

NEW YORK STATE
PUBLIC SERVICE COMMISSION

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 OF INDEPENDENT
POWER PRODUCERS OF NEW YORK, INC.

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I. INTRODUCTION

Pursuant to the New York State Public Service Commission's (Commission) April 19, 2007 order in the above captioned proceeding instituting a phase II to address longer-term contract issues ("Order"), Independent Power Producers of New York, Inc. ("IPPNY"), hereby offers its initial comments.¹ IPPNY is a not-for-profit trade association representing the independent power industry in New York State. Its members include more than 100 companies involved in the development, operation and ownership of electric generators and the marketing and sale of electric power in New York's wholesale and retail markets.

In its Order, the Commission initiates an investigation of whether a statewide integrated resource planning ("IRP") process and long-term supply contracts are needed to meet reliability and public policy goals. The Commission notes that it has consistently endorsed competition where it is more effective than regulation, but expresses its concern that markets alone may not

¹ 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, Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II to Address Longer-Term Issues* (April 19, 2007).

satisfy public policy concerns.² Pointing to the unwillingness of market participants to construct needed new merchant capacity in New York City because of regulatory uncertainty and other investment risks, the Commission proposes that long-term contracts may be needed to facilitate the financing and construction of new capacity.³ The Commission also indicates that IRP may be necessary because the New York Independent System Operator's ('NYISO') existing planning process does not address issues such as the types of projects that should be constructed to satisfy all public policy goals.⁴ The Commission therefore suggests that there may be a growing need for a comprehensive decision-making process to guide the development of New York's electricity infrastructure. To address these issues, the Commission asks interested parties to comment on a series of questions addressing the use of long-term supply contracts and IRP.

In a joint letter filed with the Commission in 2003, IPPNY and the Natural Resources Defense Council urged the Commission to initiate a proceeding to address important issues concerning the use and solicitation of long-term contracts. At that time, an electric utility had sought the Commission's approval to recover the costs of a long-term contract procured pursuant to a solicitation that was restricted to certain specific new resources. IPPNY was concerned that without Commission policy and guidance, future solicitations for long-term contracts would similarly discriminate against existing resources and certain new resources, to the detriment of the competitive wholesale electricity market.

² *Id.* at 29-30.

³ *Id.* at 30.

⁴ *Id.* at 33.

IPPNY welcomes the Commission's investigation of these important issues and appreciates the opportunity to provide comments on them.⁵ As a trade association representing wholesale suppliers, one of IPPNY's primary missions is the continued development and enhancement of reliable and efficient competitive electricity markets. A well-functioning competitive wholesale energy market is essential to meeting the State's needs for electricity at just and reasonable rates. With respect to the instant proceeding, IPPNY's interest lies mainly in ensuring that the Commission's policies on long-term contracts and IRP are complementary to the continued functioning of reliable, non-discriminatory, competitive wholesale energy markets in New York.

IPPNY understands the Commission's concern that the electricity markets in New York, as currently structured, may not always satisfy all public policy objectives. The Commission should not lose confidence in the competitive market, however. It should do everything possible to ensure that market forces, instead of regulatory intervention, achieve the required level of resource adequacy and other public policy goals in New York. This can best be achieved with properly designed and functioning wholesale markets.

The Commission acknowledged in its Order that new capacity could have adverse effects on the economics and operation of existing facilities that support system reliability and that "appropriate steps" may be required to maintain reliability.⁶ As discussed in greater detail in the response to the individual questions below, the Commission's policies on long-term contracts and IRP should be narrowly tailored to avoid undue harm to existing facilities and the competitive wholesale electricity market.

⁵ IPPNY hereby reserves all of its rights to raise any issues or concerns in the future, including, but not limited to, jurisdictional issues.

⁶ Order at note 31.

One of the greatest threats to the competitive markets and impediments to needed investment is the very real risk of regulatory intervention in the markets. Using long-term contracts to affect economic outcomes, rather than to address reliability concerns, will gravely undermine the ability of investors to rely on and respond to market signals that reflect the need for capacity additions and will severely increase the risk of investing in merchant capacity. Thus, the Commission must ensure that long-term contracts are not allowed to be used to facilitate non-competitive market intervention so as not to establish a self-fulfilling requirement for additional regulatory intervention. Consistent with this view, IPPNY proposes the following recommendations:

- The Commission should support efforts of market participants in the NYISO's committee process and at the Federal Energy Regulatory Commission ('FERC') to review the capacity market design and implement mechanisms that may be needed to ensure the market will provide economic signals sufficient to retain needed existing facilities and to site new resources in New York when they are needed. Such mechanisms may or may not include a voluntary or mandatory forward capacity market ('FCM'), among other measures.
- If a reliability need is identified, merchant solutions should be favored to correct it. If insufficient merchant solutions are proposed, it is important that an investigation ensue to determine why such solutions were not proposed.
- If a reliability need is identified in the NYISO's Reliability Needs Assessment ('RNA') and no merchant solutions come forth by a specified time, the Commission should direct the electric utility in whose service territory the need arises to hold a competitive solicitation for resources to meet the reliability need.

- The Commission should coordinate with the NYISO, electric utilities and other market participants to develop procedures that ensure that competitive solicitations for long-term contracts for reliability needs are fair and non-discriminatory and appropriately designed to yield the necessary resource(s) to meet reliability needs. This procurement process also needs to provide the price signal to the market.
- The Commission should reaffirm its policy that long-term contracts executed pursuant to properly structured competitive solicitations are presumptively prudent.
- The Commission should assure recovery of an electric utility's costs of construction of new capacity only if a competitive solicitation fails to produce a solution that can meet the reliability need in a timely manner.
- The Commission should encourage, but not require, regulated electric utilities to enter into long-term supply contracts selected through fair, open and non-discriminatory competitive solicitations available to both existing and new resources to meet reliability needs that have not been addressed by the merchant market.
- To the extent that any procurement process for long-term contracts is limited to certain types of resources or to only new resources and thus are not pursued through a competitive, non-discriminatory procurement process (Discriminatory Procurement), effective market mechanisms must be in place in the competitive wholesale markets to prevent such Discriminatory Procurement from improperly depressing clearing prices for market-based facilities.

II. COMMENTS

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?

The proper role for IRP in a state with an efficient, competitive electricity market, such as New York, if any, should be limited to identifying for market participant consideration what goods and services may be desirable and ensuring that market rules are developed that will send the price signals required for their competitive procurement. IPPNY opposes any IRP process that would undermine the efficacy of New York's competitive wholesale market.

In its Order, the Commission reaffirms its policy that development of competitive markets will help to assure the provision of safe and adequate service at just and reasonable costs.⁷ The Commission states, however, that markets alone may not automatically satisfy a broad range of public policy needs and goals. It notes that the NYISO's planning approach relies on the market, in the first instance, to decide which reliability project should go forward, but that it does not address other potential public policy concerns. The Commission states there is no comprehensive planning regarding electric system infrastructure that addresses such economic and public policy goals. Accordingly, the Commission suggests "there may be a growing need for

⁷ *Id.* at 29-30.

a rational and comprehensive decision-making approach to guide the future of New York's electricity infrastructure.⁸

Two decades ago, the Commission required the utilities to file integrated resource plans and plans for competitive bidding to acquire new generating capacity.⁹ The Commission adopted guidelines that required the utilities to select resources based not only on least cost and reliability considerations but on non-cost factors, such as the public policy goals identified in the utilities' plans. These plans were rightfully abandoned with the onset of deregulated and competitive electricity markets. The Commission's expectation was that competitive markets would select needed resources more efficiently than command and control administrative proceedings.¹⁰

A statewide IRP process that sets broad policy goals, like the former state energy plans that were adopted pursuant to the expired Article VI of the State Energy Law and governor's executive orders, may be helpful in focusing market participants' attention on long-term energy needs. However, a planning process that requires electric utilities to select resources for reasons other than meeting reliability needs, not otherwise satisfied by the competitive markets at the lowest cost, will do more harm than good to the electric industry and consumers in New York. As discussed in the answer to Questions 2 and 6, resources should be selected pursuant to fair

⁸ *Id.* at 33.

⁹ See Case 29409, *Plans for Meeting Future Electricity Needs*, Opinion No. 88-15, Opinion and Order Concerning Bidding, Avoided-Cost Pricing, and Wheeling Issues, 28 NY PSC 839, 863 (June 3, 1998); Case 29409, *Plans for Meeting Future Electricity Needs*, Opinion No. 88-20, Opinion and Order Concerning Integrated Planning and Ratemaking Issues, 28 NY PSC 1177, 1188 (July 26, 1988).

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

and open competitive solicitations to protect the competitive markets from the harmful impacts of discriminatory out-of-market contracts.

Moreover, the Commission already has policies in place to further fuel diversity, energy efficiency and environmental policies. Such policies have been developed through targeted, extensive collaborative proceedings to ensure that they are designed properly and to limit their market and reliability impacts.

Thousands of megawatts of new renewable generating capacity will be constructed in the near future as a result of the Commission's Renewable Portfolio Standard (RPS).¹¹ The NYISO's interconnection queue includes approximately 6,000 MW of proposed wind generation.¹² In addition, the Commission's electric System Benefits Charge provides hundreds of millions of dollars of funding to promote energy efficiency and other public benefit programs. Further, due to existing and forthcoming stringent environmental permit requirements, any new generating facilities will need to be clean and efficient, furthering environmental policies.

Finally, FERC has tasked the NYISO with ensuring that market power concerns are adequately addressed. In his most recent annual State of the Market report, the NYISO's Independent Market Advisor reiterated the conclusions expressed in previous reports that energy prices have been consistent with competitive outcomes and have not been influenced by the improper exercise of market power.¹³

¹¹ See Case 03-E-0188, *Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard*, Order Regarding Retail Renewable Portfolio Standard (September 24, 2004) at 6.

¹² NYISO Power Trends 2007 at 12.

¹³ David B. Patton, Ph.D., Independent Market Advisor, 2006 State of the Market Report New York Electricity Markets (May 2007) at 4. The report can be found at the following link: http://www.nyiso.com/public/webdocs/committees/mc/meeting_materials/2007-05-

In summary, IPPNY believes the competitive wholesale markets are the best means of procuring resources and services in the most efficient manner. The Commission should rely on market-based programs like the cap and trade programs for air emissions and the RPS to achieve public policy goals.¹⁴ If there is a role for “centralized planning” it is to evaluate whether there are any flaws or omissions in the wholesale market’s rules that are leading to a failure to send price signals required to procure necessary or desirable resources and services. However, the NYISO Services Tariff provisions that establish the Comprehensive Reliability Planning Process (“CRPP”) already provide that the NYISO’s Independent Market Advisor is charged with performing such an evaluation if market-based solutions to reliability needs are not forthcoming. Thus, there is no need for the Commission to institute procedures to address reliability matters that would potentially be in conflict with these already established processes.

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 Order, the Commission acknowledged that new capacity could have adverse effects on the economics and operation of existing facilities that support system reliability and that “appropriate steps could be required to ensure the integrity of the system.”¹⁵ As discussed below, the Commission should not encourage the utilities to enter into long-term contracts for purposes

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¹⁴ Cap and trade programs integrate efficiently with the competitive market by allowing resources to internalize the costs of meeting emissions requirements. The RPS pays a premium to preferred resources, also allowing for efficient integration with the competitive market.

¹⁵ Order at 31.

other than meeting reliability needs. Long-term contracts should not be used as a means to discriminate against existing resources, certain new resources or reduce market clearing prices. There is no basis to provide new resources greater compensation than existing resources because all capacity has the same value in maintaining reliability. As the Commission stated in its Order, ‘the potential long term impact on electricity prices of substantial excess capacity may overwhelm any short term benefits.’¹⁶ If the Commission allows utilities to select resources based on factors other than cost and reliability, it will interfere with the competitive market by distorting market-price signals, put existing resources at risk and harm reliability.

The Commission recognized in its Opinion 96-12 that the most efficient means of selecting new resources is via the competitive market, not through a centrally planned administrative process. One of the primary benefits of competitive electricity markets is that investment risks are shifted from captive utility ratepayers to private investors. Ratepayers would not be required to pay the more than \$350 million of cost overruns incurred by Consolidated Edison Company of New York, Inc. (‘Con Edison’) in its construction of its East River Repowering Project (‘ERRP’) had the project been developed by an independent power producer.¹⁷

IPPNY believes that the most appropriate approach to securing needed resources is to ensure the NYISO’s market design provides economic signals sufficient to retain needed existing

¹⁶ *Id.*

¹⁷ See Case 05-S-1376, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc., for Steam Service*, Direct Testimony of Con Edison witness Victor Gonnella, Exhibit VG-2 (testifying that at the time Con Edison submitted its Article X application, Con Edison estimated the cost of the ERRP to be \$406 million) and Order Determining Revenue Requirement and Rate Design (September 22, 2006) at 6 (capping cost recovery for ERRP at \$788.3 million).

facilities and to site new resources in New York. The Commission should support efforts of market participants in the NYISO's committee process and at FERC to review the capacity market design and implement mechanisms that may be needed to ensure the market functions properly. Such mechanisms may or may not include a voluntary or mandatory FCM, among other measures.

In addition, IPPNY would support a Commission requirement that the regulated electric utilities conduct competitive solicitations for long-term contracts that are non-discriminatory (*i.e.*, open to all potential resource types, and both new and existing facilities). As mentioned above, IPPNY also supports the view that if resources and services that are deemed appropriate are not procured currently by the competitive markets, the Commission should direct Department of Public Service ('DPS') staff, working with market participants in the NYISO committee process, to act in its advisory capacity to advocate for the development of new market rules and market design changes that will effectuate the competitive procurement of those goods and services, such as dual fuel capability. However, to the extent Discriminatory Procurement does occur, effective market mechanisms must be in place in the competitive wholesale markets to prevent such Discriminatory Procurement from improperly depressing clearing prices for market-based facilities. Long-term contracts must include provisions that accommodate these wholesale market rules.

Long-term contracts between electric utilities and non-utility suppliers are also appropriate to further the Commission's long-standing policy to promote competitive electricity markets by separating transmission and distribution ('T&D') from generation. In 1996, the Commission issued its seminal order setting forth its policy on competitive electricity markets

and declaring its intent to encourage competition wherever feasible.¹⁸ It concluded that introducing competition to the electric industry in New York had the potential to reduce rates, increase customer choice, and encourage economic growth. And indeed, in a recent study, DPS staff has found that the introduction of competitive markets in New York has had the salutary effects the Commission envisioned a decade ago.¹⁹

The Commission found that in a wholesale or retail competitive model, wherever feasible and in the interest of ratepayers, generation and energy service functions should be separated from T&D to eliminate concerns related to the exercise of vertical market power. As a result, the Commission established a rebuttable presumption that separation of these functions was required. Separation would allay concerns about vertical market power and anti-competitive behavior (such as favored treatment of affiliates and cross-subsidies among affiliates in both competitive and monopoly environments).²⁰ In addition, the Commission stated that divestiture would help create a larger number of competing generating companies, which would result in a dynamic and aggressive market.²¹ The PSC therefore strongly encouraged the T&D utilities to divest their generation. It also adopted vertical market power guidelines intended to limit T&D utilities from acquiring generation post-divestiture.²²

The Commission's policy has been implemented with great success. The T&D utilities have divested almost all of their generation, the vast majority of new generation has been

¹⁸ Opinion 96-12 at 32.

¹⁹ New York State Department of Public Service, Staff Report on the State of Competitive Energy Markets: Progress to Date and Future Opportunities (March 2, 2006) at 1-3 ("Staff Report").

²⁰ Opinion 96-12 at 64-65.

²¹ *Id.* at 65.

²² Cases 96-E-0900 *et al.*, Statement of Policy Regarding Vertical Market Power (July 17, 1998).

developed by independent power producers, and a competitive wholesale electricity market is now thriving in New York. One of the important benefits of competitive markets is that they provide the incentives for efficient investment and operation decisions. Since divestiture and the advent of a competitive generation market, the average availability of the State's generation units has reached record levels, approximately 95% availability.²³ The availability level of generation achieved in the competitive markets is dramatically improved in comparison to the levels experienced under the regulated regime. This greater availability equates to lower prices for the State's consumers. DPS staff recently noted:

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. The total real (i.e., inflation-adjusted) electric price for a typical residential retail customer in New York, including supply and delivery charges, has dropped by an average of approximately 16% between 1996 and 2004.²⁴

While the wholesale competitive electricity market has been successful in improving the efficiency of electricity production and reducing electricity costs, as the Commission recognized in its Order, a variety of factors has impeded the construction of generation that is not secured by long-term contracts. Long-term contracts have been needed to finance much of the new capacity that has been built by independent power producers in recent years, and absent an ICAP market design that provides effective and timely signals of the need for existing and new resources, this is likely to continue into the future.

²³ NYISO Power Trends 2007 at 13.

²⁴ Staff Report at 1-2.

If private developers are not able to finance construction of new resources or investments in existing resources, electric utilities, as the providers of last resort under the Public Service Law and the Transportation Corporations Law, may be obligated to construct needed resources themselves. To the extent sufficient, purely market-based solutions are not proposed to address identified reliability needs, the Commission should encourage electric utilities to enter into long-term contracts selected pursuant to non-discriminatory competitive solicitations to help ensure reliability needs are met at the lowest cost and to discourage electric utilities from building their own, potentially more costly resources. The Commission should encourage the use of long-term contracts to meet reliability needs by coordinating its policy with the CRPP.

The NYISO Services Tariff provisions implementing the CRPP provide that market-based solutions are the preferred means to meet a reliability need identified in the RNA. The NYISO solicits proposed market-based solutions that will meet the reliability need from market participants and regulated backstop solutions from the electric utility in whose service territory the need arises. While the NYISO reviews both market-based solutions and regulated backstop solutions to determine whether they meet the reliability needs, regulated backstop solutions are only required if the market-based solution will not be available in time to meet a reliability need. Thus, the CRPP contemplates that electric utilities will only build new generation secured by regulated cost-of-service rate treatment as a last resort.

If a reliability need is identified in the RNA and no merchant solutions come forth by a specified time, the Commission should direct the electric utility in whose service territory the need arises to hold a competitive solicitation for new resources to meet the reliability need. The Commission should coordinate with the NYISO, electric utilities and other market participants to develop procedures that ensure that the competitive solicitations are fair and non-discriminatory

and appropriately designed to yield the necessary resource(s). The procedures should also ensure the price signal from the solicitation is reflected in the market. These procedures should set forth the criteria that will be used to evaluate, on a consistent and equal basis, the electric utility's regulated backstop solution against proposals submitted in response to the solicitation, for the purpose of selecting the optimal solution to the reliability need. Only if a properly structured solicitation fails to produce a solution that can meet the reliability need in a timely manner should the utility be authorized to proceed with a regulated backstop solution that utilizes its own project.

The Commission should also encourage, but not require, regulated electric utilities to enter into long-term supply contracts selected through fair, open and non-discriminatory competitive solicitations with both existing and new generating facilities. In its Order, the Commission decided that it would not impose artificial restraints on the length of electric utility hedging arrangements as a requirement for the structuring of the portfolios supporting hedged service to mass market customers.²⁵ It authorized electric utilities to enter into hedges“of the appropriate length for the purpose of constraining volatility.”²⁶

The Commission should ensure that its policy on long-term contracts does not allow regulated electric utilities to enter into above-market contracts with new capacity resources under conditions which the value of, and the costs underlying, these contracts are not reflected in the market. Otherwise, the utility may be able to artificially suppress ICAP market clearing prices, thereby reducing the amount that it otherwise would have been required to pay to procure capacity for all of its load.

²⁵ Order at 24.

²⁶ *Id.*

Permitting such a condition to persist will lead to a bifurcated market in which new capacity that is fortunate enough to obtain a contract with the utility can receive the cost of new entry (“CONE”) (or perhaps higher than CONE) but existing resources and market-based entrants are held to depressed clearing prices. Ultimately, this would likely collapse the market. Over time, existing resources will likely be forced to execute reliability-must-run contracts, which provide compensation based on administratively determined costs rather than the rigors of the competitive markets, or cease operations.²⁷ New resource development will be hindered because potential investors will be unable to have confidence that future revenues will support their investments. Instead, because of the risk that discriminatory, out-of-market purchases by large load serving entities could devastate their future revenues, new resources would only be developed with long-term agreements.

For these reasons, the Commission should discourage utilities from entering into long-term contracts with resources selected through a process that is not competitive and open to all existing suppliers. The Commission should also require measures that protect the competitive market from out-of-market contracts in situations where a utility is required to meet a reliability need by contracting only with new resources or otherwise entering into long-term contracts with resources selected through a process that is not competitive and open to both new and existing suppliers.

²⁷ FERC has recently approved market designs in ISO New England and the PJM ISO that seek to ensure reliability without the need for reliability-must-run agreements and other out-of-market contracts.

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?

There is no need for the Commission to further encourage or require load serving entities such as the New York Power Authority and the Long Island Power Authority to enter into long-term contracts. These entities have already procured much of their supply requirements through long-term contracts and will likely continue to do so. It is important, however, that public authorities not be permitted to intrude in the market by developing new generating facilities that could have been developed on a competitive basis. The risk that a ratepayer supported authority (or any regulated utility, for that matter) may intervene in the market by building its own generation is simply a variant of the unacceptable risk discussed above concerning the use of long-term contracts to effectuate economic outcomes rather than address reliability issues.

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

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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?

Under current market conditions, possession of a long-term contract with a creditworthy entity greatly enhances the ability of developers to finance and construct new capacity resources. A variety of factors has made it difficult for needed new electricity resources to be developed in New York. As the Commission recognized in its Order, one of the most significant threats to the

development of new resources is regulatory uncertainty.²⁸ Changing market rules make it difficult for developers of new electricity resources to rely on market prices, thereby increasing development risks. If developers fear that market rules will be manipulated, inconsistently revised, or significantly undermined by changes and new initiatives, including new rules resulting from this very proceeding, they cannot commit to the long-term investments needed to maintain and develop capital intensive resources to ensure continued efficient and reliable service.

In New York, owners of existing, and developers of new, electric generating facilities face a number of initiatives that could dramatically and adversely change their potential future revenues, thereby increasing risk and ultimately causing capital to flow to alternative investments. Numerous environmental initiatives that recently have been implemented or are on the near horizon threaten the economic viability of existing and proposed resources. These include New York's implementation of the NO_x emission reduction requirements of the Ozone Transport Commission, New York State consent orders that require the owners of coal-fired generating facilities to reduce emissions, the Mercury Reduction Program for Coal-Fired Electric Utility Steam Generating Units, the Northeast Regional Greenhouse Gas Initiative (RGGI), Clean Air Interstate Rules and a number of other possible initiatives.

Each of these initiatives compounds the uncertainty for suppliers and potentially jeopardizes reliability in New York. The NYISO's recent *Power Trends 2007* report noted the need for an environmental regulatory scheme that is "transparent, works with the existing market

²⁸ Order at 30-31.

structure and provides long-term certainty.²⁹ Very little coordination exists between those governmental entities engaged in developing environmental initiatives and those responsible for maintaining a reliable electric system.

In addition, development of major generating resources has slowed since New York's comprehensive power plant siting law, Article X, expired on December 31, 2002. The expired law provided for inter-agency coordination of all necessary permits and provided a defined timeline for application approval. The state Siting Board was the primary authority on almost all siting issues, ensuring local interests did not undermine statewide resource needs. The loss of Article X has increased the cost and difficulty of obtaining the necessary regulatory approvals for new generation. Currently, generation developers must obtain needed permits from local, State and federal agencies separately and risk being rejected at a local level as part of the State Environmental Quality Review Act process.

The Commission should ensure that any policy it adopts on long-term contracts is appropriately structured to minimize any interference with wholesale markets and merchant financing of new resources. As discussed in response to Question 2, the Commission should coordinate with the NYISO's CRPP to ensure that merchant resources have an adequate opportunity to meet a reliability need before an electric utility is required to hold a competitive solicitation for a long-term contract. If the Commission requires long-term contracts without providing an opportunity for merchant proposals, investment in merchant generation will likely be impossible because any investor that must internalize merchant risk is at a significant competitive disadvantage to one whose return of, and on, investment is guaranteed.

²⁹ NYISO Power Trends at 18.

Another significant barrier to long-term contracts for the development of new resources is the uncertainty faced by electric utilities that they may not be able to recover the costs of the contracts. The Commission has a long-standing policy to reject utility requests for pre-approval of power purchase agreement (“PPA”) cost recovery.³⁰ In rejecting Con Edison’s request for pre-approval of cost recovery for a long-term contract, the Commission stated that granting approval to Con Edison would not assure cost recovery because “ratemaking is rulemaking, and 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.”³¹

The Commission distinguished its policy of pre-approving contracts between qualifying facilities (“QF”) and T&D utilities. The Commission stated that state and federal law required that T&D utilities purchase power from QFs and that “[g]iven that statutory scheme, pre-approval could be granted, upon a showing that a contract complied with the statutory standards.”³² The Commission found that, in contrast, there was no statutory requirement compelling the T&D utilities to purchase power from electric generating facilities that were not QFs.³³ Not only did the Commission refuse to approve contracts between T&D utilities and non QFs, it cautioned the T&D utilities that they may be subject to a prudence review in a future proceeding if they failed to execute the contracts. The Commission stated:

³⁰ See Case 90-E-0775, *Consolidated Edison Company of New York, Inc. et al.*, Order Accepting Contracts for Filing and Denying Petition, 1990 N.Y. P.U.C. LEXIS 54, 1 (December 10, 1990); Case 02-E-1656, *Consolidated Edison Company of New York, Inc.*, Declaratory Ruling on Cost Recovery (January 24, 2003).

³¹ Case 02-E-1656, Declaratory Ruling on Cost Recovery at 10.

³² Case 90-E-0775, Order Accepting Contracts for Filing and Denying Petition, at 9-10.

³³ *Id.* at 10.

As to the implementation of these contracts, utility managements are expected to make power supply decisions prudently, and are compensated accordingly. They may not sit on their hands and decline to make decisions in the absence of prior regulatory determinations of prudence. New York's statutory structure, sound regulatory practice, and our limited staff resources preclude such an approach. Moreover, this principle applies to all areas of utility operations, unless the law specifies a different procedure.³⁴

While the Commission eschewed pre-approval of recovery of individual PPA costs, it found utility competitive bidding plans to be a prudent means of acquiring electric capacity and declared that purchases of power under approved bidding plans would be entitled to a presumption of prudence.³⁵ The Commission adopted a policy that encouraged and authorized T&D utilities to acquire needed electric capacity through competitive bidding.³⁶ The PSC discouraged cost-recovery for construction of new generation capacity by T&D utilities unless a competitive bidding process failed to provide sufficient capacity to meet the utility's needs.³⁷ The PSC also expressed the policy that repowering of existing T&D utility facilities should not be undertaken by T&D utilities unless the repowering was shown to be less costly than resources available from a competitive bidding process.³⁸ In response to a utility's argument that the PSC does not have jurisdiction to mandate competitive bidding, the PSC stated:

³⁴ *Id.*

³⁵ Case 29409, *Plans for Meeting Future Electricity Needs in New York State*, Opinion and Order Concerning Bidding, Avoided-Cost Pricing, and Wheeling Issues, Opinion No. 88-15, 28 N.Y. P.S.C. 839 (June 3, 1988) (“Competitive Bidding Order”).

³⁶ *Id.*

³⁷ *Id.* at 843.

³⁸ *Id.*

We did not mandate bidding. Utilities will be permitted to reject bids, build their own capacity, and be accorded traditional rate base treatment for their prudent investment, provided that they can justify, as prudent, their rejections of outside bids.³⁹

...

The main issue in the present case is whether bidding provides a useful way to choose among third-party producers. We conclude that it does, and that it also provides a valuable yardstick against which to judge such other power supply proposals as may in the future come forth from the utilities or from other entities.” Of course, a utility that refuses even to consider outside bids before building a unit or making a major purchase will have a hard time justifying a certificate or demonstrating prudence.⁴⁰

In its Competitive Bidding Order, the Commission directed the State’s T&D utilities to file proposed guidelines for capacity bidding and draft RFPs.⁴¹ O&R proposed a PPA provision that provided that the PPA would be filed at the Commission for its approval within 60 days of submittal and that the Commission’s approval would constitute authorization by the Commission of full PPA cost recovery.⁴² The Commission ordered O&R to delete the proposed PPA provision.⁴³ The Commission stated it would review and approve O&R’s bidding procedure and that contracts formed pursuant to the process would be presumed prudent.

³⁹ Case 29409, *Plans for Meeting Future Electricity Needs in New York State*, Opinion and Order Denying Petitions for Rehearing, Opinion No. 88-15(A), 28 NY PSC 1705, 1709 (November 2, 1998)(quoting Competitive Bidding Order at 843).

⁴⁰ *Id.* at 1709-10 (quoting Competitive Bidding Order at 844).

⁴¹ Competitive Bidding Order at 863.

⁴² Case 88-E-241, *Orange and Rockland Utilities, Inc.*, Opinion and Order Establishing Guidelines for Bidding Program, 29 N.Y. P.S.C. 221, 256 (April 13, 1989).

⁴³ *Id.* at 257. In additional orders, the Commission ordered the State’s other electric utilities to delete similar provisions from their proposed PPAs. See, e.g., Case 88-E-234, *Rochester Gas and Electric Corp.*, Opinion and Order Establishing Guidelines for Bidding Program, Opinion No. 90-4 (January 19, 1990); Case 88-E-246, *Consolidated Edison Company of New York*, Opinion and Order Establishing Guidelines for Bidding Program, Opinion No. 89-30 (September 13, 1989); Case 88-E-244, *New York State Electric & Gas Corp.*, Opinion and Order Establishing Guidelines for Bidding Program, Opinion

Lacking the authority to pre-approve cost recovery for long-term contracts, the Commission should encourage utilities to procure long-term supply through competitive bidding if needed to meet reliability needs by reaffirming its policy that contracts executed pursuant to properly structured competitive solicitations are presumptively prudent. The Commission should also reaffirm its policy denying cost recovery for utility construction of generation unless a competitive bidding process failed to provide sufficient capacity to meet the utility's needs.

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?

As discussed in the answer to Question 2, the Commission should require the regulated electric utilities to conduct competitive solicitations for long-term contracts to meet a demonstrated reliability need if the only alternative means of solving the reliability need is for the utilities to build new resources themselves. The solicitation should be open to all potential resources that the NYISO has determined will adequately solve the reliability need. The Commission should not impose any other constraints that would restrict the resource types eligible for long-term contracts.

If electric utilities engage in Discriminatory Procurement, the Commission should condition the utilities' cost recovery on the adoption of the market mechanisms discussed above to limit any anti-competitive impacts the discriminatory long-term contracts could have on existing suppliers and competitive markets. The Commission should avoid creating a need for reliability-must-run contracts to assure that required resources continue to operate. A return to

cost-of-service rate treatment for generation will undermine the competitive market and raise prices for consumers.

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 discussed in response to Questions 2 and 6, resources should be procured through non-discriminatory competitive solicitations. Discriminatory Procurement should be subject to market mechanisms that limit any anti-competitive impacts long-term contracts could have on existing suppliers and competitive markets.

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?

Long-term contract costs can be recovered from either the electric utility's customers buying commodity from the utility or all of the utility's delivery customers through a non-bypassable wires charge. Recovery of long-term contract cost should depend upon the purpose of the contract. The Commission ruled in its Order that the costs of long-term contracts to hedge volatile electricity prices should be recovered only from the utility's commodity customers that subscribe to the hedged service.⁴⁴ This cost recovery mechanism should apply to any long-term contract unless the contract is executed to meet a reliability need.

As discussed above, the Commission should encourage electric utilities to execute long-term contracts that are needed for reliability by presuming such contracts prudent if they were selected pursuant to non-discriminatory competitive solicitations. The Commission should take further steps to reduce the risk of non-recovery. It should allow the utilities to recover above-market costs of capacity (which could result by application of measures required to protect the

⁴⁴ Order at 22.

competitive market), if any, purchased pursuant to long-term contracts, to the extent such capacity is needed to meet a reliability need, from all of the electric utilities' delivery customers through non-bypassable wires charges. Cost recovery for any capacity purchased under the long-term contract beyond that needed to meet a reliability need should be recovered only from the utility's commodity customers.

Regardless of how long-term contract costs are recovered, however, contracts selected pursuant to Discriminatory Procurement should be subject to the market protection mechanisms discussed above to ensure that they are not a vehicle for creating a bifurcated market that harms all resources that are unable to obtain a favored long-term contract. Contracts that are selected pursuant to open, non-discriminatory solicitations need not be subject to market protection mechanisms.

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 Commission should reaffirm its policy that long-term contract costs are presumptively prudent if the long-term contract is selected pursuant to a fair and non-discriminatory competitive solicitation. With respect to long-term contracts needed to meet NYISO RNA needs, the Commission should require utilities to demonstrate that their competitive solicitations are open to all resources that the NYISO deems adequate to solve reliability needs before the Commission approves cost recovery. The Commission should support the cost of these contracts being used to send market signals. The Commission should also require utilities to demonstrate that winning non-utility bidders provide the lowest cost solution to meeting the reliability need.

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 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 NYISO's rules already adequately accommodate long-term contracts. Indeed, more than half of the electricity consumed in New York is sold through short, medium and long-term bilateral contracts. Additional capacity is sold through financial contracts that provide similar price hedging benefits without linking the sale to a physical delivery contract. No changes to the NYISO's rules are necessary so long as long-term contracts are selected pursuant to competitive solicitations that are open to all existing and new potential resources. If solicitations are not open to all existing resources, NYISO market rules should ameliorate the impact of the discriminatory long-term contracts on NYISO ICAP prices paid to existing and new merchant generators. As discussed in the answer to Question 2, capacity built by or contracted to an electric utility that is not procured pursuant to a non-discriminatory competitive solicitation should be subject to market mechanisms that protect existing resources from depressed clearing prices.

III. CONCLUSION

Consistent with the principles discussed herein, the Commission should ensure that any policies it adopts concerning long-term contracts and IRP do not interfere with the competitive market.

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