

BEFORE THE
STATE OF NEW YORK
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 KEYSpan CORPORATION

Pursuant to the Commission's "Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II to Address Longer-Term Issues" issued April 19, 2007, KeySpan Corporation ("KeySpan") hereby submits the following comments.¹

KeySpan supports the Commission's goal of encouraging utilities to use non-discriminatory long-term contracts to support existing and develop necessary new electricity resources. Non-discriminatory long-term contracts can be effective as complements to competitive markets that are structured and operating properly. However, to prevent these Commission-encouraged long-term contracts from causing undue influence on the wholesale energy markets, the Commission needs to establish and implement its guidelines in accordance with the design of the wholesale markets. KeySpan's comments below are directed in response to those questions in the Commission's Order on which it has input.

- 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**

¹ KeySpan subsidiaries, including KeySpan-Ravenswood, LLC and the KeySpan Energy Delivery Companies, submitted comments in Phase I of this proceeding.

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?

When contemplating an integrated resource planning process, the Commission needs to recognize the degree to which New York's wholesale and retail market structure, market operations, and market participants have evolved over the last decade. The New York Independent System Operator, Inc. ("NYISO") is an important partner with the utilities, who still own their transmission and distribution systems but largely divested their generation resources. The NYISO and the transmission owners work together arduously, with the participation and advice of the Commission, as well as other market participants and interest groups, to evaluate the resource needs of New York on short- and long-term bases and plan for the satisfaction of those needs. The Commission need not and should not seek to reinvent the integrated resource planning wheel by engaging in a separate planning process. Instead, the Commission can inform utilities, the NYISO, and consumers regarding its objectives with its continued participation in existing processes so that the results of those efforts can reflect Commission priorities.

It is worth noting that upon the identification of a reliability need by the NYISO's Comprehensive Reliability Planning Process, the market is given the first chance to offer a solution. KeySpan has been and continues to be an advocate for efficient market operations and for market responses to resource needs. As such, KeySpan wishes to emphasize that it supports the Commission's evaluation of expanded use of long-term contracts, so long as long-term contracts are non-discriminatory and complement efficient competitive market operations.

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?**

KeySpan believes that long-term contracts are important tools for utilities to satisfy their load-serving obligations. Gas utilities have used such contracts for years to meet pipeline capacity requirements. The Commission should similarly encourage, though not require, utilities to execute non-discriminatory long-term contracts to procure electric resources at reasonable prices. Utilities should open their contract procurement processes to all resources on a non-discriminatory basis. When a contract results from a fair process, it should be viewed more favorably by regulators, consumers, and other market participants.

The Commission should recognize, however, that the existing wholesale electricity markets are not structured to produce certain public policy goals. If long-term contracts are required to accomplish certain public policy goals, like fuel diversity, mitigation of market power, or environmental improvement, then markets should be adjusted to account for the impacts of such contracts. If public policy goals are valued by utilities or consumers, then they should be willing to compensate all market participants offering competitive products that satisfy those goals, while allowing the wholesale and retail markets to reflect these levels of compensation.

For example, the Commission has worked with NYSERDA to implement the Renewable Portfolio Standard and construct a market that rewards premiums to

developers offering resources with tangible environmental benefits. For the most part, however, this program is separate and distinct from the wholesale market. In addition, to enhance fuel diversity, the NYISO received approval from the Federal Energy Regulatory Commission for tariff provisions that will provide increased compensation to certain resources that are able to switch their fuel from natural gas to oil during peak conditions.² While these programs intend to provide public benefits, and they do, there should be better coordination between these measures and the wholesale and retail markets.

If both wholesale and retail market designs place greater value on dual-fuel capability or clean operations and provide the incentives necessary to encourage developers to build facilities with those characteristics, then direct regulatory intervention should be minimal or non-existent. If willing parties do not provide these facilities, it is likely because the market is not producing signals to demonstrate the need. This could be because the market already has the right mix of resources, or it could be because the market is not functioning in a way to allow the display of the proper price signals. Before resorting to long-term contracts for the sake of public policy goals, though, it would be worthwhile to give the markets time to develop and mature before making judgments on whether they can produce the society-desired outcomes.

One of the possible unintended consequences of targeted or discriminatory long-term contracts is the evisceration of competitive wholesale markets. In the quest to reduce price volatility, policymakers encouraging long-term contracts could inadvertently depress wholesale prices to the point where long-term contracts would be absolutely necessary to sustain and build resources. KeySpan believes that the reduction of market

² *New York Independent System Operator, Inc.*, 119 FERC ¶ 61,130 (May 11, 2007). The tariff provisions are limited to specific resources in areas with transmission and gas infrastructure constraints.

volatility can be a worthy public policy goal only so long as there are other means by which the market and resources without contracts can continue to see appropriate price signals for infrastructure investment. It would be an unfortunate result of this proceeding if increased use of long-term contracts found its foundational support in faulty market structures. Accordingly, the Commission should take care to ensure that its encouragement of long-term contracts complements wholesale competitive markets and does not hamper the continued progress of those markets. To the extent the Commission's contracting policies implicate changes to competitive wholesale markets, those changes should be made at the same time as implementation of the contracting policies.

Indeed, one of the biggest reasons for the reluctance of developers to build new resources is regulatory uncertainty. Regulatory intervention must not take the form of setting policies that have chilling effects on developing competitive markets. New market structures get put in place in piecemeal fashion for only a few short years before regulators and market participants conclude they are not working as expected and must be altered. In the meantime, resources that relied on the continued operation and development of those market structures find their expectations thwarted. With this environment of regulatory uncertainty, it is no wonder that investors are wary to commit capital to electric resources without a long-term contract. Better coordination between wholesale and retail market changes would at least reduce the uncertainty created by conflicting or incompatible market designs.

- 3. Should Load Serving Entities (“LSEs”) 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?

As an active market participant in multiple forums around the State, KeySpan has come to recognize the broad range of constituencies and their differing opinions regarding integrated resource planning. For some of those constituencies, execution of long-term contracts, or taking a partial position in a contract with a specific resource, would enable them to take a more active role in accomplishing policy goals that are important to them. Among the goals that have been enunciated are price reductions and environmental improvement. Participating financially in these long-term contracts would allow interested parties to “put their money where their mouth is” and provide the direct financial support necessary to develop the mix and volume of generating resources that would satisfy their particular policy goals. To the extent those contracts were more expensive than other options, the parties most interested in achieving the policy goal would be supporting its accomplishment without getting a free ride from their local LSEs.

To the extent market mechanisms are put in place to value resources that provide the service desired by public policy, long-term contracts could also draw interest from investors as possible counter-parties. Creative financial minds could produce contracts that would provide infusions of capital for resources in exchange for the long-term output of resources meeting the public policy goal. With such arrangements, investments could move forward, and investors would then bear the risk of the market outcomes for the products from these resources.

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

KeySpan contends that statewide coordinated resource procurement should only occur through operation of properly-constructed capacity auctions administered by the NYISO. The NYISO's capacity auctions, whether under their present structure or as parts of longer-term forward capacity markets, are designed to ensure statewide reliability based on the satisfaction of reserve margins established by the New York State Reliability Council. With this type of reliability-centered coordinated resource procurement, the actions of load-serving entities across transmission districts combine to provide the level of resources necessary for reliable operation of the electric system. If the auctions are not procuring the desired mix and quantity of resources, then stakeholders should consider changes to the market before using targeted or discriminatory procurement processes.

Otherwise, though, transmission owners are the parties in the best position to continue to design and build their systems to provide effective service to their end-use customers. The NYISO provides a forum where those resource plans are collected to ensure system-wide stability.

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?

The most significant barrier to the execution of long-term contracts is the lack of willingness on the part of utilities to pay contract prices necessary to encourage

electricity resources to sell their output for fixed prices. The mere assurance of payments via a long-term contract is not enough for an electricity resource if said payments will not be sufficient for the resource to earn a satisfactory return of and on its investment.

The successful completion in recent years of projects supported by long-term contracts would seem to indicate that under certain sets of circumstances, barriers to the development of new resources are not substantial. Those sets of circumstances, however, may involve discriminatory procurement practices that tilt consideration toward new resources, to the exclusion of existing resources and other resources under development. In those situations, discriminatory contracts may be awarded to new resources that entail costs above those produced by the markets. The Commission should not use this proceeding as a means to encourage or enable further execution of long-term discriminatory contracts.

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?

One of the most important ways to avoid anti-competitive impacts from long-term contracts is to design the procurement process properly. If long-term contracts are open to all resources to offer their supply, then the award of the contract to the least-cost resource should not distort the operation of the competitive market—whether the resource is new or existing.

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?

KeySpan respectfully suggests that the Commission issue a Policy Statement on Non-Discriminatory Long-Term Contracts instead of developing strict guidelines or regulations. With an illustrative list of policy considerations for long-term contracts, LSEs could structure their resource procurement practices in order to receive favorable Commission review that does not involve second-guessing of the utility's contracting practices.

The bedrock principles for that Policy Statement should focus on the maintenance of reliability and the efficient operation of competitive markets. The Commission should encourage LSEs to conduct non-discriminatory competitive procurement processes to contract with resources that can provide the needed electricity on a reliable and cost-efficient basis. The Policy Statement would also encourage LSEs to seek long-term contracts in response to competitively-produced market signals instead of in defiance of such signals.

In its Policy Statement, the Commission should also indicate the propriety of placing value on resources that will still be needed to preserve system reliability even after the addition of incremental new resources supported by long-term contracts. LSEs and the Commission must recognize the market impacts of introducing incremental new resources supported by long-term contracts. If these new resources produce market prices that make necessary existing facilities or facilities already under development uneconomic, then the Commission's encouragement of long-term contracts for new

resources will have partially failed. Allowing necessary price signals to prevail in the market, notwithstanding the addition of the new resource, would help to avoid this result.

- 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 best way to harmonize long-term contracts with NYISO market operations is to ensure that the costs underlying the long-term contracts are somehow reflected in the NYISO's auctions. When resources committed via bilateral contracts are bid into the NYISO's auctions at a zero price, they can distort the settlement of the market prices when they are combined with resources bid in by other parties at the prices at which the other parties seek to sell their products. The cost of the bilateral contract needs to be incorporated into the market because that price, like the bids from the other parties, represents the price it seeks—and, indeed, received—for its product. Once the realities of long-term contract prices are reflected in the market, they should not further impact results in markets.

- 11. Are there any other creative solutions that might be considered to address the issues identified herein?**

The design and implementation of effective forward capacity markets could help to maintain reliable resource levels, manage price volatility, and reduce concerns related to discrimination and market power. Forward capacity markets would involve longer procurement periods than at present, so they would offer sustained revenue streams to

help avoid the boom or bust cycles that have characterized resource development in the past. Effective forward capacity markets would then be able to inform parties about future prices, thereby allowing them to incorporate that knowledge into negotiation of voluntary long-term contracts. Long-term contracts should always complement efficient competitive markets. In the absence of a successful competitive market, long-term contracts will be subject to no discipline and could result in the inefficiencies and bloated costs that characterized the period before deregulation. Such results should be the goal of no one.

CONCLUSION

KeySpan commends the Commission for its expanded inquiry into the use of long-term contracts by utilities to satisfy their electric supply responsibilities. KeySpan reiterates its support for the Commission to encourage, though not require, utilities to use non-discriminatory long-term contracts to meet their resource needs. Such contracts should be open to all resources on a non-discriminatory basis. Fair contracting procedures, along with markets that are structured and operating properly, will help to guide utilities toward the execution of contracts that are cost-effective and supportive of societal goals.

Respectfully submitted,

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