markets. Currently, Hess is developing a new generation resource project in Bayonne, New Jersey that would interconnect into the New York electric transmission grid at Gowanus, located in New York City. In developing this project, Hess' concern is not whether or not there is an absence of IRP or long-term contracts. Rather, Hess' concern as to this project is the imposition of expected interconnection deliverability requirements to be proposed by the NYISO in June 2007. If implemented, these NYISO interconnection rules would prevent the efficient and timely interconnection of new and cleaner generation resources such as Hess' project in favor of existing less efficient and more polluting generation, thereby shielding the latter category from increased competition.

Thus, in developing new infrastructure projects, the existence or absence of IRP or long-term contracts is irrelevant to Hess and, most likely, other merchant generators seeking to have their projects interconnected into the New York electric transmission system. Drawing from Hess' experiences with the development of its proposed generation project, the most important factor behind encouraging infrastructure development is the presence of well-thought out, consistent rules and procedures that assists – and does not hinder – the market in filling in these needs.

Finally, imposition of IRP and long-term contract requirements will distort the market-reflective price signals necessary for Hess and other ESCOs to develop the value-added products and services that, to date, over 1.3 million customers have sought and received, thereby depriving customers of access to these products and services. One example of these value-added products and services is the provision of "green power" from renewable energy sources. Other examples include demand response and energy efficiency products that could help the current Administration achieve its "15 by 15" goal of decreasing the demand for electricity by 15 percent by 2015 through increased energy efficiency. By contrast, however, implementation of policies that block customers from receiving market-reflective price signals, and thereby the signals needed to encourage customers to be more energy conscious and efficient, will render the ambitious "15 by 15" goal an impossible milestone to achieve.

To date, no party has adequately demonstrated that IRP and long-term contracts will be the cure-all elixir that solves any and all perceived deficiencies in New York's electric infrastructure development. In fact, there is evidence suggesting that IRP and long-term contract requirements will create inefficient redundancies to ongoing planning

efforts, substantially undermine the robust competitive retail market structure now in place in New York, and harm customers through imposition of substantial stranded costs.

Hess therefore recommends that the Commission, in place of expedited consideration and implementation of IRP and long-term contract requirements, establish a comprehensive three-part process designed to thoroughly explore and remove all existing and immediate barriers to meaningful electric infrastructure development. Specifically, and as discussed further herein, the Commission – through Hess' proposed three-part process – should: (1) identify and remove immediate existing and potential barriers to the siting, construction, interconnection and operation of new electric infrastructure; (2) specifically identify additional deficiencies associated with electric infrastructure development and craft market-based remedies that specifically address the particular deficiency; and (3) institute a comprehensive study process, with full stakeholder participation and input, to explore the appropriateness of a planning process in the event all other possible policy options are implemented and exhausted.

DISCUSSION

I. IT IS BOTH UNNECESSARY AND DANGEROUS FOR THE COMMISSION TO RE-INSTITUTE AN INTEGRATED RESOURCE PLANNING PROCESS IN NEW YORK

Question #1: ***Should there be a statewide integrated resource planning process to examine long term electricity resource needs? To what extent or in what manner would a statewide integrated resource planning build on or parallel existing reliability planning processes? What time frame should be examined in such a process and what issues should be considered? What is the role of the utilities and other interested parties in the process? How should the process differ from any previous integrated resource planning processes? What processes should be adopted, if any, to ensure that resource portfolios at the utility and statewide level satisfy overall planning objectives and public policy considerations? How should immediate concerns and long range considerations be addressed?***

The Commission should not re-institute an IRP process in New York. As discussed herein, IRP is a policy that in today's market is redundant to other planning processes already in place, and in the past has harmed customers by exposing them to billions of dollars in stranded costs while nearly bankrupting utilities in the process. While the Commission has expressed in the Phase II Order a desire to consider IRP on an expedited basis,[4] Hess respectfully suggests that, given these impacts, it is at best premature and at worst reckless to pursue this approach. This is especially true where, as here, no party has adequately demonstrated that re-institution of an IRP policy will overcome current barriers to the siting, construction, interconnection and operation of new electric infrastructure that numerous project developers, including Hess, now face. Hess therefore recommends that the Commission implement the three-step process outlined in greater detail in this section.

[4] Phase II Order at 33.

A. IRP Is Duplicative Of Existing Processes Designed To Ensure The Availability Of Adequate And Reliable Electric Infrastructure.

First, it should be noted that re-institution of an IRP process is unnecessary because IRP would be duplicative and redundant of processes already in place that are designed to ensure the availability of adequate and reliable electric infrastructure. For example, the NYISO has implemented a Comprehensive Reliability Planning Process – codified in Attachment Y to its Open Access Transmission Tariff – in which it performs a Reliability Needs Assessment ("RNA"). Through the RNA, the NYISO identifies resource needs over a ten year period and then uses this information to issue solicitations for market-based solutions to the State's electric infrastructure needs.

In addition, NYISO's neighboring independent system operators – ISO New England and the PJM Interconnection – have implemented forward-looking capacity constructs to identify electric infrastructure needs. Specifically, ISO New England has instituted a Forward Capacity Market and PJM has implemented a Reliability Pricing Model intended to match projected infrastructure needs with market-based solutions.

Hess submits that re-institution of IRP is redundant to processes already in place at the NYISO and – given the fundamental flaws of and New York's checkered history with IRP – is an inferior mechanism to both the NYISO's current RNA process as well as the processes implemented by ISO New England and the PJM Interconnection.

B. IRP Has Harmed Consumers And Utilities In The Past And Will Likely Harm Consumers And Utilities If Re-Instituted.

Second, the history of IRP in New York is littered with examples of how the inability to accurately forecast New York's long-term electric needs resulted in harm to customers and utilities. One example was the introduction of the "six-cent law" under

which the State made an IRP-based determination that non-utility generation was needed to meet the State's long-term electricity resource requirements and further determined that a price cap was needed to apply to this resource. Underlying this determination were planning assumptions as to future trends in electricity requirements, pricing, and other elements that impact wholesale and retail electricity markets. These forecasts, however, turned out to be grossly inaccurate and caused several New York utilities to execute uneconomic long-term contracts. The high costs of these uneconomic contracts were borne by their ratepayers in the form of billions of dollars in stranded costs and ultimately threatened the financial viability of the utilities.

Another example of the harmful legacy of the IRP process is the saga of the Shoreham Nuclear Plant, the costs of which continue to be borne by Long Island customers to this day. As a recently issued White Paper examining the progress of retail electric competition in New York State summarized:

> In 1965, when the Long Island Lighting Company (LILCO) first announced its intention to build a nuclear plant in Suffolk County, elected officials fervently embraced the project. Within a year, LILCO acquired a 455-acre site between the sparsely populated hamlets of Shoreham and Wading River, and declared its new plant would be on line by 1973, at a cost of $65-$75 million. By the time Shoreham was fully decommissioned on Oct. 12, 1994, it cost nearly $6 billion – about 85 times higher than the original estimate – and destroyed LILCO. The intervening years were marked by astonishingly low worker productivity, design changes ordered by federal regulators, and extensive battles over evacuation plans. Though Shoreham never produced a kilowatt of commercial power, the agreement that shuttered the plant forever made ratepayers responsible for most of Shoreham's cost, saddling Long Island with some of the highest electric rates in the nation.[5]

[5] Capitol Hill Research Center, *Retail Electric Competition in New York: Benefits for the Present, Promise for the Future – An Examination of Progress of Electric Market Restructuring in New York State, 1995-Present* (May 1, 2007) ("NY Competition White Paper") at 4-5 (internal citation omitted). <http://www.resausa.org/NY/pdf/NY_WhitePaper.pdf>.

The valuable lesson that was taught by the implementation of IRP in the pre-restructuring era was that the inherent inability to accurately forecast New York's long-term electric infrastructure needs harmed consumers by exposing them to billions of dollars in stranded costs and nearly bankrupted New York's utilities. Re-institution of IRP on an expedited basis will undoubtedly expose a new generation of customers to billions of dollars more in stranded costs since it is based on the same fundamentally flawed premise that the State can by administrative fiat accurately forecast New York's long-term energy needs by outguessing markets. Hess respectfully suggests that a different approach is needed for electric infrastructure development in New York.

C. The Commission Should Establish A Comprehensive Three-Step Process That Removes Existing Barriers, Identifies Deficiencies And Applies Market-Based Solutions To Cure Perceived Infrastructure Deficiencies.

The failures of IRP in the pre-restructuring era took place at a time when there was no competition, no market price signal and IRP attempted to replicate such a signal. Today, New York has a robust and viable competitive retail electric market structure that does produce for some customer groups market-reflective price signals. Thus, it is both pointless and dangerous for the Commission to utilize IRP to replicate a market price signal that already exists, especially where IRP produced a legacy of inaccurate and imprecise forecasting, failure to produce sufficient new cost-effective electric infrastructure and imposition of substantial costs on customers.

Hess therefore recommends that the Commission reject establishment of IRP or similar form of centralized planning in New York and in its place institute a comprehensive three-step process designed to narrowly identify specific market-based

deficiencies in the infrastructure development process and establish market-based mechanisms to remedy the identified deficiency. The first step of this process would be to identify and remove immediate existing and potential barriers to the siting, construction, interconnection and operation of new electric infrastructure. Examples of such barriers are further discussed in Hess' response to Question #11. The second step of Hess' proposed process would be to specifically identify perceived additional deficiencies associated with electric infrastructure and craft market-based remedies specifically tailored to address the particular deficiency.

The third step, which would be implemented in the event the Commission determines that some form of planning process is absolutely necessary following the implementation and exhaustion of all other possible options, is establishment of a comprehensive study process that differs from the IRP processes implemented during the pre-restructuring era. The objective of the comprehensive study process would be to identify, in a thorough and systematic fashion, all of the various planning and public policy goals that need to be addressed and the formulation of the best approach given the varied and, at times, conflicting nature of these policy goals.

In order for the comprehensive study process to provide meaningful results, the process must include all affected stakeholders including customers, utilities, ESCOs, and other energy providers. In addition, the comprehensive study process must thoroughly analyze and address the following issues:

Goals. The Commission must identify with specificity the precise energy policy goals it seeks to achieve through implementation of an IRP process. These goals may include fuel diversity, demand side management and other energy efficiency goals,

environmental impacts, customer impacts, utility financial impacts, economic development or other goals. Along with specific identification of the policy goals must come an analysis and demonstration that these goals can be met through implementation of a planning process.

In addition, the study process must address the prioritization of the identified policy goals, which in several cases come into conflict in the infrastructure planning process. For example, fuel diversity may lead to retail rate increases for customers, financial burdens on utilities and restriction of additional generating capacity. Should fuel diversity as policy goal take priority over cost impacts to customers and utilities? The comprehensive study process must analyze and answer this and other questions concerning the specific energy policy goals the Commission seeks to achieve.

Current Status. It is extremely important for the Commission to know the State's current status in terms of electric infrastructure before making any determination as to whether institution of a planning process is an appropriate policy, and if it is, what is the best approach for ensuring the most efficient and cost effective infrastructure is obtained. In order to accomplish this, the Commission must thoroughly examine and comprehensively identify the status of the State's infrastructure on both a statewide and individual utility basis. While the Commission can utilize information incorporated in the NYISO planning process for a portion of its examination, this information alone will not be sufficient. Because the NYISO primarily addresses the narrower issue of reliability to the exclusion of other policy goals such as fuel diversity, demand side management and customer impacts, the Commission must undertake a more thorough qualitative and quantitative analysis in the comprehensive study process.

Physical and Economic Constraints. The Commission must identify on both a qualitative and quantitative basis the existing and potential physical and economic constraints that, if not removed, will restrict or preclude the implementation of any particular resource planning strategy or public policy goal identified in the comprehensive study process.

Impact on Competitive Markets. The Commission has long supported the development of robust and sustainable competitive retail electric markets. By all measurements, competitive retail electric markets promote economic efficiency and yield substantial consumer benefits. These benefits include increased customer choice of value-added products and services, downward pressure on electric prices, environmental improvements through the availability of green power and energy efficiency product offerings and reduced stranded cost burdens for customers.[6] The results of these benefits are apparent today as more than 1.3 million customers and 41.3% of the State's electric load has switched to ESCO supply service, numbers that have steadily elevated throughout the restructuring era in New York.[7]

Thus, retail electric markets play a substantial and vital role in the State's overall energy policy. Any policies that disrupt or destroy these markets will have substantially adverse consequences for customers who have affirmatively chosen to receive their electric supply through a product specially tailored for them by an ESCO. In addition, any disruptive policies will erect barriers that will prevent ESCOs from continuing to

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[6] NY Competition White Paper at 1, 7-21.

[7] Case No. 07-M-0458, *Order on Review of Retail Access Policies and Notice Soliciting Comments* (Apr. 24, 2007) ("Retail Markets Order") at 4; New York Public Service Commission, *NYS Electric Retail Access Migration Report, March 2007* <http://www.dps.state.ny.us/Electric_RA_Migration.htm>.

viably compete in New York at a time when the ESCO industry has grown by 33% between 2003 and 2005 alone, with approximately 100 approved ESCOs in New York, at least 76 of which are active.[8] With ESCOs unable to viably compete in New York, many of the benefits they provide in the form of customer-tailored, value-added products – including their ability to integrate green power, energy efficiency and demand response measures into their products – will disappear with the ESCOs to the detriment of New York's customers.

As discussed in Hess' response to Question #2, implementation of policies that incorporate long-term fixed prices into utility commodity supply will irreparably harm the ESCOs' ability to compete and substantially undermine New York's vibrant retail electric market structure. IRP and long-term contracts are two mechanisms that will integrate long-term fixed prices into utility commodity supply. It is therefore essential for the Commission, as part of the comprehensive study process, to take into account and identify with precision the adverse impacts of any proposed IRP or long-term contract policies on New York's robust and vibrant competitive electric markets.

Interaction With Other Planning Processes. It is of critical importance that the Commission identify, analyze and attempt to assimilate the various planning processes of other governmental entities and energy bodies within New York State. For example, the City of New York has recently issued an energy plan ("PlaNYC") in which it has proposed that the City's energy requirements be met through measures that do not include the construction of new electric generation plants in the City. The PlaNYC proposal is inconsistent with the NYISO's recent Power Trends 2007 Report, which concluded that continued load growth in and limited transmission capability into

[8] NY Retail Competition White Paper at 10.

southeastern New York creates the need for substantial infrastructure development (including generation) in New York City.[9]

The planning processes of other State and local entities may differ from and impact upon a planning process proposed by the Commission. It is therefore incumbent on the Commission, through the comprehensive study process, to analyze and reconcile these and other actually or potentially conflicting planning processes before making any determination as to whether a particular planning process is an appropriate mechanism for addressing infrastructure development.

Identification of the Level of Utility Load. Currently, 41.3% of the State's electric load is served by an ESCO with that percentage greater in some utility service territories.[10] Given these substantial load migration numbers and steady elevation of this migration of load throughout the era of restructuring in New York, it is not unreasonable to conclude that this percentage may increase, thereby resulting in lower levels of electric requirements being met by the utilities. Con Edison's recent electric rate case filing to the Commission provides a compelling example, as it confirms a material decline in the utility's spot purchases between 2004 and 2006 "primarily due to customers migrating from full-service to retail access."[11]

Increasing customer migration trends pose two difficult questions when considering whether IRP and long-term contracts are appropriate policy mechanisms to

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[9] *See* NYISO Power Trends 2007 Report at 2, 15-16, 22-23.

[10] New York Public Service Commission, *NYS Electric Retail Access Migration Report, March 2007* <http://www.dps.state.ny.us/Electric_RA_Migration.htm>.

[11] Case No. 07-E-0523, Petition and Exhibits of Con Edison in Support of its Proposal To Increase the Charges or Its Electricity Service and Make Other Changes (May 4, 2007), Pre-Filed Testimony of Joseph A. Holtman at 6-7.

employ. First, how are IRP processes and long-term contracts to be handled when no one knows what the level of the utility's load is going to be over the term of an IRP process or long-term contract? Second, and related, what should be the appropriate level of utility load when determining the amount of load that is to be procured by the utility and what are the cost implications of this decision for customers since the utility's captive ratepayers will absorb these costs absent a Commission finding of imprudence?

The Commission must undertake a careful and detailed analysis to answer these questions as part of the comprehensive study process, taking into account the steady growth of retail access statewide and in the individual utility service territories.

Interaction with Other Commission Policies. The Commission has implemented a number of regulatory policies that will substantially impact both the supply and use of electricity and therefore materially impact the policies and goals of any Commission-proposed IRP policy. First, the Commission approved in 2004 a renewable portfolio standard ("RPS") process in which by 2011, 25% of the State's electricity requirements will be supplied by a renewable energy source.[12] The RPS process adopted by the Commission directly impacts the level and type of generation resources available in New York State.

Second, the Commission, in its recent orders addressing utility revenue decoupling mechanisms ("RDMs") [13] and the development of an Energy Efficiency Portfolio Standard ("EEPS"),[14] has embarked on an aggressive effort to increase the role

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[12] Case No. 03-E-0188, *Order Approving Renewable Portfolio Standard Policy* (Sept. 24, 2004) ("RPS Order").

[13] Case No. 03-E-0640, *Order Requiring Proposals For Revenue Decoupling Mechanisms* (Apr. 20, 2007) ("RDM Order").

[14] Case No. 07-M-0548, *Order Instituting Proceeding* (May 16, 2007) ("EEPS Order").

and impact of energy efficiency throughout New York State. Adoption of aggressive RDM and EEPS policies will require substantial financial outlays in order to encourage customers to reduce their electric demand, which could in turn substantially impact the use of electricity in New York State.

It is essential for the Commission to incorporate into the comprehensive study process an analysis of these and other Commission policies. In so doing, the Commission should address how it can assimilate the RPS, RDM, EEPS and other programs that substantially impact the available supply and use of electricity into a chosen planning process.

Political and Social Obstacles. The Commission would be prudent to identify and analyze all political and social obstacles that may inhibit the achievement of the policy goals identified in the comprehensive study process. For example, standing as barriers to meaningful development of electric infrastructure in New York State are the absence of an Article X generation plant siting process and the anticipated existence of NYISO interconnection standards that will prevent the efficient and timely interconnection of new and cleaner electric generation plants into New York's electric transmission grid. NIMBY and conflicting political priorities between and among the State and local governments present additional obstacles to the siting, construction and operation of new infrastructure in New York. Without the removal of these barriers, it is highly unlikely that IRP or long-term contracts will result in the development and operation of any meaningful level of additional infrastructure. Accordingly, the comprehensive study process must address potential political and social obstacles to infrastructure development.

Economic Impacts. Implementation of an IRP process and long-term contracts will have substantial economic impacts on customers, utilities and the overall decision as to which infrastructure projects should be pursued. The comprehensive study process must therefore incorporate a thorough economic analysis of the various alternative infrastructure development proposals, including the costs and benefits of each alternative and the overall economic impact of their adoption and implementation.

In addition, the study process' economic review must also incorporate an analysis of the financial impacts on both the New York utilities and customers. With respect to the utilities, this analysis must address the impact of an IRP process or long-term contracts on the utilities' ability to obtain capital at reasonable rates. That the utilities will need access to capital in the coming years is a given in light of the fact that, at minimum, they will need to finance improvements to their electric distribution structure. A prime example is Con Edison's recent electric rate filing with the Commission in which it seeks to increase electric distribution rates by $1.2 billion due in large measure, according to Con Edison, to needed enhancements of its electric distribution infrastructure.[15]

The study process must also recognize that the utilities' ability to access capital and proposals to increase rates to meet distribution needs is an economic factor that will substantially impact customers. Assuming that the costs cited by the utilities are deemed prudently incurred, these are costs that will ultimately be borne by customers. For example, in the case of Con Edison in light of its recent electric distribution rate filing with the Commission, it is conceivable that Con Edison's ratepayers could be forced to

[15] *See, e.g.*, Case No. 07-E-0523, Petition and Exhibits of Con Edison in Support of its Proposal To Increase the Charges or Its Electricity Service and Make Other Changes (May 4, 2007), Letter Petition; Direct Testimony of the Infrastructure Investment Panel.

bear well over $1 billion in costs associated with implementation of IRP and long-term contract requirements on top of a potential $1.2 billion distribution rate increase. In light of these very real and substantial cost impacts, the Commission must incorporate economic impacts into the comprehensive study process.

Economic Development. The comprehensive study process should also analyze how each proposed infrastructure development alternative will impact upon and be impacted by economic development throughout New York State. In addition, economic development initiatives already established or that could be established by the State or local economic development agencies could serve as useful alternatives to IRP planning or long-term contracts. The study process should therefore review existing programs of the Empire State Development Corporation and the New York City Economic Development Corporation as well as other State and local economic development agencies. Following this review, the Commission should determine which, if any of these existing programs, serve as useful models for developing new programs to attract developers to build new electric infrastructure in New York.

II. THE COMMISSION SHOULD NOT REQUIRE OR OTHERWISE MANDATE UTILITIES TO ENTER INTO LONG-TERM CONTRACTS WITH GENERATION ENTITIES

Question #2: ***Should major regulated electric utilities be required or encouraged to enter into long-term contracts, with existing generators, proposed generators, and other entities, that facilitate the construction of new generation, the development of additional energy efficiency, the development of additional renewable generation resources, the re-powering of existing generation, or the relief of transmission congestion? Should such contracts be entered into for the purposes of improving fuel diversity, mitigating market power, or furthering environmental policies?***

As with the proposed implementation of IRP, introduction of a mandatory long-term supply contracting requirements between utilities and generation entities are unnecessary and dangerous mechanisms that will not be the cure-all elixir that solves any or all perceived deficiencies in the development of New York's electric infrastructure. First, as discussed in Hess' response to Question # 11, long-term contracts fail to address and remove the immediate existing barriers to infrastructure development in New York. Second, the costs of such contracts are recoverable from customers if deemed prudently incurred by the utility, thereby imposing substantial additional costs on customers in addition to distribution rate increase requests pending or soon to be pending before the Commission. Third, long-term contracts prevent customers from receiving the market-reflective price signals they need to conserve energy and shop for a value-added product or service that ESCOs can custom-tailor for the customer's particular needs. Fourth, long-term contracts generate long-term fixed prices that can expose customers to price shock at the end of the contract period.

Long-term contracts are harmful because they result in prices that do not reflect actual market conditions in which energy is bought and sold. Thus, customers receiving a commodity price based on a long-term contract receive incorrect price signals that lead

to inefficient customer usage. The longer the term over which prices are fixed by contract the greater the probability that the price will diverge from the market. Thus, during periods when the long-term contract price exceeds the market price, customers will be overpaying for their electric usage. Conversely, during periods when the market price exceeds the long-term contract price, customers will receive a price signal that their electricity is less expensive than it actually is and over-use.

In addition, the inability of customers to receive correct, market-reflective price signals impairs their ability to shop for and choose a value-added ESCO product that, unlike utility service, can be custom-tailored to fit the customer's specific energy needs. Specifically, the receipt of a market-reflective price signal enables customers to see their true costs of energy consumption and use this information to obtain the energy supply product that is best tailored to their own specific consumption needs.[16] This price signal is best conveyed when the default service price is market-reflective, whether on a real-time or short-term basis. With this price signal, customers can shop for and ESCOs can compete against one another to innovate and develop product offerings that are tailored to the customer's specific needs.[17] Default-service prices based, even in part, on long-term contracts ensures that customers will be prevented from receiving the price signals necessary to shop for and for ESCOs to construct products that are tailored to the customer's specific energy needs. The end result is the erection of a substantial barrier to

[16] NY Retail Competition White Paper at 8-9.

[17] *Id.*

the ESCOs' ability to viably compete in New York that substantially undermines the State's competitive retail electric markets.[18]

It should also be noted that given the ability to receive correct, market-reflective price signals, customers can use this information about the true costs of their consumption to change their consumption patterns and become more energy efficient and demand responsive. Today, many customers are doing just that by receiving price signals and using those signals to conserve on their own or shop for green power, demand response and energy efficiency products from ESCOs.[19] The corollary is that implementation of policies that interfere with the customer's ability to receive correct, market-reflective price signals will impair their ability to conserve, whether on their own initiative or through a value-added product from an ESCO. Such an interference that inhibits energy efficiency initiatives runs a grave risk of ensuring that ambitious Administration goals such as the "15 by 15" plan cannot be met by 2015.

Furthermore, in addition to exposing customers to the harms associated with receiving incorrect price signals, long-term contracts can harm customers by exposing them to price shocks at the end of the contract period. One only needs to be reminded of New York's experience with the take-or-pay exposure that several New York natural gas utilities had that resulted from long-term natural gas contracts entered into in the 1970s and 1980s – contracts that imposed substantial costs on the gas utilities' ratepayers. Likewise, where electric prices have been frozen in amber for long periods of time, as was the case for Maryland's residential electric customers and is the case for many

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[18] *Id.*

[19] *See, e.g.*, NY Retail Competition White Paper at 11-12, 17-18 and 20-21.

Pennsylvania customers, long-term contracts have not left a legacy as harbingers of stable, low-cost electric rates or facilitators of infrastructure development. Indeed, the recent experiences of the Maryland Public Service Commission, which has grappled with the consequences of a residential customer retail market based on long-term fixed prices, illustrates this ratepayer harm:

> The Commission concurs with the parties that rate stability is an important policy goal generally...Recent experience suggests that longer term fixed prices do not contribute to that goal; indeed they create a false sense of complacency that costs are in fact stable, followed by a painful transition when rates are finally adjusted to reflect current costs.... The upshot is that frequent, albeit small rate changes, are a better vehicle for insuring relative rate stability (and a more gradual reflection of changes in current market prices) rather than longer periods of frozen rates, followed by rate shock.[20]

Recently, the Pennsylvania Public Utility Commission ("PUC") has had to grapple with the expiration of long-term fixed-priced default service that has been in place for most Pennsylvania electric distribution company ("EDC") service territories for nearly a decade and will expire at the end of 2010. On May 10, 2007, the Pennsylvania PUC issued a default service rulemaking order in which it approved regulations that will transition customers away from long-term contracts following the expiration of the current rate caps in place at the end of 2010.[21] In so doing, the Pennsylvania PUC provided the following rationale against adopting default service based on long-term contracts:

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[20] Maryland Public Service Commission Case No. 9056, *I/M/O The Commission's Investigation Into Default Service For Type II Standard Offer Service Customers*, Order No. 81019 (Aug. 28, 2006) at 16.

[21] Pennsylvania Public Utility Commission Docket No. L-00040169 – Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant To 66 Pa.C.S. § 2807(e)(2), *Final Rulemaking Order* (May 10, 2007) ("PA Final Rulemaking Order").

> In conclusion, we are generally skeptical of the DSP's [Default Service Provider's] ability to beat the market over periods of time greater than one year. Incumbent EDCs have simply not provided any real record in this or other default service proceedings to show that they can anticipate changes in market prices, and take advantage of this information to obtain consistently lower prices through long-term contracts compared to short-term and spot market purchases...We believe customers will save more money as DSPs gradually increase their utilization of short-term fixed price contracts and spot market products, and what data we do have supports this premise.[22]

Finally, and as discussed in more detail in Hess' response to Question # 11, imposition of a long-term contracting requirement for utilities will not overcome or eliminate existing barriers to the development of additional electric infrastructure. Hess respectfully suggests that without the removal of these real and substantial barriers to the siting, construction, interconnection and operation of new infrastructure, no amount of long-term contracts will cure any real or perceived deficiency of electric infrastructure development in New York.

The Commission should therefore not require or otherwise mandate utilities to enter into long-term supply contracts. Instead, the Commission should examine, as part of the three-step process outlined by Hess in its response to Question #1, whether there is a specific need for additional infrastructure, determine what barriers exist to the implementation of the new infrastructure, and devise a market-based solution to address the concern.

[22] PA Final Rulemaking Order at 25.

III. THE COMMISSION SHOULD NOT REQUIRE OR OTHERWISE MANDATE OTHER LOAD SERVING ENTITIES TO ENTER INTO LONG-TERM CONTRACTS WITH GENERATION ENTITIES

Question #3: ***Should Load Serving Entities other than utilities, including the New York Power Authority and the Long Island Power Authority, be required or encouraged to enter into long-term contracts as described above? What role, if any, might entities other than Load Serving Entities play in such resource procurement?***

Under no circumstances should other LSEs such as ESCOs be required or mandated to enter into long-term supply contracts. Such a policy would not only strike at the heart of retail competition but would improperly interfere with the ESCOs' relationships with their customers and the ESCOs' business models designed to provide customers with the electricity products they desire.

An ESCO's very survival depends on its ability to develop the products and services that customers desire. ESCOs do not dictate products to customers, rather they develop and offer products that customers want and demand. The ESCO's supply portfolio is developed in response to its assessment of what the customer desires based on the individual preferences of the customer. Thus, requiring or mandating the specific supplies to be acquired by an ESCO would undermine the competitive market and fly in the face of having the customers' individualized preferences dictate the supply portfolio developed by ESCOs. Respectfully, the State should not be substituting its own preferences for those of customers who have proactively shopped for and are receiving service from an ESCO.

In addition, requiring ESCOs to enter into long-term contracts is inherently discriminatory and anticompetitive as it places ESCOs and utilities on an inherently uneven playing field. If the Commission were to order utilities to enter into long-term

contracts, then under the Public Service Law they would be entitled to recover the entire cost of those contracts from their captive ratepayers unless the Commission found those costs to be imprudently incurred.[23] Thus, utilities are able to recover their long-term contract costs regardless of their economic viability or whether they conform to the customer's individualized preferences – as long as they are deemed prudent, they are recoverable.

An ESCO subject to long-term contract requirements would not have the same ability to recover its long-term contract costs. Because ESCOs, unlike utilities, assume the risk of their investments, if an ESCO enters into a long-term contract that turns out to be uneconomic then instead of recovering the cost of the contract from customers it absorbs the cost, which could potentially lead to financial ruin. The end result is an undermining of the competitive marketplace through a discriminatory and anti-competitive policy that ultimately harms customers.

The Commission should therefore not require ESCOs to enter into long-term contracts. If customers want energy products that require ESCOs to make long-term procurements from generation resources then ESCOs will enter into long-term contracts to fulfill their customers' specific needs. Customers should determine whether a long-term supply contract should be and needs to be executed by an ESCO, and not the State.

[23] Public Service Law §§ 65 and 66.

IV. IT IS PREMATURE FOR THE COMMISSION TO CONSIDER WHETHER RESOURCE PROCUREMENT SHOULD BE COORDINATED ON A STATEWIDE BASIS

Question #4: ***Should resource procurement, as described in Question #1, be coordinated on a statewide basis? What regulatory oversight, if any, would be appropriate?***

It is premature for the Commission to consider whether resource procurement should be coordinated on a statewide basis. This is especially true in light of the fact that Question #1 does not reference resource *procurement* but rather a resource *planning process*. There is a substantial difference between these two concepts as the latter must be undertaken and completed before any consideration of the former. The Commission should, at a minimum, first complete the comprehensive three-step process outlined in Hess' response to Question #1 before approaching the issue of how resource procurement should be coordinated.

V. IT IS UNREASONABLE TO PRESUME THAT THE PERCEIVED ABSENCE OF LONG-TERM CONTRACTS IS DUE TO THE EXISTENCE OF BARRIERS

Question #5: ***What barriers, if any, exist that discourage long-term contracts for development of new electricity resources? What other barriers exist, if any, for the development of new electricity resources? Should incentives beyond what exist today be created to encourage entry into long-term contracts generally, or to foster the development of any particular type of resource? How could those incentives be structured consistent with the goal of acquiring the most cost-effective resources?***

Question #5 appears to presume, without providing any foundation or supporting evidence, that the lack of new electric infrastructure in New York is directly related to the absence of long-term contracts. Such an untested and, at this stage, baseless presumption should not be used as the basis for developing policy, particularly one that will have far

reaching consequences for customers, utilities, ESCOs, retail markets and other vital areas of the State's energy industry.

First, this presumption fails to consider that the existence of barriers other than the absence of long-term contracts is the cause for the perceived lack of sufficient electric infrastructure in New York. As outlined in Hess' response to Question #11, these barriers are more relevant and significant to whether new and cleaner electric generation can be constructed in or interconnected into New York than any absence of long-term contracts.

Second, this presumption fails to consider that the perceived absence of long-term contracts may not be the result of any barriers preventing their existence. Rather, their absence may be more directly related to customer preferences in the competitive market. As discussed in Hess' response to Question #3, ESCOs deal directly with their customers on a daily basis to tailor their electric supply products to match their customer's individualized needs and preferences. It is possible to conclude that some customers are comfortable entering into pricing arrangements that are developed on a more real-time, short-term or medium-term basis. These customer preferences may lead ESCOs to enter into short-term, medium-term or long-term supply contracts to procure the energy needed to provide the customers their desired products. That ESCOs may or may not enter into long-term contracts are reflections of the market preferences of customers and not the existence of barriers preventing the existence of long-term contracts.

VI. THE COMMISSION SHOULD NOT MICROMANAGE PRIVATE BUSINESS ARRANGEMENTS REGARDING RESOURCE PROCUREMENT

Question #6: ***Should constraints be imposed that would, under certain circumstances, restrict the resource types eligible for long-term contracts, limit the length of contract terms or establish the content of other contract conditions? What steps should be taken to limit any anti-competitive impacts long-term contracts might create?***

The implication of Question #6 is consideration of a policy that would result in governmental micromanagement with purely private business arrangements between buyers and sellers. The Commission should not attempt to restrict the types of resources a supplier can acquire or impose other constraints, limitations or conditions on what are commercial relationships between willing buyers and sellers. Such micromanagement is, at best, problematic and counterproductive and should therefore not be pursued by the Commission.

VII. IT IS PREMATURE FOR THE COMMISSION TO CONSIDER IMPOSING RESTRICTIONS OR GUIDELINES ON RESOURCE PROCUREMENT PRACTICES

Question #7: ***Should restrictions or guidelines be imposed on the resource procurement practices employed in selecting the resources that would be acquired under the long-term contracts?***

It is premature for the Commission to consider imposing restrictions or guidelines on resource procurement practices absent the undertaking and completion of the comprehensive three-step process outlined in Hess' response to Question #1.

VIII. LONG-TERM CONTRACT COSTS, IF EVER IMPOSED, SHOULD BE RECOVERED THROUGH THE SYSTEM BENEFITS CHARGE OR OTHER COMPETITIVELY NEUTRAL RECOVERY MECHANISM

Question # 8: ***How should long-term contract costs be recovered from customers, and should different recovery mechanisms be developed based on the type of resource that is acquired under the contract, the length of the contract, or other factors?***

Hess opposes implementation of long-term contracts for the reasons set forth throughout these comments. If, however, the Commission were to ever implement a requirement that utilities enter into long-term contracts then the recovery of their costs should be accomplished through the Societal Benefits Charge ("SBC"). The SBC is the appropriate mechanism for such cost recovery for two significant reasons. First, the Commission's purpose in implementing this policy would be to accomplish a number of social goals, including, presumably, electric infrastructure development, fuel diversity and mitigating adverse environmental impacts. Second, cost recovery through the SBC would be competitively neutral since the SBC is a non-commodity rate component and therefore all customers, whether they take commodity supply service from an ESCO or the utility as a provider of last resort, are subject to this charge.

Finally, in the event that the Commission determines that the SBC is not the appropriate cost recovery mechanism for long-term contracts then it should mandate recovery of these costs through another competitively neutral recovery mechanism similar to the SBC. This is necessary to equitably reflect that all customers, whether receiving commodity supply service from an ESCO or the utility, would socially benefit from the infrastructure development goals sought by the Commission.

IX. IT IS PREMATURE FOR THE COMMISSION TO EXAMINE LONG-TERM CONTRACT COST RECOVERY QUALIFICATION ISSUES

Question # 9: ***What procedures should be followed in reviewing a long-term contract in establishing its qualification for cost recovery? Under what circumstances, if any, should recovery of contract costs be pre-approved?***

It is premature for the Commission to examine long-term contract cost recovery qualification issues absent any prior undertaking or completion of the comprehensive three-step process outlined in Hess' response to Question #1.

X. LONG-TERM CONTRACTS/NYISO RULES HARMONIZATION MUST BE ADDRESSED WITHIN THE NYISO STAKEHOLDER COMMITTEE PROCESS

Question #10: ***Can long-term contracts (energy and/or capacity) be harmonized with existing NYISO rules for energy and capacity markets, and with potential NYISO forward capacity markets? If so, how can they best be harmonized? What changes to the NYISO market rules, if any, would be necessary or appropriate for the purpose of accommodating long-term contracts? Should NYISO market rules recognize or ameliorate the impact, if any, of long-term contracting on the NYISO capacity prices paid existing generators, or, if amelioration is appropriate, should it be accomplished through non-NYISO mechanisms?***

The Commission's Question # 10 is premature given that it has yet to complete the comprehensive study process outlined in Hess' response to Question #1. Furthermore, in order for the Commission to be able to answer this question it must not only study the NYISO's rules but also collaborate and coordinate with the NYISO stakeholder committees in order to determine whether harmonization of long-term contracts and NYISO market rules is practical or feasible. Without meaningful participation in the NYISO stakeholder process and involving all NYISO members to specifically explore this issue, it is far too soon for the Commission to address this question.

XI. THE COMMISSION SHOULD FIRST ADDRESS REMOVAL OF EXISTING AND POTENTIAL BARRIERS TO THE DEVELOPMENT OF ADDITIONAL ELECTRIC INFRASTRUCTURE

Question # 11: ***Are there any other creative solutions that might be considered to address the issues identified herein?***

Missing from the Commission's singular focus on long-term contracts and IRP in the Phase II Order is any discussion or consideration that immediate barriers to new electric infrastructure exist having nothing to do with the absence of IRP or long-term contracts. Hess can speak from experience to this point as it has a proposed generation project now in the NYISO's interconnection queue that would be adversely impacted by new interconnection deliverability standards expected to be proposed by the NYISO in June 2007 be adopted.

As discussed herein, adoption of these new interconnection standards will place new, cleaner generation projects on an uneven playing field with older, more polluting and less efficient existing generation plants, which will discourage new generation from entering the New York market. These rules and other existing barriers are far more pressing concerns to Hess in developing a new generation resource for New York than any absence of long-term contracts and IRP.

Rather than take a tunnel-vision approach that IRP and long-term contracts can and will solve all of New York's electric infrastructure problems, the Commission needs to first address removal of immediate existing and potential barriers to the siting, construction, interconnection and operation of electric infrastructure. Specifically, the Commission needs to address: (1) the lack of a streamlined statewide generation plant siting process; (2) the development of NYISO interconnection rules that will discourage the development of new and cleaner generation projects; and (3) the lack of sufficient

economic development initiatives to encourage infrastructure developers to build their projects in New York.

A. The Commission Should Remove Barriers Created By The Absence Of An Article X Generation Plant Siting Process.

The absence of a statewide, streamlined generation plant siting process in New York since the expiration of Article X of the Public Service Law in 2002 has resulted in a barrier to new generation development far more real, immediate and substantial than the absence of an IRP process or long-term contracts. As stated in the NYISO's recently released Power Trends 2007 Report:

> For ten years New York had a streamlined process – codified in Article X of the Public Service Law – for granting permits to power plants 80 MW and over. The law provided a one-stop permitting process that helped developers secure approvals in approximately 12 months and incorporated what would have otherwise been local permitting issues. Article X expired at the end of 2002 and annual efforts to pass similar legislation have failed. Today, permits for large new generation facilities must be obtained through the State Environmental Quality Review Act (SEQR) process, which is more complicated and lengthy than the one that existed under Article X. The requirement for local permits often results in delays, additional expense and may be used to block locally unpopular projects. This additional uncertainty can make New York State a riskier, and therefore less attractive, option for potential investors.[24]

Re-institution of an Article X generation plant siting process is a necessary prerequisite for addressing any perceived deficiency in electric infrastructure development in New York. Without reinstitution of such a process, implementation of an IRP process or long-term contracts will fail to produce meaningful new infrastructure. It will, in the process, also result in the imposition of harmful costs on customers and utilities and destruction of competitive retail markets, thereby forcing ESCOs and the value-added products they are providing to customers out of New York. It is therefore

[24] NYISO Power Trends 2007 Report at 22.

incumbent on the Commission to proactively, publicly and vigorously support reinstitution of an Article X siting process as a first resort before beginning to consider whether IRP or long-term contracts are appropriate infrastructure development mechanisms.

B. The Commission Should Actively And Vigorously Oppose Any Proposed NYISO Interconnection Rules That Act As Barriers To Interconnecting New And Cleaner Generation Projects in New York.

As discussed in these comments, Hess is in the process of developing a new generation resource for New York. This resource, which is located in Bayonne, New Jersey, would interconnect into the NYISO's transmission system at Gowanus, located in New York City, and would provide both a new and environmentally cleaner resource for the State. Hess' project is now before the NYISO in its interconnection queue.

To provide some broader context, Hess' project is one of 102 projects currently in the NYISO's interconnection queue. Eleven of these projects are for upgrades to the existing transmission system and five are for new transmission lines. The remaining 86 projects are comprised as follows: 24 are for gas-fired or dual-fuel generation (8,238 MW), 54 are wind-power projects (6,031 MW), four are repowerings of existing nuclear generation facilities (360 MW), one is a coal-fired generation project (536 MW), two are upgrades to hydroelectric facilities (160 MW) and one is a direct connection of a large manufacturing facility to the grid.[25] Twenty-seven of these proposals were interconnection requests made to the NYISO in 2006.[26] A real and substantial threat,

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[25] *See* NYISO Power Trends 2007 Report at 12.

[26] *Id.*

however, looms over Hess' proposed project and, likely, many of the other projects referenced above that have nothing to do with the absence of long-term contracts.

In June 2007, the NYISO is expected to make a compliance filing before the Federal Energy Regulatory Commission ("FERC") proposing new generation interconnection standards for proposed infrastructure projects. In this filing, the NYISO will likely propose implementation of a two-level interconnection deliverability requirement[27] for proposed generation that, if implemented, will serve as a substantial barrier to entry for new generation into New York's electric transmission system.

Specifically, new generation projects – under what will likely be the new two-level standard – will be subject to a more onerous deliverability requirement that has not been applied to existing generation resources. Projects falling short of this two-part test would be required to fund transmission upgrades required to meet the deliverability standard and would be limited to serving only the NYISO's energy and ancillary services markets without access to the NYISO's capacity markets. This, in turn, creates financially burdensome requirements on new generation projects that will discourage developers from siting in New York. This is especially true where existing generators were and will not be subject to the same requirements thereby creating an inherently uneven playing field that all of the long-term contracts and IRP processes that the Commission could mandate cannot overcome. This process also protects and shields existing generation resources from having to compete with new and cleaner generation resources in New York's wholesale electric markets.

[27] "Deliverability" refers to the extent to which the energy from a new generator or merchant transmission line must be able to be transmitted to all loads on the NYISO system without transmission constraints.

The end result of these anticipated NYISO interconnection rules will be a system whereby existing less efficient and more polluting generation plants are afforded special protections and preferential treatment compared to new and cleaner generation trying to access the New York electric transmission system. It would elevate existing generation owners to the status of *de facto* owners of the New York electric transmission system when, in fact, it is ratepayers who have paid for the transmission system. Given these circumstances, the Commission should vigorously oppose the imposition of these rules within the NYISO governance committees and before the FERC.

C. State And Local Government Agencies Should Develop Economic Development Initiatives To Encourage Infrastructure Developers To Build Their Projects In New York.

Noticeable by its absence is any discussion in the Phase II Order of utilization of economic development initiatives to attract infrastructure developers to build their projects in New York. Economic development initiatives should be developed and utilized for infrastructure development in New York if there is indeed a lack of sufficient electric infrastructure in New York and particularly, as some advocates claim, in southeastern New York.

As with other companies in a variety of industries, electric infrastructure project developers are businesses who must determine whether building their projects in New York is in their best economic interests as opposed to building their projects elsewhere. Likewise, New York must compete to retain businesses that have chosen to locate their offices and facilities in New York and attract new businesses to come to New York. For numerous companies of all sizes and in a variety of industries, the Empire State Development Corporation and the New York City Economic Development Corporation

have crafted a variety of innovative economic development packages. These packages are specifically designed to provide the companies with a number of financial and tax incentives to locate in New York and to ensure an adequate amount of job growth to benefit New Yorkers.

The economic development packages and initiatives developed by agencies such as the Empire State Development Corporation and the New York City Economic Development Corporation should serve as models for attracting new electric infrastructure development in New York. Such policies can be extremely helpful especially during a time when, as now, many parties, including the City of New York, are expressing concern over the need for new electric infrastructure, especially in the southeastern portion of New York. Economic development packages developed by these and other agencies have, for example, resulted in attracting Fortune 100 companies to locate their corporate headquarters in Manhattan. The same aggression and creativity in developing economic development packages for these companies should be utilized to attract electric infrastructure developers to site their projects in New York.

CONCLUSION

Hess appreciates the opportunity to offer comments on the issues and questions raised in the Phase II Order. For the reasons set forth in these comments, the Commission should reject implementation of IRP or long-term contracts as they have not been proven to be necessary or effective in producing additional electric infrastructure. Rather, the Commission, in place of any expedited consideration of IRP or long-term contracts, should institute a comprehensive three-part process to: (1) remove immediate existing and potential barriers to the siting, construction, interconnection and operation of new electric infrastructure; (2) specifically identify deficiencies associated with electric infrastructure and craft market-based remedies to specifically address the particular deficiency; and (3) comprehensively study, with full stakeholder participation, the appropriateness of a planning process should the Commission, after implementing and exhausting all other options, determine that such a process is needed.

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Respectfully submitted,

Jay L. Kooper
Director of Regulatory Affairs
Hess Corporation
One Hess Plaza
Woodbridge, NJ 07095
Tel: (732) 750-7048
Fax: (732) 750-6899
E-Mail: jkooper@hess.com