

Greenberg Traurig

Doreen U. Saia
Tel. (518) 689-1430
Fax (518) 689-1499
saia@gtlaw.com

June 5, 2007

VIA HAND DELIVERY

Hon. Jaclyn A. Brillig
Secretary
New York State Public Service Commission
Executive Office 14th Floor
3 Empire State Plaza
Albany, New York 12223-1350

Re: Case 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
Initial Comments

Dear Secretary Brillig:

Enclosed are the original and ten copies of AES Eastern Energy, L.P., Dynegy Power Corporation, Inc., Entergy Nuclear Power Marketing, LLC, The Mirant Parties and US Power Generating Company, LLC's Initial Comments in the above-referenced proceeding.

Please date stamp the enclosed copy of this letter and return it to our messenger as proof of filing. If you have any questions with respect to this filing, please call or email me.

Very truly yours,

GREENBERG TRAUIG, LLP


Doreen U. Saia

DUS/aaw

Enclosures

cc: Official Service List (via U.S Mail & email; w/enc.)

ALB 1105862v1 6/4/2007

ALBANY
AMSTERDAM
ATLANTA
BOCA RATON
BOSTON
BRUSSELS*
CHICAGO
DALLAS
DELAWARE
DENVER
FORT LAUDERDALE
HOUSTON
LAS VEGAS
LONDON*
LOS ANGELES
MIAMI
MILAN*
NEW JERSEY
NEW YORK
ORANGE COUNTY
ORLANDO
PHILADELPHIA
PHOENIX
ROME*
SACRAMENTO
SILICON VALLEY
TALLAHASSEE
TAMPA
TOKYO*
TYSONS CORNER
WASHINGTON, D.C.
WEST PALM BEACH
ZURICH

*Strategic Alliance
Tokyo-Office/Strategic Alliance

NEW YORK STATE
PUBLIC SERVICE COMMISSION

Case 06-M-1017 - Proceeding on Motion of the Commission as to the
Policies, Practices and Procedures for Utility
Commodity Supply Service to Residential and
Small Commercial and Industrial Customers

**INITIAL COMMENTS OF AES EASTERN ENERGY, L.P., DYNEGY
POWER CORPORATION, INC., ENTERGY NUCLEAR POWER
MARKETING, LLC, THE MIRANT PARTIES AND US POWER
GENERATING COMPANY, LLC**

June 5, 2007

Doreen U. Saia
GREENBERG TRAURIG, LLP
Attorneys for AES Eastern Energy, L.P.,
Dynergy Power Corporation, Entergy
Nuclear Power Marketing, LLC,
the Mirant Parties and US Power
Generating, LLC
54 State Street, 6th Floor
Albany, New York 12207
(518) 689-1430
saiaad@gtlaw.com

NEW YORK STATE
PUBLIC SERVICE COMMISSION

Case 06-M-1017 - Proceeding on Motion of the Commission as to the Policies, Practices and Procedures for Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers

INITIAL COMMENTS OF AES EASTERN ENERGY, L.P., DYNEGY POWER CORPORATION, INC., ENERGY NUCLEAR POWER MARKETING, LLC, THE MIRANT PARTIES AND US POWER GENERATING COMPANY, LLC

In accordance with the schedule established by this Commission in its “Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II To Address Longer Term Issues” (“Long Term Contracts Order”) issued in the above-captioned proceeding, AES Eastern Energy, L.P., Dynegy Power Corporation, Inc., Entergy Nuclear Power Marketing, LLC, [the Mirant Parties]¹ and US Power Generating Company, LLC (“New York Suppliers”) hereby submit their Initial Comments.² The New York Suppliers collectively have invested billions of dollars in New York State to purchase and subsequently operate and maintain a fuel diverse group of generating assets, including nuclear facilities, coal fired facilities, natural gas facilities and dual fueled oil-gas fired facilities. These assets are located

¹ The Mirant Parties are comprised of Mirant Bowline, LLC, Mirant Lovett, LLC and Mirant New York, Inc. The Mirant Parties also are submitting Supplemental Initial Letter Comments contemporaneously in this proceeding.

² The New York Suppliers generally support the initial comments being submitted by the Independent Power Producers of New York, Inc. (“IPPNY”) in this proceeding (“IPPNY Comments”).

across New York State from just outside Buffalo to within one of the most complex load pockets in the world, New York City.

I. EXECUTIVE SUMMARY

In its Long Term Contracts Order, the Commission poses eleven questions.³ These questions essentially focus on two core issues: (i) are long term contracts needed or desirable to facilitate new construction; and (ii) should such contracts be issued within the framework of a State directed, integrated resource planning process.

As set forth more fully herein, over the past ten years, major market rule changes have been made as the wholesale competitive markets have evolved in New York from their nascent stage to their current, more refined structure.⁴ Generating companies -- and their shareholders⁵ -- have faced substantial regulatory uncertainty during this wholesale market maturation period. At this stage, core market design issues have largely been

³ While the New York Suppliers have submitted these Comments in response to the Commission's request, the New York Suppliers hereby reserve all their rights to raise any issues in the future, including jurisdictional concerns.

⁴ For example, in 1999, when the wholesale markets began, there were no bid caps on the energy market. It was during this period that most of the generating units were divested in New York by the investor-owned utilities to merchant generators. However, before the summer 2000 peak periods, bid caps were imposed on the energy markets. See FERC Docket No. ER00-1969-000, et al., New York Independent System Operator, Inc., "Order on Tariff Filing and Complaints," 91 FERC ¶ 61,218 (2000) ("Bid Cap Order"). Likewise, it was not until 2003 that flaws inherent in the capacity market structure were corrected to allow the value of capacity to be more accurately reflected in the markets. See FERC Docket ER03-647-000, New York Independent System Operator, Inc., "Order Conditionally Accepting for Filing Tariff Revisions," 103 FERC ¶ 61,201 (2003) ("Demand Curve Order").

⁵ Under the prior regulated regime, the investor-owned utilities were permitted to recover costs from ratepayers deriving from their stranded investments in their generating facilities. See, e.g., Case 94-E-0098, et al., Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation for Electric Service, Opinion No. 98-8, "Opinion and Order Adopting Terms of Settlement Agreement, Subject To Modifications and Conditions" (issued March 20, 1998) at 40-41. In direct contrast, to the extent that rule changes rendered generator investments either partially or fully uneconomic, such losses have been borne by the merchant generator's shareholders alone.

addressed. Generators, however, now face significant regulatory uncertainty in the form of the plethora of new environmental initiatives currently under consideration.⁶

Having resolved many of its market design issues over the past ten years,⁷ the New York competitive wholesale markets contain much promise. Indeed, as has been consistently determined in reports issued by a number of independent bodies as well as the Commission's Staff just last year, New York has developed the most complete and efficient set of competitive electric markets in the country.

These markets efficiently price energy, ancillary services and capacity products which, in turn, provide the critical price signals necessary to facilitate longer term transactions. Scarcity pricing rules ensure that prices accurately reflect real-time physical shortages on the system a substantial portion of the time. Demand response programs have been developed to ensure that these critical resources ameliorate shortage conditions. Over the past two years, the New York Independent System Operator, Inc. ("NYISO") has augmented its wholesale competitive market design with a

⁶ In its 2007 Power Trends Report issued last month, the NYISO focused on the fact that a series of federal and State environmental compliance programs may affect power plant cost and operations in the near future. Given these major environmental initiatives, the NYISO recommended that environmental regulators, generators and the NYISO must work together "to develop compliance programs that work within the existing electric market structure while maintaining electric reliability and providing the transparency and long-term certainty needed for future power sector investment." (See New York Independent System Operator, Inc., "Power Trends 2007" (issued May 3, 2007) at 3-4. The New York Suppliers strongly endorse the NYISO's recommendation and believe that the Commission and the Empire State Development Corporation also should be engaged in these efforts to ensure that energy, environmental and economic development issues are addressed in a balanced fashion.

⁷ Separate and apart from the In City capacity issues, Dr. Patton's most recent State of the Markets Report identified a number of recommendations to further refine the market design. While these recommendations may contribute to an improved market structure overall, none require major change to the fundamental market structure that is currently in place in New York.

comprehensive reliability planning process (“CRP Process) which was subject to review from, and approved by, the Federal Energy Regulatory Commission (“FERC”).⁸

It is in this context of New York’s well-structured wholesale competitive markets that the Long Term Contracts Order’s eleven questions must be considered. The NYISO’s CRP process first looks to merchant development to respond to any reliability needs that are identified in the RNA. The New York Suppliers support this approach. To ensure the further development of competitive markets, the New York Suppliers believe that it is critical to provide merchant development with the first opportunity to meet identified reliability needs.⁹

Notwithstanding the significant progress that has been made in New York’s markets, the combination of regulatory uncertainty and other factors identified herein may ultimately stifle investment and thwart needed development. Thus, if RNA identified reliability needs are not sufficiently addressed through merchant proposals,¹⁰ long term contracts should be permitted to facilitate appropriate facilities to satisfy such needs. To address fuel diversity or other properly vetted public policy considerations,

⁸ The CRP process essentially breaks down into three segments: (i) the NYISO development and issuance of its Reliability Needs Assessment (“RNA”) which identifies the reliability needs from a statewide perspective for the next ten years; (ii) the NYISO solicitation of market-based and regulated back-stop solutions to such needs; and (iii) the NYISO development and issuance of the CRP document which identifies the solutions to such needs.

⁹ While the details have not yet been released, the NYISO announced last month that it had received statewide market-based proposals totaling 1700 MW in response to its notice soliciting solutions for the 2007 RNA findings.

¹⁰ If sufficient market based proposals are not submitted to resolve the identified reliability needs, the NYISO’s CRP process directs the NYISO’s independent market advisor, Dr. David Patton, to review the market rules and structure to ensure that there is not a design flaw. See New York Independent System Operator, Inc., Open Access Transmission Tariff (“OATT”), Attachment Y, Section 5.2, Original Sheet Nos. 951-52. The New York Suppliers support this requirement. If a design flaw exists or develops over time, it must be corrected. Absent doing so, further contracts are likely to be needed in the future to continue to “band-aid” the problem.

such contracts to meet reliability needs may need to be focused toward a specific form of resource. In addition, the investor-owned utilities should be permitted to enter into a prudent combination of short term, medium term and long term contracts to meet their existing customers' projected load requirements and reduce their exposure to price volatility.

However, under all circumstances, the terms and conditions of such contracts must be consistent with, and not otherwise undermine, the existing competitive markets.¹¹ Given the comprehensive nature of the NYISO's existing CRP process, the development of a separate, State-directed, integrated resource planning process is not warranted at this time. State efforts identified below should be narrowly tailored to act in parallel with, and be complementary to, the CRP process.

II. BACKGROUND

Following an extensive, two year collaborative process focused to address the shortcomings of the then existing regulated electric markets, this Commission issued Opinion No. 96-12 on May 20, 1996,¹² its seminal decision adopting a retail competitive market structure.¹³ In the Competitive Opportunities Order, this Commission established that its vision for competitive markets included effective competition in the generation sector, reduced prices as compared to regulated rates, increased customer choice and an

¹¹ For example, the utilities should not be permitted to enter into contracts that are reached pursuant to a discriminatory process or are otherwise designed to "flood" the market.

¹² See PSC Case 94-E-0952, In the Matter of Competitive Opportunities Regarding Electric Service, "Opinion and Order Regarding Competitive Opportunities for Electric Service," (issued May 20, 1996) (hereinafter "Competitive Opportunities Order").

¹³ In its brief addressing the Recommended Decision in the Competitive Opportunities Proceeding, DPS Staff supported the implementation of a competitive market structure. (See Competitive Opportunities Order at 23-24.)

independent system operator to administer the bulk transmission system and wholesale markets. (See Competitive Opportunities Order at 25-26.)

First addressing cost considerations, this Commission determined that competitors would have a greater incentive to lower costs than utilities under a cost of service regulatory regime. (Id. at 30.) In addition, competitive markets would require merchant generators to bear the risk of their investment decisions, not the investor-owned utility's customers. (Id. at 30-31.) Finally, moving to a competitive market structure would allow energy efficiency measures to be pursued more aggressively. (Id. at 31.)

Turning to the issue of generation divestiture, this Commission held that the movement to a restructured market required "avoid[ing] undue concentration of market power and particularly the use of monopoly power on the distribution side to unduly restrict choice on the generation side." (Id. at 64.) Based on this determination, this Commission encouraged the divestiture of generation assets. (Id. at 65.)

In the Competitive Opportunities Order, this Commission focused on the fact that its decision to further competitive opportunities in electric markets mirrored similar efforts then being undertaken by the FERC. (Id. at 33.) Through a series of orders issued in 1999, the FERC approved the structure of, and the market rules for, the NYISO's markets.¹⁴ These orders include the directive that the NYISO must monitor the markets that it administers or controls for market power and mitigate conduct when it determines that market power has been exercised.¹⁵ On December 1, 1999, the NYISO began

¹⁴ See, e.g., FERC Docket Nos. ER97-1523-000, et al., Central Hudson Gas & Electric Corporation, et al., "Order Conditionally Accepting Tariff and Market Rules, Approving Market-Based Rates, and Establishing Hearing and Settlement Judge Procedures," 86 FERC ¶ 61,062 (1999).

¹⁵ See, e.g., FERC Docket Nos. ER97-1523-000, et al., supra, "Order Accepting For Filing In Part and Rejecting In Part Market Monitoring and Mitigation Plan, Subject to Modifications" 89 FERC ¶ 61,196 (1999) and "Order on Rehearing and on Compliance Filing" 90 FERC ¶ 61,317 (2000).

operating the New York bulk power system. By that time, a significant amount of generation formerly owned by the investor owned utilities had been divested to merchant generators.

As the Long Term Contracts Order acknowledges, regulatory uncertainty can be a factor that has a significant impact on the level of investment that is made. (See Long Term Contracts Order at 30-31.)¹⁶ Like the competitive wholesale markets in the neighboring regions, the NYISO markets experienced major structural changes in their early years. Initially, such measures took the form of additional mitigation placed on the supply side of the market. For example, in response to very high energy prices in the Midwest the previous summer, \$1,000 bid cap provisions were added to the New York markets prior to the 2000 summer peak periods.¹⁷ As a direct result, the ability of merchant generators to bid the true value of energy during peak periods was significantly circumscribed. In 2001, automated mitigation provisions were implemented.¹⁸ In 2002, the NYISO was directed to file a comprehensive market power mitigation plan. Approving the NYISO's comprehensive Market Monitoring and Mitigation Plan, the FERC expressly found that the plan "protects the New York market from the exercise of

¹⁶ While regulatory uncertainty is a significant factor, it is not the only factor that drives investment. As discussed more fully below concerning the New York City market in response to Question #2, equally important are the level of capital that is available in equity markets and the level of surplus currently on, or projected to be added to, specific regions of the State.

¹⁷ See FERC Docket No. ER00-1969-000, et al., supra, Bid Cap Order.

¹⁸ See FERC Docket No. ER01-2076-000, New York Independent System Operator, Inc., "Order Accepting Tariff Filing as Modified," 95 FERC ¶ 61,471 (2001). The FERC's decision concerning the need for the automated mitigation measures in the unconstrained "Rest of State" market subsequently was vacated on appeal and the case was remanded back to the FERC. See Edison Mission Energy, Inc. v. FERC, 394 F.3d 964 (2004). As of this time, automated mitigation provisions are limited to the New York City markets.

market manipulation that could result in rates that are unjust and unreasonable without discouraging the entry of new resources into the market.”¹⁹

Under peak load conditions in 2002, the real time market models then in place produced artificially low clearing prices. Likewise, the flaws inherent in the then existing vertical demand curve capacity market structure had fully revealed themselves by this same time with the NYCA capacity market clearing price ultimately collapsing to as low as \$0.10 per kW-month. In short, neither the scarcity value or the reliability value of generation was being reflected in the market.

Two major initiatives were undertaken throughout the fall and winter to correct these major market design flaws. First, scarcity pricing rules were developed to more accurately reflect the value of demand response programs and physical shortage conditions on the system.²⁰ Second, DPS Staff introduced a new capacity proposal that was expressly designed to reflect the value of capacity beyond the minimum installed reserve requirements. DPS Staff’s proposal evolved into the ICAP Demand Curves.²¹ Indeed, in its Comments in support of the NYISO’s Demand Curve filing, this Commission emphasized that the newly proposed ICAP Demand Curves “would enhance reliability over the long term by providing a more effective economic signal for new investment and would have, as an ancillary effect, a moderating effect on energy

¹⁹ The NYISO’s filing combined rules then in place under the NYISO’s Market Monitoring and Mitigation Plan with rules located in other parts of its tariffs. Several refinements were made to these rules at that time. See FERC Docket No. ER01-3155-002, New York Independent System Operator, Inc. “Order on Compliance Filings,” 99 FERC ¶ 61,246 (2002) (hereinafter “Comprehensive Mitigation Plan Order”).

²⁰ See, e.g., FERC Docket No. ER03-303-000, New York Independent System Operator, Inc., “Order on Tariff Filing,” 102 FERC ¶ 61,313 (2003).

²¹ As noted by this Commission’s Staff, the Demand Curves have ensured payment for almost 1,000 MW of demand response resources. See New York State Department of Public Service, “Staff Report on the State of Competitive Energy Markets: Progress To Date and Future Opportunities” (issued March 2, 2006) (hereinafter “DPS Staff 2006 Study”) at 25.

prices.”²² Prior to the summer 2003 peak periods, the FERC issued orders approving both of these new market designs.²³

With its energy and capacity markets largely in order, the NYISO then turned its attention to the implementation of a comprehensive planning process. Throughout the spring and summer 2004, the NYISO conducted extensive discussions through a series of meetings with its Market Participants to develop the components of its CRP process. Approved by the FERC in late 2004,²⁴ the NYISO’s CRP process ensures that the NYISO determines the reliability needs and resource procurement requirements for the bulk power system on a statewide basis for the next ten years. (See Planning Order at 2.)²⁵

Focusing on the need to properly align with, and continue to advance, the competitive market structure, the CRP process requires the NYISO to first turn to market based solutions to address identified reliability needs. Under the CRP process, the NYISO is permitted to rely upon a regulated solution only if it makes the affirmative

²² See FERC Docket ER03-647-000, supra, “Comments of the New York State Public Service Commission” (dated April 11, 2003) at 1-2.

²³ In 2005, the NYISO further refined its market design by implementing co-optimized energy and ancillary services in its real time markets to complement its existing co-optimized, day ahead energy and ancillary services markets. See FERC Docket No. ER04-230-000, et al., New York Independent System Operator, Inc., “Order Accepting Tariff Filing Subject to Modification,” 106 FERC ¶ 61,111 (2004). At the time this filing was approved, New York State was -- and, in fact, today, remains -- the only region with fully co-optimized energy and ancillary services markets. Because such co-optimization leads to the most efficient scheduling of resources, consumers benefit by receiving energy and ancillary services at the overall lowest cost.

²⁴ See FERC Docket Nos. ER04-1144-000 and ER04-1144-001, New York Independent System Operator, Inc., “Order Accepting in Part and Rejecting in Part Tariff Amendments,” 109 FERC ¶ 61,372 (2004) (hereinafter “Planning Order”).

²⁵ The NYISO completed its first CRP process in August, 2006. Because the NYISO received sufficient responses through the updated Transmission Owner plans and proposed market-based solutions, it was not necessary to trigger any regulated response. The NYISO currently is engaged in its second CRP process. As noted herein, the NYISO recently received statewide market-based responses totaling 1700 MW in response to its 2007 RNA findings.

decision that the submitted market based solutions are insufficient to address the identified reliability needs.

During the development of the CRP process, the form of the solution that would be eligible to address the reliability needs was discussed at great length. Importantly, as approved by the FERC, under either the market based or regulated approaches, demand response, generation and transmission are all eligible alternatives to resolve identified reliability needs.²⁶

Today, New York's wholesale competitive markets are widely heralded as the most efficient markets in the country.²⁷ Identifying New York's markets as "the most complete and efficient set of electricity markets in the U.S.," Dr. Patton found in his State of the Markets Report issued last month that "[t]he NYISO markets continue to deliver substantial benefits to the States' consumers by meeting its demands at the lowest cost." (See 2007 Patton Report at 2-3.)²⁸ Noting that "transparent, efficient market signals are available to guide decisions," Dr. Patton further emphasized that "relying on private investment that is made in response to competitive price signals shifts the risks and costs

²⁶ The CRP expressly states, "Such responses will be open to all resources, including generation, demand response providers, and merchant transmission developers." See NYISO OATT at Attachment Y, Section 6.2, Original Sheet No. 953 (emphasis added).

²⁷ It must be noted that the structure of a subset of one of the NYISO's markets, the In City installed capacity ("ICAP") market, is currently under review in a FERC initiated proceeding. See FERC Docket Nos. ER07-360-000, EL07-39-000, New York Independent System Operator, Inc. "Order Rejecting Proposed Tariff Revision and Instituting Hearing and Settlement Judge Procedures," 118 FERC ¶61,182 (2007) (hereinafter "In City ICAP Proceeding"). In the In City ICAP Proceeding, both supply side and load side bidding issues have been raised. In initiating the proceeding, the FERC emphasized that the proceeding "should consider the justness and reasonableness of the New York ISO's in-city ICAP market, and whether and how market rules need to be revised to provide a level of compensation that will attract and retain needed infrastructure and thus promote long-term reliability while neither over-compensating nor under-compensating generators." (See ICAP Proceeding Order at 6.)

²⁸ For example, the Analysis Group found that the consolidation of commitment areas and more efficient dispatch of energy and reserves through the NYISO markets reaped a conservative estimate of \$225 million in net production cost savings for 2006. See Tierney and Kahn, "A Cost-Benefit Analysis of the New York Independent System Operator: The Initial Years" (issued March, 2007) (hereinafter "Analysis Group Report") at 24-27; see also 2007 Power Trends Report at 13.

of poor decisions and project management from New York's consumers to the investors.”
(Id. at 3.)

Additional independent reports have come to the same conclusion, including this Commission's Staff report issued just over one year ago.²⁹ Specifically, the DPS Staff 2006 Study concluded, “An evaluation of New York's wholesale electricity markets under several metrics (i.e., price, robustness of spot and forward markets, generation and transmission infrastructure, demand side response programs, and generator performance) indicates that New York's wholesale markets are among the most advanced in the nation and that wholesale competition has led to significant efficiencies.” (See DPS Staff 2006 Study at 1-2.)³⁰ DPS Staff further found that wholesale commodity prices, on a fuel price adjusted basis, generally stayed flat for the period from 2000 through 2005.³¹ (Id. at 2.)

Because New York's markets have evolved over time to produce transparent and efficient price signals, generators have honed their operations to respond to these price signals to the ultimate benefit of consumers. For example, merchant generators do not have captive ratepayers to “cover” their revenue requirements. As a result, as reported in

²⁹ See DPS Staff 2006 Study; see also, Analysis Group Report.

³⁰ While DPS Staff noted the need to make further refinements to ensure the further development of competitive markets, DPS Staff emphasized such changes should be market-based. See DPS Staff 2006 Study at 3. The NYISO also has emphasized the need for market-based mechanisms. See 2007 Power Trends Report at 26.

³¹ Some parties have assailed the wholesale competitive markets because allegedly they have not produced prices that are low enough. Because fuel constitutes the single largest variable cost, there is indisputably a direct link between fuel prices and electric prices. In fact, in the DPS Staff 2006 Study, this Commission's Staff pointed to the direct impact that higher natural gas prices have on electric prices, explaining, “Generally, average wholesale energy prices have increased on a nominal basis. Much of the increase in the wholesale price can be attributed to the changes in natural gas and oil prices.” (See DPS Staff 2006 Study at 10.) Today's natural gas prices are nearly 200% higher than they were when these markets began, escalating from \$4.25/MMBtu in 2000 to \$12.00/MMBtu in 2005. (Id.) However, as compared to a year ago, natural gas prices have fallen by approximately 25%. As found by Dr. Patton in his 2007 Report, this led to electric prices in 2006 that were 20% to 30% lower in most areas than the 2005 prices. (See 2007 Patton Report at 4.)

a number of independent studies, generators are achieving availability rates at their facilities at unprecedented high levels.³² Such improved availability rates have benefited consumers in three principal ways. First, they produced lower overall energy costs. Second, the much higher availability rates over the last five years played a major role in allowing the New York State Reliability Council to accept a reduced installed reserve margin (“IRM”) for the 2007-2008 Capability Year from the previous level of 18% to 16.5%.³³ This, in turn, reduced capacity prices which further inured to the benefit of customers. Third, the higher availability rates have avoided the need to bring new facilities on line.

In addition, generators have taken steps to maximize the output of their facilities. For example, a number of nuclear units have made the necessary capital investments to “uprate” these facilities thereby increasing their overall capacity.³⁴ Moreover, as highlighted by this Commission’s Staff, nuclear facilities also have significantly reduced the duration of maintenance outages and otherwise have improved the reliability of their

³² In its 2006 Study, this Commission’s Staff reported improvements in generator performance, noting, “Locational Based Marginal Pricing (LBMP) and Unforced Capacity (UCAP) - based Installed Capacity pricing provide generators incentives to be available when the bulk power system most needs them. The availability of generators during the summer months increased to 90.3% of the time versus 86.5% prior to the NYISO’s operation.” (See DPS Staff 2006 Study at 16.) The Analysis Group and the NYISO have both issued reports making similar findings. See, e.g., 2007 Power Trends Report at 1, 13 (noting that, “The performance of New York power plants, as measured by their availability to sell energy into the state’s wholesale electricity markets, continues to change for the better, and has made a significant contribution to the reliability of the New York bulk electricity grid”); see also Analysis Group Report at 29-32 (noting significant outage rate improvements for fossil units from the average outage rate of 9.5% in 1999 cut almost in half to an average outage rate of 5.5% for the 2001-2005 period.)

³³ See FERC Docket No. ER07-429-000, New York State Reliability Council, LLC. On March 5, 2007, the FERC issued an order accepting the 16.5% IRM for the 2007-2008 Capability Year. See FERC Docket No. ER07-429-000, supra, “Order Accepting Proposed Installed Capacity Requirement for the 2007/2008 Capability Year,” 118 FERC ¶ 61,179 (2007).

³⁴ In 2006, Entergy Nuclear Operations, Inc. took steps to uprate its Indian Point 2 and Indian Point 3 facilities by 36 MW and 38 MW, respectively. Constellation has taken similar steps. Taking these steps allows additional customers’ loads to be met without constructing new facilities.

operations. (See DPS Staff 2006 Study at 16.)³⁵ Likewise, fossil-fueled generators have taken steps to improve the heat rates, and therefore, the efficiency of their units.

Due to the work that has been completed over the last ten years, the core structure of the New York markets has largely been developed thereby substantially reducing any regulatory uncertainty with respect to the markets themselves. Indeed, limited refinements have been made to the NYISO markets over the past two years.³⁶ However, as reflected in the NYISO 2007 Power Trends Report, generators now face regulatory uncertainty in the form of potential new environmental requirements. (See 2007 Power Trends Report at 2.)

Specifically, carbon dioxide emission requirements, high electric demand day operational limitations, mercury emission limits and additional NOx requirements are all under consideration. As found by the NYISO, this panoply of potential new regulations will challenge New York State's ability to "accommodate continued strong grid reliability, existing electric market structures and the long-term certainty and transparency needed to promote equipment retrofit and additional power plant construction in New York." (Id.)³⁷

³⁵ In the DPS Staff 2006 Study, DPS Staff noted that, due to these improved operations, the average capacity factor for nuclear units has increased from approximately 60 percent prior to 2000 to approximately 90 percent currently. (See DPS Staff 2006 Study at 16.)

³⁶ Such changes have gone forward to further improve or refine, not make major modifications to, the overall market design.

³⁷ As discussed in more length in response to Question #6 and Question #7, to the extent that long term contracts are used going forward, they must be structured to account for these new requirements.

III. INITIAL COMMENTS OF THE NEW YORK SUPPLIERS ON THE ELEVEN QUESTIONS POSED IN THE LONG TERM CONTRACTS ORDER

The Commission has posed eleven questions in its Long Term Contracts Order. Given the complex and interrelated nature of New York's markets, these questions cannot be considered in isolation. Rather, an understanding of how the markets have evolved over time to become the premier markets in the country as set forth, supra, must serve as the backdrop. Based on this backdrop, the New York Suppliers believe that the markets have demonstrated that they are working as intended. Thus, largely with the exception of the need to better address emerging environmental issues, major structural modifications to the overall market design or to the planning process are not warranted at this time.

In light of the foregoing, the New York Suppliers offer their Initial Comments on the Commission's eleven questions.

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 process 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?

As set forth, supra, through an extensive and deliberative stakeholder process that continued for the better part of a year, the NYISO developed its CRP process. Under the NYISO's CRP process, the NYISO, an independent body, comprehensively evaluates

New York's reliability needs on a statewide basis for a ten year period. Market participants play an important role in this process. Market Participants, including the utilities, provide the NYISO with the required data to conduct its CRP related studies.³⁸ In addition, prior to finalizing its reports, the NYISO shares its study results with all stakeholders, including this Commission's Staff, to receive their input.³⁹

If the NYISO identifies reliability needs in its RNA, the NYISO's tariff mandates that three important requirements must be met. First, the NYISO must rely on market-based solutions and may only turn to regulated solutions if the market based solutions are deemed insufficient.⁴⁰ This requirement comports with the goals enunciated by this Commission in its Competitive Opportunities Order that merchant generators, not investor-owned utility customers, should bear the risk of investment decisions. (See Competitive Opportunities Order at 30-31.) Second, the NYISO's independent market adviser is required to conduct a market review to ensure that the lack of proposed merchant projects is not due to market design flaws.⁴¹ Third, the NYISO must consider all available alternatives -- namely, not just transmission but also generation and demand response -- for both merchant and regulated solutions.⁴² By not favoring one technology or alternative over another, the NYISO's process allows for the most efficient option to go forward.

³⁸ See NYISO OATT, Attachment Y, Section 4.4, Original Sheet No. 950.

³⁹ Id. at Attachment Y, Section 5.1, Original Sheet No. 951.

⁴⁰ Id. at Attachment Y, Section 7.1, 7.2 and 7.3, Original Sheet Nos. 954-55.

⁴¹ Id. at Attachment Y, Section 5.2, Original Sheet Nos. 951-52.

⁴² Id. at Attachment Y, Section 6.2, Original Sheet No. 953.

DPS Staff actively was engaged in the meetings that culminated in the development of the CRP process. In fact, when the NYISO submitted its proposed CRP process to the FERC for approval, DPS Staff, on behalf of this Commission, filed comments in support of the NYISO's tariff amendments "strongly encourag[ing]" the FERC to approve them. In its CRP Comments, this Commission stated that "[o]verall, the tariff amendments establish an efficient and nondiscriminatory approach to planning bulk electric power system reliability in New York."⁴³ (See NYPSA CRP Comments at 1-2.) To reach its conclusion, this Commission pointed to, *inter alia*, that the NYISO would be evaluating reliability on an ongoing basis, the NYISO would rely on market based solutions in the first instance and the NYISO process would be open to competition from all alternative solutions. (*Id.* at 2.) Approving the NYISO's CRP process, the FERC held that the NYISO's proposed tariff amendments "establish[ed] a comprehensive planning process for reliability needs for New York." (See Planning Order at 1.)

The NYISO's CRP process comprehensively addresses the reliability needs on the system for the next ten years. However, by its design, it does not determine the best suited solution to such needs. If a regulated backstop solution ultimately is required, this Commission will be involved in determining the proposal that best serves the public interest. If, as discussed below, public policy considerations must be taken into account, this Commission also will be involved in determining such structure. In either event, the Commission's planning role must be carefully tailored to operate in parallel with, and be complementary to, the well-structured CRP process. Otherwise, superimposing a whole new process onto the markets and potentially drastically changing the market structure

⁴³ See FERC Docket ER04-1144-000, *et al.*, *supra*, "Notice of Intervention and Comments in Support of the New York State Public Service Commission" (dated September 10, 2004) (hereinafter, "NYPSA CRP Comments").

will have the undesirable result of once again mirroring New York's markets with substantial regulatory uncertainty.

With respect to the issues raised in this Question #1 concerning public policy considerations and immediate concerns versus long range considerations, it is true that, from a siting perspective, the playing field is tilted environmentally and economically toward natural gas facilities. Other public policy considerations, such as fuel diversity or national security, may dictate the need to encourage the development of other resources, including clean coal, nuclear, renewables and demand response. However, such considerations, while real and important, do not warrant developing an integrated resource planning process that operates in a vacuum.

Rather, to the extent that the Commission identifies a public policy consideration that may need to be addressed through the composition of New York's generation portfolio, the Commission should institute a targeted, generic proceeding to determine whether and how to address such consideration. Such proceeding, as noted above, must ensure to the degree possible that it is in parallel with, and complementary to, the NYISO CRP process. The Commission's actions with respect to its Renewable Portfolio Standards ("RPS") proceeding provide a useful structure to be considered in this regard.⁴⁴

In 2003, the Commission instituted the RPS Proceeding to explore the development of a renewable portfolio standard that would be designed to increase the proportion of renewable energy consumed by retail customers in New York.⁴⁵ A key

⁴⁴ See Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard (hereinafter "RPS Proceeding").

⁴⁵ See Case 03-E-0811, supra, "Order Regarding Retail Renewable Portfolio Standard" (issued September 24, 2004) (hereinafter "RPS Order").

component of this proceeding involved addressing the concerns associated with, and developing rules that would allow, more renewable generation, that was otherwise uneconomic, to be brought on line.

As a first step, the Commission directed that an extensive collaborative effort be held with interested parties to discuss the issues associated with the RPS design. (See RPS Order at 16.) The Commission further acknowledged that the potential impacts of this program on the electric grid must be analyzed and directed its Staff to report back on this issue. (Id. at 3, 81.)⁴⁶ In that regard, the NYISO together with the New York State Energy Research and Development Authority, jointly retained a consultant to conduct a comprehensive two phase reliability analysis to measure these impacts.⁴⁷ The NYISO also obtained a complete market analysis from its independent market advisor, Dr. David Patton, to measure the potential impacts of this program on the competitive markets.

Following a two year process, this Commission issued an order approving the implementation plan for the program. In its RPS Implementation Order, this Commission, inter alia, addressed the reliability and cost impacts of the program.⁴⁸ (See

⁴⁶ Characterizing system reliability as being of “paramount importance and concern,” this Commission stated, “... while we are proceeding with the RPS, we also acknowledge that the implementation phase should be sufficiently flexible to accommodate a process for review and analysis of the potential impacts of renewable generation on the electric grid, as well as the ability to reflect modifications, if any, that are necessary to protect the reliability of the electric system.” (See RPS Order at 3.)

⁴⁷ See GE Power Systems Energy Consulting, “The Effects of Integrating Wind Power on Transmission System Planning, Reliability and Operations -- Report on Phase I: Preliminary Overall Reliability Assessment” (issued February 2, 2004); GE Energy Consulting, “The Effects of Integrating Wind Power on Transmission System Planning, Reliability and Operations -- Report on Phase II: System Performance Evaluation” (issued March 4, 2005.)

⁴⁸ As the result of these studies, certain requirements were placed on wind generators to be permitted to operate on the New York system. See Case 03-E-0188, supra, “Order Approving Implementation Plan, Adopting Clarifications and Modifying Environmental Disclosure Program” (issued April 14, 2005) (hereinafter “RPS Implementation Order”) at 62-65. It must be noted that the reliability determinations that were made in these studies were based on an assumption that up to 3,300 MW of wind resources would be added to the system. With more than 6,000 MW of wind resources currently listed on the NYISO’s Interconnection Queue, these analyses need to be revisited.

RPS Implementation Order at 61-66.) In addition, to limit the impacts of its initiative on competitive markets to the degree possible, the Commission developed a “premium” cost structure for this program.

Structuring a targeted generic proceeding in this manner sufficiently allows the impacts associated with a public policy goal to be fully considered from both a markets and reliability standpoint. Doing so properly will allow environmental, energy and economic development needs to be carefully balanced. As such, it properly aligns well-vetted, narrowly drawn State initiatives with the ongoing successful development of New York’s competitive markets.⁴⁹

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?

In its Long Term Contracts Order, this Commission characterizes merchant participants as “unwilling or unable” to invest in needed new infrastructure in New York City and concludes that “[t]he existing wholesale electricity market structure in New York City has not led to much merchant driven supply nor shown much promise for new merchant driven market entry.” (See Long Term Contracts Order at 30.) Such a conclusion, however, may be premature.

⁴⁹ In its Long Term Contracts Order, the Commission summarily states, “The NYISO’s approach maintains the reliability of the system, but investment in new resources, whether demand or supply, may be advisable and in the public interest long before similar additions would be required by the NYISO to maintain reliability.” (See Long Term Contracts Order at 33.) Further clarification and details are needed concerning: (i) what circumstances support such actions; and (ii) whether, and if so, how such actions can be taken consistent with the continued development of the wholesale competitive markets.

First, it must be acknowledged that the cost to construct, and the challenges associated with siting, new generation in New York City are perhaps the most substantial in the country. As demonstrated herein, regulatory uncertainty on top of these hurdles undeniably has affected new merchant development in New York City.⁵⁰ However, limited new facilities in New York City also resulted from a downturn in the equity markets over this time period as well as a near-term expected capacity surplus in the New York City market.⁵¹

Notwithstanding the foregoing, continued regulatory uncertainty, particularly now in the form of significant environmental initiatives, as well as other factors may hamper sufficient merchant development. As a result, under certain circumstances, new long-term contracts may need to be issued. However, before turning to whether regulated utilities should be required or encouraged to enter into such contracts, the underlying reason for these contracts first must be considered. A utility may enter into a long term contract for one of four reasons: (i) to hedge price volatility to meet the existing load needs of its customers; (ii) to provide a regulated backstop solution to a RNA identified reliability need; (iii) if requested on a discriminatory basis, to meet a public policy goal; or (iv) if requested on a discriminatory basis, to artificially suppress the market clearing prices thereby lowering its overall costs.

⁵⁰ The fact that the New York Power Authority (“NYPA”) stepped into the markets in 2001 to construct a series of peakers throughout New York City and on Long Island exacerbated the overall regulatory uncertainty that was occurring in these markets.

⁵¹ The NYISO publicly posts its Interconnection Queue which sets forth proposed projects to be added to the system, including their projected in service dates. This allows parties to track the progress of new projects, such as the 1,000 MW of new generation that was added to the City at approximately the same time.

Turning first to the hedging considerations, the New York Suppliers believe that the investor-owned utilities should be free to issue requests for proposals to new and existing generation on a non-discriminatory basis to provide a hedge for them to meet the projected load requirements of their existing customers. To best achieve hedging results, the utilities should have flexibility to utilize a mix of short-term, medium-term and long-term contracts.⁵² If a utility elects to pursue a hedging strategy, however, the vast majority of the risk for having done so should be borne by its shareholders, not its ratepayers. Correspondingly, its shareholders, not its ratepayers, also should reap the vast majority of any financial upside that is produced by its hedging strategy. As long as such contracts are sought on a fair, nondiscriminatory basis and are utilized to meet the utility's projected existing loads, no further bidding requirements should be placed on these contracts.

Utilities also should be encouraged to enter into contracts to address reliability needs when market based solutions are not sufficient⁵³ or to enter into contracts to address public policy considerations, such as fuel diversity or furthering environmental policies. Going forward with such projects will likely require a contract to meet these public policy goals or reliability needs. Addressing reliability based or public policy long term contracts, however, is far more complex.

⁵² Suppliers generally have taken the position that the utilities should be given sufficient flexibility to enter into short-term, medium-term and long-term transactions to manage their supply portfolios effectively. See Case 06-M-1017, supra, "Comments of Independent Power Producers of New York, Inc." (dated November 17, 2006) at 3-4; see also, Case 06-M-1017, supra, "Comments of Entergy Nuclear Power Marketing, LLC" (dated November 17, 2006) at 4.

⁵³ Under the NYISO's CRP process, the investor-owned utilities act as the "backstop" to ensure that reliability is maintained. Specifically, if the NYISO determines that market-based solutions are not sufficient, it must direct the investor-owned utility to proceed with its regulated backstop solution. The New York Suppliers believe that the utilities should be encouraged to do so by issuing a request for proposals to all available alternatives to resolve the reliability problem.

It has long been established by the FERC that capacity in whatever form and of whatever vintage has the same reliability value and should receive the same price.⁵⁴ However, as demonstrated in the pleadings submitted in the FERC In City ICAP proceeding concerning the new capacity constructed by NYPA and brought on line under contract by Consolidated Edison Company of New York, Inc., when new units are brought on line before they are needed to meet load, these long term contracts can have the unintended consequence of artificially suppressing the price for other existing units.⁵⁵ This must not be permitted.

Thus, if a reliability need is not met by merchant proposals, the market rules and structure must be reviewed to ensure there is no design flaw. When proceeding to the regulated backstop solution, the investor-owned utility should be directed to issue a nondiscriminatory request for proposals to satisfy this need.⁵⁶ This will allow all alternatives to be considered, not just transmission alternatives. Likewise, if following proper vetting through a targeted generic proceeding as discussed in response to Question #1 a long term contract is deemed necessary to address a public policy goal, an investor-

⁵⁴ See FERC Docket No. ER03-647-000, New York Independent System Operator, Inc., “Order Conditionally Accepting For Filing Tariff Revisions,” 103 FERC ¶ 61,201 (2003); see also FERC Docket Nos. ER05-1410-001, et al., PJM Interconnection, L.L.C., “Order Denying Rehearing and Approving Settlement Subject to Conditions,” 117 FERC ¶ 61,331 (2006), reh’g pending (hereinafter “PJM RPM Order”).

⁵⁵ See FERC Docket No. ER07-360-000, supra, “Protest of the NRG Companies” (dated January 24, 2007) at 5; see also, FERC Docket No. ER07-360-000, supra, “Protest of KeySpan Ravenswood, LLC To New York Independent System Operator, Inc.’s Tariff Revisions to Modify Installed Capacity Market Mitigation Measures Applicable to Certain In-City Generating Units” (dated January 24, 2007) at 4-5.

⁵⁶ As discussed in the IPPNY Comments being submitted in this proceeding, merchant parties are best suited to go forward with these projects as it allows investment risks to be shifted from captive utility ratepayers to private investors as envisioned in this Commission’s Competitive Opportunities Order. For example, Con Edison’s ratepayers suffered exposure to more than \$350 million in cost over-runs for the East River Repowering Project that otherwise could have been avoided. (See IPPNY Comments at 11.)

owned utility may be directed to issue a request for proposals to satisfy that targeted need.

However, in either case, such contracts must be properly structured.⁵⁷ Specifically, such contracts must fairly allocate the risks associated with payments for environmental emissions credits.⁵⁸ In addition, such contracts must be tailored to accommodate load-side bidding mitigation rules and otherwise must be consistent with

⁵⁷ In the Long Term Contracts Order, this Commission acknowledges “the possible adverse effects new capacity could have on the economics and operation of existing facilities that support system reliability.” (See Long Term Contracts Order at 35.) To address this issue, the Commission states in a footnote, “If that uneconomic capacity is needed for reliability and is not replaced by new capacity, appropriate steps could be required to ensure the integrity of the system.” (*Id.* at n.31.) While not stated explicitly, presumably the Commission is referring to reliability must run type agreements. However, there is a series of decisions identifying the shortcomings of such agreements, finding that they should be entered into only as a last resort and establishing that competitive market structures produce the most effective and efficient results. For example, addressing the first proposal to execute a reliability must run agreement in New England, the FERC held, “In short, extensive use of RMR contracts undermines effective market performance. In addition, suppressed market clearing prices further erode the ability of other generators to earn competitive revenues in the market and increase the likelihood that additional units will also require RMR agreements to remain profitable. Therefore, we believe that ISO-NE, rather than focusing on and using stand-alone RMR agreements, should incorporate the effect of those agreements into a market-type mechanism.” See FERC Docket No. ER03-563-000, Devon Power LLC, et al., “Order Accepting, in Part, Requests for Reliability Must-Run Contracts and Directing Temporary Bidding Rules,” 103 FERC ¶ 61,082 at 9 (2003). Indeed, two neighboring regions, PJM and ISO-NE, spent the better part of three years fixing their flawed capacity market designs with one of the express purposes being to eliminate the need for this type of agreement. See FERC Docket Nos. ER05-1410-000, et al., supra; see also FERC Docket Nos. ER03-563, et al., supra. To date, New York has avoided the need for these agreements. As such, the New York Suppliers urge that any future contracts be structured to be consistent with New York’s competitive markets to the degree possible.

⁵⁸ For example, in the December 5, 2006 Regional Greenhouse Gas Initiative (“RGGI”) Pre-proposal issued for consideration by the New York State Department of Environmental Conservation (“DEC”), DEC requested comments on the approach of applying a 100% allowance auction structure which will require generators to purchase all of their carbon dioxide emissions credits. See New York State Department of Environmental Conservation, “Regional Greenhouse Gas Initiative Pre-proposal” (issued December 5, 2006). While the proposed rules for such auction have not yet been produced, the cost to purchase such allowances will be an additional cost that could be very significant. In its recently filed rate case, Con Edison has proposed to pass through all of its RGGI and other environmental initiative costs to its ratepayers through its Market Supply Charge. See Case 07-E-0523, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Electric Service, Con Edison Filing Letter (issued May 4, 2007) at 11, Proposed Sixth Revised Leaf No. 159-A. This approach as well as other approaches must be considered to address these costs. Indeed, it is likely that such risks may be one of the primary factors that may cause merchant proposals to fail to come forward in the first place.

the competitive markets.⁵⁹ In other words, the true value of the contract must be reflected through its bids into the competitive markets. Allowing any other approach will, over time, undermine the competitive markets and hinder, rather than foster, future generation development.

Finally, with respect to the final issue raised in Question #2 concerning whether long-term contracts should be used for the mitigation of market power, the New York Suppliers believe that long-term contracts cannot effectively address market power issues. Any potential market power issues associated with the administration of the wholesale electric markets fall within the province of the FERC. Indeed, as discussed herein, by FERC order, the NYISO is responsible for monitoring for, and mitigating, the exercise of market power in the markets that it administers and controls.

To do so, the NYISO developed its comprehensive Market Monitoring and Mitigation Plan which the FERC has found protects the New York market from the exercise of market manipulation.⁶⁰ The Market Monitoring and Mitigation Plan provides clearly defined mitigation measures that effectively address any market power concerns. To the extent that any new form of exercise of market power were to become an issue in the future, the Market Monitoring and Mitigation Plan is the proper vehicle to address it.

⁵⁹ The capacity market structures recently approved by the FERC in the two adjoining regions, PJM Interconnection and ISO-NE, both include load side bidding mitigation provisions to guard against the use of new contracts to artificially suppress the capacity price for existing units. See PJM RPM Order; see also FERC Docket No. ER03-563, supra, “Order Accepting Proposed Settlement Agreement,” 115 FERC ¶ 61,340 (2006), reh’g pending.

⁶⁰ See FERC Docket No. ER01-3155-002, et al., New York Independent System Operator, Inc., “Order on Compliance Filings,” 99 FERC 61,246 (2002).

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?

Like merchant generators, energy services companies (“ESCOs”) do not have captive ratepayers to cover costs that they are not able to recoup through the markets. As competitive entities, ESCOs should be permitted to determine for themselves whether and how they wish to hedge their portfolios to meet their customers’ needs.

As State authorities, different consideration should be given to NYPA and the Long Island Power Authority (“LIPA”). Both of these entities are uniquely situated to offer opportunities within a request for proposals that ultimately will lead to cost savings for consumers. For example, last year, the Governor’s Office of Regulatory Reform (“GORR”) announced a multi-agency effort as part of its Advanced Clean Coal Initiative (“ACCI”). Due to its unique structure, NYPA was able to issue a request for proposals in the ACCI that, *inter alia*, included: (i) the designation of itself as the lead agency for siting purposes; (ii) more advantageous bonding capability; and (iii) access to a \$50 million carbon capture and sequestration fund.⁶¹

As noted in response to Question #1, public policy considerations should be properly vetted through a targeted, generic proceeding. While this Commission has no jurisdiction over either entity, there may be instances for public policy or environmental purposes when it would be appropriate to encourage these entities to issue a request for proposals for a long-term contract to achieve a particular public policy goal.

⁶¹ See New York State Advanced Clean Coal Initiative, New York Power Authority, “Long-Term Supply of Advanced Clean Coal Power Plant Capacity and Energy and Other Products-Request for Proposals” (issued September 1, 2006) at Addendum A.

While such limited activity by either NYPA or LIPA may be appropriate, the New York Suppliers caution that NYPA and LIPA should not undertake their own construction efforts in the future.⁶² As was the case with NYPA's peaker construction in 2001 and its Poletti II construction in 2005, taking such steps -- particularly in the absence of effective load side mitigation measures -- sends a strong message to merchant entities that their investments can be undercut at any time by regulated or government sponsored projects. Such actions are only likely to chill future merchant investment thereby undermining the goals espoused by this Commission in its Competitive Opportunities Order.

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

As discussed at length in response to Question #1 above, by its very design, the NYISO's CRP process effectively and efficiently coordinates resource needs on a statewide basis. As such, no additional regulatory oversight is necessary or appropriate.

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?

A number of barriers currently exist that discourage long-term contracts for the development of new resources. First, due to the fact that any sizeable generation project costs hundreds of millions to site and construct, there are a limited number of parties that have sufficient credit capability to make such significant investments. Second, those

⁶² To the extent that either entity needs to address load growth by its customers, it should continue to proceed with requests for proposals for new facilities as it has successfully done in the past.

parties with such capability will assess the regulatory risk of investing in these markets. As noted in response to Question #1, the New York markets generally have stabilized over the past two years. That said, more years of stability may be needed before the capital markets regain enough confidence to invest heavily again in the New York markets.

Third, many of the investor-owned utilities have the credit capability to go forward with these projects. However, to date, the terms and conditions imposed on them in their retail rate cases largely have acted as a disincentive to make such investments. For example, under the terms of one of its rate cases, Con Edison implemented a 90/10 sharing mechanism pursuant to which its shareholders only were permitted to receive 10% of the benefits from bilateral contracts executed outside the NYISO spot markets.⁶³ Such a structure encourages the utilities to make spot market purchases which they then are permitted to pass through to their ratepayers. In addition, as discussed at length in response to Question #9, the willingness of these entities to enter into such contracts is further stymied by the fact that they may subsequently find themselves subject to an after-the-fact prudence review. For this reason, as further discussed in our response to Question #9, the New York Suppliers support developing financial incentives for the utilities to undertake these risks.

Question #5 next raises the issue of whether other barriers exist that affect the development of new electricity resources. First, by its very nature, siting new electric facilities is a complex and time-consuming undertaking that involves many State and

⁶³ See Case 96-E-0897, *et al.*, In the Matter of Consolidated Edison Company of New York, Inc.'s Plans for (1) Electric Rate/Restructuring pursuant to Opinion No. 96-12; and (2) the formation of a Holding Company pursuant to Public Service Law, Sections 70, 108, 110 and certain related transactions, "Order Approving Compliance Filing" (issued April 24, 2000) at 15.

local parties. Second, development will be affected by the state of the capital markets in general and the amount of investment available for dedication to the energy markets. This can be further complicated where, as now, a number of regions are growing capacity tight and will be vying for a finite stream of investment dollars. Third, as discussed throughout, inextricably linked to the release of such dollars is the degree of regulatory certainty -- or lack thereof -- that is deemed to exist in the markets in question.

Question #5 raises the final issue of whether incentives should be created to encourage long-term contract execution generally or to foster the development of any particular type of resource. Included at the end of this question is the issue of how to structure such incentives consistent with the goal of acquiring the most cost effective resources.

With respect to the first part of this issue, as discussed in response to Question #9, it may be appropriate to give the investor-owned utilities financial incentives within their rate cases to compensate them for the real risks that they face associated with entering into these long-term contracts. With respect to the second part of this issue, as discussed in response to Question #1, a targeted generic proceeding should be utilized to determine whether any incentives are needed to foster the development of a particular form of resource. By definition, however, a generator that is pursued to address such a public policy goal may not, in fact, be the most cost-effective resource.

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?

And

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?

As established in response to Question #1 above, following a properly vetted, targeted generic proceeding, the Commission may determine that a certain public policy goal should be advanced through the execution of a long-term contract. By definition, the request for proposals for such a contract will restrict the resources that will be eligible to respond to it.

As a general matter, contract conditions must be developed that are as consistent as possible with the competitive market structure and that address regulatory risk. Thus, for example, such contracts should contain mechanisms that fairly allocate the costs of environmental requirements. Likewise, as further demonstrated in response to Question #2, such contracts should contain provisions that accommodate load side bidding requirements. Lastly, except with respect to targeted public policy goals as discussed at length in response to Question #1, the request for proposals for such contracts must be open to both new and existing resources and must be issued on a fair and nondiscriminatory basis.

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?

As was true of the response to Question #2, the response to this question must first consider the underlying reason for the long-term contract at issue. Specifically, if an investor-owned utility chooses to hedge the projected load requirements of its existing customers, such costs should be included as a commodity charge that is assessed only to the customers that continue to take commodity service from the utility. To the extent that the contracts executed by the utility become uneconomic, the utility's shareholders should bear the vast majority of that risk. However, as reflected in response to Question #2, correspondingly, the utility's shareholders also should reap the vast majority of the benefits if the utility's hedging practices are successful.

On the other hand, long-term contracts to address reliability needs or to further public policy goals such as fuel diversity or national security merit different treatment. By their very nature, these contracts benefit all ratepayers, not just those that continue to take commodity service from the utility. As such, the utility should be permitted to receive full cost recovery through a nonbypassable T&D wires charge.

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

The response to Question #9 once again depends upon the underlying reason for the contract. For contracts that the investor-owned utility elects to execute for hedging purposes to meet the projected load requirements of its existing customers, this

Commission determined in the first part of the Long Term Contracts Order issued in this proceeding that the parameters of the hedging contracts that would apply to each utility are best determined in its respective individual rate case. (See Long Term Contracts Order at 15.) As a threshold matter, for any of the utilities to be eligible for any cost recovery from ratepayers associated with these contracts, the utilities should be required to offer these contracts to both new and existing suppliers on a fair and nondiscriminatory basis.

The cost recovery that each utility receives then should be subject to the terms that are approved in its respective retail rate case. This approach will allow all interested parties to address this issue in the overall context of the rate plan under consideration and the particular circumstances of the utility's service territory. As discussed in more length in response to Question #2, as a general matter, the New York Suppliers support the basic principle of providing the utilities with the ability to obtain higher revenues for their shareholders if they execute a hedging strategy well. Conversely, the utility's shareholders, not its ratepayers, should be required to bear the risks if such hedging contracts ultimately are ill-advised.

With respect to contracts that are executed to meet reliability needs, as noted in response to Question #2, the request for proposals for such contracts must be open to all available alternatives through a transparent and competitive process. The same is true for contracts to meet a public policy goal except, of course, to the extent that the public policy goal limits the scope of solutions. Even in that case, however, it is critical that an open and competitive process be utilized.

The results of the process utilized by the investor-owned utility should be subject to review by DPS Staff akin to the review that was required when the investor-owned utilities divested their generation portfolios.⁶⁴ Upon a finding that the process that was utilized by the utility was fair, open and competitive, its contract should be presumed to be a reasonable and prudent means of procuring electric supply under current conditions thereby permitting cost recovery.

Question #9 raises the final issue of whether there are circumstances under which such contracts should be “pre-approved.” It is not clear, however, how such contracts could be pre-approved as a matter of law. Indeed, this Commission rejected Con Edison’s attempt to secure such pre-approval just four years ago when it sought a declaratory ruling from this Commission concerning its request for proposals for 500 MW of new capacity in New York City.⁶⁵ In its Petition, Con Edison specifically sought an advanced prudence determination from this Commission specifying that “the costs of any purchases of capacity and energy to be made as a result of the RFP...would be fully recoverable by the Company in rates, even if, despite the Company’s reasonable actions,

⁶⁴ See, e.g., Case No. 96-E-0891, In the Matter of New York State Electric & Gas Corporation’s Plans for Electric Rate/Restructuring Pursuant to Opinion No. 96-12 “Order Authorizing The Process For Auctioning of Generation Plant” (issued April 28, 1998); see also Case 96-E-0897, In the Matter of Consolidated Edison Company of New York, Inc.’s Plans for (1) Electric Rate/Restructuring Pursuant to Opinion No. 96-12; and (2) the Formation of a Holding Company Pursuant to PSL, § 70, § 108 and § 110, and Certain Related Transactions, “Order Authorizing The Process For Auctioning of Generation Plant” (issued July 21, 1998).

⁶⁵ See Case 02-E-1656 - Consolidated Edison Company of New York, Inc. - Petition for a Declaratory Ruling with respect to Cost Recovery of Payments for Capacity and Associated Energy To Be Made as a Result of a Recently-issued Request for Proposal Soliciting 500 MW of New Capacity, “Petition for Declaratory Ruling” (issued December 26, 2002) (hereinafter “Con Edison Petition”). Inasmuch as the Con Edison 500 MW RFP was limited to new capacity only, it was discriminatory in nature. Thus, it is not the type of contract for which the New York Suppliers support allowing cost recovery as discussed in response to this Question #9. Indeed, the fact that the contract that was issued under this RFP did not include bidding requirements has been highlighted as one of the central issues in the In City ICAP Proceeding currently pending before the FERC.

the contracted for capacity and energy turns out in hindsight to be unnecessary or more costly than other alternatives.” (See Con Edison Petition at 7.)

Citing to longstanding precedent in New York State, this Commission issued an order emphasizing that ratemaking constitutes rulemaking, and therefore, “one commission can neither bind future commissions nor relieve future commissions of their duty to balance ratepayer and shareholder interests when setting ‘just and reasonable’ rates.”⁶⁶ (See Con Edison Order at 10; citations omitted.) Thus, this Commission expressly declined to act on Con Edison’s pre-approval request. (*Id.* at 10-11). In light of Commission precedent, the New York Suppliers request clarification concerning this last aspect of Question #9.

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 NYISO market rules, if any, would be necessary or appropriate for the purposes 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?

Contracts of varying duration -- short, medium and long -- have been an integral part of the NYISO’s markets since their inception in 1999. Indeed, as reflected in the President’s Reports given at the monthly NYISO Management Committee meetings, approximately 50% of the transactions in the NYISO’s markets occur on a bilateral basis. To the extent that the investor-owned utilities elected to enter into hedging contracts in the future to meet their projected existing loads, such contracts would continue to be bid into, and settled from, the market as they are presently.

⁶⁶ See Case 02-E-1656, *supra*, “Declaratory Ruling on Cost Recovery” (issued January 24, 2003) (hereinafter “Con Edison Order”).

To the extent that the investor-owned utilities enter into contracts either to meet reliability needs or to address public policy considerations, such contracts must not undermine the functioning of the competitive markets. Currently, however, the NYISO's tariffs do not contain load bidding mitigation rules to place requirements on capacity sales from these contracts. The need for such rules is one of the core issues that has been raised in, and must be addressed by, the In City ICAP Proceeding.

As discussed in response to Question #2, market power mitigation in the wholesale markets falls within the FERC's province. By FERC order, the NYISO, through its MMP, is charged with monitoring for, and when determined to be exercised, mitigating market power. All mitigation rules associated with the wholesale markets must be addressed in the NYISO's Market Monitoring and Mitigation Plan. Accordingly, the New York Suppliers actively will participate in the In City ICAP Proceeding to address consideration of, and the specific terms for, load side mitigation rules.⁶⁷

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

Given the advanced and generally well-functioning nature of New York's competitive markets, the New York Suppliers do not believe that major modifications are needed. Rather, interested parties and regulators should continue to work collaboratively together to ensure the further development of these markets including the steps that must

⁶⁷ Question #10 alludes to "potential NYISO forward capacity markets." Currently, the NYISO conducts a voluntary six-month strip auction. Discussions in New York concerning a longer term forward market have been preliminary and at a relatively high level as of this time. The NYISO has indicated that it intends to issue a forward capacity market strawman proposal in the near future. The New York Suppliers intend to actively participate in these discussions that will consider this proposed improvement to foster the next stage of the development of competitive markets. However, because these discussions are still in the preliminary stages, it is premature to discuss whether, and if so, how, to harmonize long term contracts with a forward type capacity market.

be taken to address new environmental initiatives to produce a result that properly balances New York's environmental, energy and economic development needs.

The New York Suppliers will, however, review creative solutions to the degree that they are proposed by other parties in their initial comments in this proceeding. To the extent warranted, the New York Suppliers will respond to such creative solutions in their reply comments in this proceeding.

IV. CONCLUSION

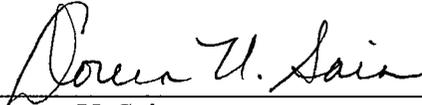
In its Long Term Contracts Order, this Commission emphasizes that it has consistently endorsed competitive markets, where feasible, as the means to assure the provision of safe and adequate service at just and reasonable rates. (See Long Term Contracts Order at 29-30.) As established herein, the competitive wholesale markets are working in New York State to the benefit of its consumers. While we must now carefully address the panoply of new environmental initiatives that are currently under consideration, a drastic reversal in course is simply not warranted or advisable.

Based on the foregoing, the New York Suppliers believe that investor-owned utilities should be permitted to engage in hedging practices to meet their projected loads of their existing customers which include a mixture of short, medium and long term contracts. When reliability needs or public policy considerations are identified, we must continue to first look to market-based solutions to address them. To the extent that market-based solutions are not sufficient, the investor-owned utilities should be directed to issue a request for proposals that is open to all available alternatives to meet the regulated back-stop solution. Any long-term contract executed pursuant to such request

must be structured to be consistent with, and not in any way undermine, the competitive wholesale market structure.

Dated: Albany, New York
June 5, 2007

Respectfully submitted,



Doreen U. Saia
GREENBERG TRAUIG, LLP
Attorneys for AES Eastern Energy, L.P.,
Dyncgy Power Corporation, Entergy
Nuclear Power Marketing, LLC,
the Mirant Parties and US Power
Generating, LLC
54 State Street, 6th Floor
Albany, New York 12207
(518) 689-1430
saia@gtlaw.com

ALB 1105925v1 6/5/2007