

**STATE OF NEW YORK
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**

**Comments by
City of New York**

June 5, 2007

Summary of Position

The City of New York (“City”) believes that utility power-supply portfolios should be planned and managed to (1) moderate consumers’ exposure to sharp price spikes, and (2) improve the regional mix of generation, transmission and demand-side resources. The utilities should work with the Public Service Commission and other relevant stakeholders to design and implement an Integrated Portfolio Management process, consistent with the following basic principles:

- The severe market-price risks currently borne by consumers should be mitigated.
- Resource procurement should be used to overcome inefficiencies and excessive volatility in the market.
- The integrated planning process should lead to prudent procurement decisions.
- The utilities should recover all their reasonably incurred costs of procurement.
- Resource procurement should be competitively neutral, neither encouraging nor discouraging consumers from choosing competitive power suppliers.
- Power should be procured either by the distribution utility or, in cooperation with the utility, a special-purpose entity or existing public authority.
- Resource procurement should take into account and to the extent possible should be harmonized with existing entities and activities that address related issues, including the New York Independent System Operator (“NYISO”), the Con Edison System Reliability Assurance Study (“SRAS”) process, and also newly-emergent activities that will bear on the issues discussed herein, notably implementation of the New York City PlaNYC 2030.

Responses to Questions Posed by Commission

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?

New York City's long-term resource needs should be addressed at two levels. First, an integrated planning process should be conducted at the zonal level in order to address New York City's unique reliability, siting, and environmental constraints. Second, integrated planning should be carried out at the statewide or regional (e.g., Southeast New York ("SENY")) level to identify resource options outside of Zone J that can improve the reliability and reduce the costs of electric service in NYC and throughout the rest of the State.¹ At both the zonal and statewide level, the planning process should be designed to identify the portfolio of generation, transmission, and demand-side resource options that will best maintain reliability, minimize costs, mitigate price volatility, improve environmental and health quality, and advance other public-policy goals. The planning horizon for this process should be at least ten years.

Every year, as part of its Comprehensive Reliability Planning Process, the NYISO conducts a Reliability Needs Assessment ("RNA") to determine capacity needs in each zone over a ten-year period. The annual RNA identifies the amount of "compensatory megawatts" that would need to be installed in each zone to maintain reliability in each zone and across the entire New York Control Area. However, the RNA does not investigate whether reliability can be maintained with more cost-effective alternatives to capacity additions (e.g., transmission upgrades) or whether additions or upgrades beyond those required for minimum reliability requirements might be economically justified. A significant limitation of the RNA process is that the use of "last resort" options for reliability will, by definition, be ones that can be implemented quickly, which typically means gas-fired peaking capacity. The effect of such choices is to heighten our reliance on natural gas, and to thereby reduce fuel diversity, and thereby expose the market to potentially greater long-term risks while solving a short term problem.

The integrated planning process should be structured to build on the NYISO's reliability planning, using the annual RNA modeling parameters and outputs as a baseline for evaluating alternative resource options. The results of the integrated planning process, in turn, should be fed back through the NYISO's reliability-planning process to ensure that the resource portfolio identified through integrated planning meets minimum control-area and zonal reliability requirements.

Each utility (or some alternative entity acting on behalf of the utility's customers) should develop draft portfolio targets for generation, transmission, and demand-side resources for review by interested parties and the Commission. Those targets would represent the optimal mix based on regional priorities, such as stabilizing generation costs for ratepayers and dealing with local transmission constraints. Each utility should also develop a procurement plan to acquire the resource mix identified in its portfolio targets.

For New York City, the targets and acquisition plan would include the following:

- balancing the short-term portfolio among various contract and spot purchases
- balancing the short-term portfolio between in-City and Upstate resources, for both energy and capacity
- ensuring the development of qualifying in-City resources to improve reliability and reduce energy costs, fuel use, pollutants and greenhouse gases

NYSERDA, or perhaps another entity under a reenacted PSL Article VI, could if necessary undertake a statewide process to establish targets for resource additions and mechanisms for using various utilities' procurement processes to ensure the development of those resources. Such mechanisms would generally be mid- to long-term contracts, divided among the utilities affected by various supply problems. Where regional problems exist, spanning multiple utilities but less than the entire state—such as SENY—

¹ In particular, a statewide or regional planning process should identify and assess transmission projects that span multiple zones within the NYISO or that interconnect the NYISO with other control areas.

the relevant utilities and key stakeholders such as the City of New York should participate in a regional solution.

The long-term planning process envisioned herein differs from the prior form of IRPs in two key respects. First, the long-term planning process would establish procurement targets for resource additions, not prescriptive limits on the types or amounts of capacity to be procured as in traditional IRPs.² Second, the long-term planning and procurement process relies on market mechanisms to the extent feasible to procure capacity and energy. In particular, portfolio targets can be met through competitive procurements of long-term contracts.

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?

Utilities should be encouraged or, if necessary, effectively required to enter into economically beneficial long-term contracts for new market resources. Unlike spot-market purchases or shorter-term contracts with existing units, long-term contracts will attract new entrants and thereby change the amount of resources available in the market. Increasing the amount of newer, more-efficient resources reduces prices, mitigates price volatility, raises the efficiency of fuel use for electric generation, reduces emissions of pollutants and CO₂, and increases diversity of both fuel and resources. A utility or other entity procuring long-term power can require that the power be supplied from new generation or transmission resources, thus spurring construction of additional, cleaner, and more-efficient resources.

Long-term contracts induce new construction and reduce prices, compared to sole reliance on speculative merchant construction of new resources, for the following reasons:

- Financing costs are lower for projects that have long term contracts
- More developers will participate in an RFP for a long-term purchased-power agreement than will develop projects on a merchant basis. Such competition creates a larger and more diverse pool of candidate resource additions

The NYISO has attempted to elicit market solutions to reliability problems by publicizing the needs in its Reliability Needs Assessment (March 16, 2007) and relying on the short-term markets and financial intermediaries to encourage developers to add generation, transmission or load reductions. The ISO indicated that it received some “responses from the responsible transmission owners identified in the RNA and certain market-based responses,” but “cannot determine with certainty that, at this time, sufficient market-based solutions will qualify to meet the Reliability Needs identified in the RNA” and has started to seek regulated solutions from the utilities.³ For the most part, those regulated solutions since restructuring have generally been limited to transmission projects, and Commission guidance will likely be necessary if the utilities are to expand into generation or demand response.

Long-term contracts can also moderate the prevailing multi-year boom-bust cycle. Typically, no resources are added until prices get very high. The high prices cause a development rush, resource additions exceed requirements, and prices fall. Then prices are depressed for significant periods and generation owners experience financial distress and bankruptcy, resulting in high risk premiums for future projects, no additions, shortages, high prices, and a repeat of the cycle.⁴ This cycle is characteristic of industries that are capital intensive, and have high fixed costs, long project lead times and so-called

² This aspect of the long-term planning and procurement process is discussed further in response to Question 6 at page 11 below.

³ Letter from Henry Chao, May 15, 2007

⁴ This pattern has been observed in various generation markets, such as the Midwest, the Southeast, upstate New York, New England, and PJM. Due to the recognized difficulties associated with adding generation in New York City, the existing market is unlikely to support building sufficient capacity, let alone excess, in Zone J, as the history of the last several years has shown.

“lumpy” capacity additions such as power generation, liquefied natural gas, chemical manufacturing, and mining. New York City is especially vulnerable to the tight-supply phase of the power market boom-bust cycle, as a large share the City’s energy is supplied by divested generators with energy payments based on soaring market clearing prices, and accompanying disincentives to install additional capacity that presumably would reduce those prices.⁵

Finally, long-term contracts with new resources may serve to mitigate market power in Zone J, reducing market concentration and reducing the profitability of strategic withholding on the part of certain pivotal suppliers.

Long-term contracts will clearly be needed to bring on line new generation plants and transmission lines in New York City. Despite the somewhat tenuous capacity situation in New York City, and the high energy costs, very little merchant resource development has occurred. Of some 6,500 MW of generation proposed for Zone J, about 1,970 MW has been built. Of the completed generation, 1,700 MW, or 86%, was built by the load-serving utilities (Con Edison and NYPA), or under contract to them. No generation is currently under construction in Zone J; the next addition is likely to be NYPA’s 660 MW transmission connection with FPL Energy’s Red Oak plant in New Jersey.

This lack of new merchant additions in Zone J does not result from a lack of proposals. Several resource additions have been proposed, largely or fully licensed, and then delayed for years, apparently for lack of a contract. The current lack of the one-stop siting approval previously available through PSL Article X may discourage development of some new large generation, but even projects with existing Article X approvals are not going forward.⁶ While merchant generation has been stymied, southeast New York has

⁵ This assumes that markets are workably competitive; recently seen distortions in the Zone J capacity market caused by economic withholding may raise concerns over the reliability of such an assumption. However, there are far more robust mitigation mechanisms operative in the NYISO energy market than currently exist in the capacity market.

⁶ For example, Astoria Energy SCS received Article X approval in November 2001 for 1,000 MW, but more than five years later has proceeded with only 500 MW— not coincidentally, the exact amount now under a ten-year capacity and energy contract with Con Edison. Similarly,

continued to be overly reliant on antiquated in-City plants with relatively high emissions and poor operating efficiencies.

The experience with transmission has been equally bleak. While numerous transmission projects have been proposed into Zone J, from PJM and upstate, and the PSL Article VII transmission-siting statute remains in force, all have failed due to the lack of contracts. In contrast, LIPA has been willing to enter into long-term contracts for transmission capacity, and has therefore been able to put the 330-MW Cross-Sound Cable from New England into service and has the 660-MW Neptune cable from New Jersey to Long Island expected to enter service on or before July 1, 2007. In a similar fashion, NYPA has selected from bidders on its recent RFP the planned Hudson Transmission Partners line that will connect Red Oak to West 49th Street in Manhattan.

Of the several parties in the power-supply market—utilities, energy-service companies (“ESCOs”) that sell power to retail customers, wholesale marketers, financial intermediaries, and the NYISO—the utilities, NYPA and LIPA appear to be the only existing entities that could currently commit to the long-term contracts necessary to bring new resources on-line. In the longer term, some other entity could be created specifically to procure power on behalf of ratepayers, with the guaranteed ability to pass the costs through retail rates.

Energy-service companies generally purchase the bulk of their energy and capacity in short-term bilateral contracts, structured to approximate the size, length and shape of their retail service contracts. Since bilaterals are not generally available to exactly match retail load shapes, ESCOs balance and shape their contract purchases in the NYISO spot markets, from which they also purchase ancillary services. ESCOs’ portfolios are generally too small and too volatile to include utility-scale long-term resource commitments. As a result, ESCOs are not in a position to commit to the long-term contracts needed to support resource additions.

the Siting Board approved the repowering of the Astoria plant (now owned by US Power Generating) in June 2003, but to date the owners have not proceeded with construction.

The NYISO has responsibility for identifying that resource additions are needed to ensure reliability, but its ability to bring resources on-line is limited. The NYISO has no current capability for procuring long-term resources, cannot require construction of generation or inter-ISO transmission, and cannot provide long-term incentives for developers to add resources. Even the NYISO's ability to require utilities to add transmission within New York has not been tested.⁷ And as the ISO's responsibility in this area is essentially limited to maintaining reliability, it cannot effectively use even its limited tools to pursue cost-reduction resources. Consequently, no progress has been made in reducing the large disparity in capacity and energy prices between Zone J, Upstate New York and PJM.

Wholesale marketers and financial players provide short- and medium-term contracts, particularly for energy, but are unwilling to take on long-term purchase contracts unless they have a customer who is willing to sign an off-setting contract to hedge the intermediary's risk.

Thus, by what amounts to a process of elimination, the distribution utility (or a new special-purpose entity) is the logical counterparty for long term contracts. The utilities are virtually certain to continue serving very large portions of the generation load for many years to come. This is particularly true under virtually any plausible scenario concerning retail customer migration in a market such as Con Edison's characterized by millions of residential customers. And of course, all utilities will continue to have financial relationships with their delivery customers indefinitely. Hence, they are logical parties to enter into the long-term contracts necessary to improve the generation and transmission system, regionally and statewide. If the utility is unable or unwilling to enter into such contracts, some other entity can be given the role of power purchaser, with the costs flowed through the utility's rates.

Long-term contracts should be solicited and awarded through a competitive RFP process. In soliciting long-term power contracts, a utility can require (or express a preference for) location, technology, emissions, pricing arrangements (e.g., basing fuel prices on long-

⁷ In other words, if the NYISO concludes that a transmission line is needed to maintain reliability, but the incumbent transmission owners fail to pursue construction, it is not clear how

term contracts), and interconnection to deal with local, regional and statewide problems. This was Con Edison's approach in the solicitation that led to the contract with SCS Astoria Energy, which in short order led to the construction of a highly efficient 500-megawatt combined-cycle plant. This experience tends to refute the oft-heard claims that the real issue for potential builders is the expense and difficulty of building generation plants in the City.

The New York Power Authority's recent RFP for 500 MW of capacity was quite flexible: both generation and transmission resources were eligible, bidders could offer capacity only or capacity with energy, and the term could be for ten or more years. The RFP indicated a preference for resources that reduce electricity costs Citywide, add to the diversification of the total number of electricity supply sources and creditworthy counterparties, contribute to the diversification of fuel supply of electricity supply sources, and contribute to policy objectives, including improvements to environmental and health quality and consistency with the City of New York's land-use policies and rezoning plans. It is noteworthy that NYPA's RFP, with its promise of a long term power-purchase agreement with a credit-worthy counterparty, attracted diverse bids from fourteen different generation and transmission developers.

Utilities should also be encouraged to build or contract for inter-regional transmission on behalf of all end use customers in their transmission-service territories, and permitted to recover the costs through their transmission tariffs. This would solve the current dilemma in southeast New York where no party is ultimately responsible for procuring inter-regional transmission, aside from LIPA as a load-serving entity. Con Edison has not increased the transfer capability between Zone J and either upstate New York or PJM for approximately 20 years.⁸

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

the NYISO could implement its conclusion.

⁸ A notable exception is the planned M29 line from Westchester to northern Manhattan, which is expected to recover transfer capacity lost to load growth in southeast New York.

into long-term contracts as described above? What role, if any, might entities other than Load Serving Entities play in such resource procurement?

Both LIPA and NYPA already engage in long-term contracting on behalf of their respective customer loads, and should be encouraged or required to participate in statewide or regional long-term planning processes and procurements. In New York City, as noted above, either NYPA or Con Edison would be the logical counterparty for long-term contracts. No other entities are likely to be able to serve that role, at least in the near term.

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

Statewide coordination may be appropriate for procurement of resources that provide statewide or regional benefits, or for procurement of transmission resources that span multiple zones or control areas. Where a statewide or regional planning process identifies a need for such resources, the Commission, in consultation with participants in the statewide or regional planning process, could be responsible for: (1) designating the utility or utilities responsible for conducting the procurement; (2) overseeing the technical evaluation and selection of project proposals; and (3) coordinating with the NYISO on issues of resource deliverability and conformance with reliability standards.

For procurement of resources that are identified through the zonal planning process, Commission oversight could be limited to prudence review of the procuring-utility's conduct. In addition, the Commission could oversee the technical evaluation and selection of resource options proposed in response to utility solicitations. Finally, it may be appropriate for the Commission to provide coordination between the statewide (regional) and zonal planning processes, to ensure consistency of planning assumptions and outcomes.

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?

As discussed above in response to Question 2, non-utility LSEs serving load in Zone J (other than NYPA) are unlikely to enter into long-term contracts, as their load positions are too small and too volatile to support utility scale long-term contracts. Likewise, wholesale marketers or brokers are unlikely to contract for long-term off-take from new resources, in the absence of other parties willing to enter into offsetting long-term contracts which hedge wholesalers' risks.

Two factors may have discouraged Con Edison from executing strategic contracts to resolve the supply constraints in serving the needs of the New York City. First, the Company is under pressure to reduce its share of the retail market. It is understandably reluctant to incur long-term contract obligations that might appear to require long-term maintenance of its current market share. Second, the Commission has not assured the Company that it would recover its costs from previous long-term contracts, including the SCS Astoria Energy project. While the Commission's strong suggestion that Con Edison would recover the costs of prudent contracts were sufficient for the Company to proceed with SCS Astoria Energy, further clarification of cost-recovery standards would be useful.⁹

There are two situations where incentives for utility procurement may be appropriate. First, it may be more efficient for a utility to directly develop, rather than to procure through competitive solicitation, certain resources, such as energy-efficiency resources or transmission investments. In such instances, incentives for superior performance may be appropriate. Second, the Commission may require the utility to participate in its own solicitation, in order to provide a "regulatory back-stop" in the event that market-based offers are inadequate or are not priced competitively. And in the event that the utility project is selected, it may well be reasonable to allow an appropriate adder to the utility's authorized rate of return to compensate for the additional financial risk associated with such plant investment.

⁹ See Declaratory Ruling on Cost Recovery, PSC Case No. 02-E-1656 (issued January 24, 2003)

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?

In general, the City believes that solicitations for power contracts should be as flexible as reasonable, in order to promote robust bidder participation and competitive pricing of supply offers. Rather than prescribe limits on eligible resource types (e.g., baseload vs. peaking; generation vs. demand-response) or project capacity, the RFP should provide the portfolio targets established under the long-term planning process, clarifying that such targets are not proscriptive, and then invite project proposals of type and size that serve respondents' commercial interests.

In certain instances, it may be appropriate to set aside contracts for renewable resources, transmission projects, or advanced technologies such as IGCC (as in NYPA's recent RFP), to advance environmental and other public-policy objectives. Moreover, to secure long-term market improvements with new, efficient generation, it may be appropriate either to limit eligibility to new capacity or major upgrades, repowering, or overhauls of existing capacity, or simply to establish weighting criteria for RFP bid applications that express preferences for certain resources or combinations of resources that are viewed as particularly desirable. Alternatively, utilities could conduct separate solicitations for short-term contracts with existing capacity for the purposes of hedging near-term prices for power-supply service ("PSS") for customers not taking competitive retail service.

In all cases, uniform contract terms and conditions should be established and codified in a non-negotiable *pro forma* agreement in advance of any solicitation. Since the *pro forma* agreement is not subject to revision by any one bidder, all bidders can compete, and all offers can be evaluated, solely on the basis of project price, performance, and attributes.

As discussed below in response to Question 8, potential anti-competitive impacts from long-term contracting can be ameliorated through the mechanisms for recovering the costs of such contracts. Specifically, the City proposes that PSS rates be set to reflect current market conditions, with any difference between PSS rates and portfolio costs (including long-term contract costs) recovered from all customers through a wires charge

or credit, on the rationale that expected benefits within a utility service territory flowing from an accepted RFP bid would accrue to all ratepayers. Accordingly, the associated costs should be borne by all. Any such broad-based sharing as would be experienced in the very large and densely populated Con Edison service territory would also tend to diffuse the ratepayer impact of such associated contract costs.

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?

In general, any proposal for a procurement process should be subject to Commission review and approval, with specific restrictions or guidelines determined on a case-by-case basis.

The Commission should consider imposing restrictions to discourage utility self-dealing. One possible approach would be to preclude utilities from offering “backstop” contracts at prices that exceed cost or from awarding contracts with affiliates at market prices.

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 fixed-price power contracts complicate the coordination of cost recovery with facilitation of the competitive market. Competitive suppliers are likely to offer customers power priced to reflect the wholesale market prices over the next quarter, year, or whatever period the customer is likely to stay with the supplier. If power-supply service to customers not taking competitive retail service is priced on a mix of short-term market prices and longer-term contracts, the PSS price will sometimes be higher than the competitive offers and sometimes lower. When the PSS price is below the prevailing market price, customers would tend to stay with, or switch back to, PSS service. If the contract prices result in a PSS price that is higher than the market price, customers would tend to leave the PSS for lower retail offers.

The possibility of the PSS deviating significantly from the market prices creates the following four potential problems.

- Stability of the PSS: If the market price declines (compared to earlier expectations), the PSS price may be greater than that competitive bidders would offer, resulting in migration from PSS to competitors. The short-term full-requirements purchases would automatically shrink as the PSS requirements decline, and the utility could let some mid-term contracts expire without replacement so the PSS would not be burdened with excessive supplies of power. But as PSS sales fall, the above-market costs of the longer-term contracts would be spread over smaller volumes of sales, requiring higher prices and promoting more migration. Unless customers are prohibited from leaving PSS, the entire mechanism for paying the PSS contracts may be undermined.
- Stability of competition: On the other hand, if the market price rises more than expected, the stable prices of the mid- and long-term contracts in the PSS portfolio will tend to keep the PSS price well below market. Competitive suppliers would not be able to match those prices, and retail competition would be limited until market prices came back into line with the portfolio.
- Higher prices for full-requirements supply: If the bidders on the short-term full-requirements supplies know that the PSS price may diverge significantly from the market, they may build into their prices the risks of (1) dumping large amounts of power into a weak market, if market prices fall and load migrates to competitive suppliers and (2) buying large amounts of power from an expensive market, if market prices rise and load returns to PSS. That risk premium could raise PSS prices.
- Gaming by large customers: As PSS prices rise above competitive offers, large customers will quickly migrate to the competitors. As PSS prices become economic, the large customers will return. Small customers are likely to respond more slowly, due to higher transaction costs. So small customers may bear more of the costs of any periods that PSS is above market, while getting fewer benefits when PSS is below market. Further limiting the rights of customers to switch would moderate this problem, but also interfere with competition.

The potential problems can be avoided by viewing the costs of the strategic resources in each year as having the following two parts:

- A market-equivalent portion, charged as part of the PSS rates;
- A portfolio differential, charged or credited to all customers through the delivery rates.

The market-equivalent portion of the cost could be valued based on the cost of short-term purchases, or by selling the supply resources into the short-term market. The remaining cost of the portfolio would be the portfolio differential.

Con Edison currently has this system in place for its strategic resources, including the SCS Astoria Energy PPA: market-equivalent costs are charged through the Market Supply Cost (“MSC”), while the portfolio differential, positive or negative, flows through the Monthly Adjustment Clause (“MAC”).

If the market prices are high in a particular year, the portfolio differential would be a net credit to all customers, whether they are supplied by PSS or a competitive supplier. If market prices are low, the portfolio differential would be a charge to customers. Thus, the long-term portfolio would have the direct effect of stabilizing total power-supply costs for all customers.¹⁰ All power consumers in the service territory would share the risks and rewards of the long term contracts.

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?

Utilities, if expected to move the market, must be given appropriate performance incentives and adequate assurance of cost recovery for the planning and procurement of strategic resources. Any utility that undertakes integrated resource management in good faith, following guidelines developed by the Commission or other supervisory organizations, should be entitled to expect full recovery of its costs.

Con Edison previously requested that the Commission provide a full guarantee of cost recovery for payments for energy and capacity that the utility planned to purchase following the issuance of an RFP, and its entry into a subsequent contract. This process, as noted above, ultimately led to the expeditious construction of the 500 MW Astoria Energy power plant. The Commission declined to provide that absolute guarantee, but otherwise encouraged Con Edison to proceed with the RFP.¹¹ The City of New York agrees that the PSC cannot offer any utility absolute assurance of cost recovery for future actions, but the Commission should clearly establish that the costs of reasonable commitments will be recovered, and that questions of prudence should properly be judged on the basis of the facts and circumstances known at the time of entry into such contracts. The standard for denying cost recovery should be very high. In particular, the Commission should clearly establish that the recovery of contract costs is independent of actual market costs over the life of a long-term contract; a reasonable commitment remains reasonable, even if economic conditions change after the fact, as can often be expected.

To increase the utilities' assurance of cost recovery, the Commission should provide clear direction and provide for oversight of the IRM process by its Staff and participation therein by other interested customer parties. If such parties are involved from the beginning, and they are able to support the utility's filings, the Commission will be better able to give the strong assurances the utilities seek.

The Commission should also consider whether the contract commitments are likely to affect a utility's credit rating. If that appears to be the case, the Commission should work with the utility to develop appropriate mechanisms to protect the company.

Alternatively, the State and the City of New York can consider the use of public

¹⁰ In addition, the new resources brought on-line in response to various RFPs will ensure adequate supply and help avoid price spikes due to capacity shortages and excessive reliance on natural gas or any other fuel.

¹¹ See Declaratory Ruling on Cost Recovery, *supra* at page 12

agencies, such as power authorities or other special-purpose entities, to contract with developers and charge customers directly, with the utility acting only as a billing agent.

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?

Long-term contracts are bilateral agreements, which are entirely consistent with the existing NYISO energy and capacity markets, and with potential forward capacity markets. No special effort should be necessary to harmonize long-term contracts with the markets.

There is no need for the NYISO market rules to recognize or ameliorate any effect that long-term contracts may have on the capacity prices paid to existing generators. In general, neither the Commission, nor any other party, guaranteed any particular set of capacity prices or market conditions to the owners of existing generation when they bought or built their plants. To the contrary, when the Commission approved divestiture of generation by the utilities, both the Commission and the utilities projected that new entry would reduce market prices dramatically. That was in large part the stated or implicit purpose of restructuring.

The owners of existing generation act in their self-interest in deciding whether to add or retire capacity at their facilities, and in pricing their energy and capacity to maximize their revenue. For example, it has been widely recognized that certain generators have economically withheld capacity in order to maintain high prices in Zone J. It is only equitable that participants on the load side of the market should act in their own economic interest, particularly in the face of such conduct and market conditions. Moreover, even in the absence of overreaching by incumbent market participants, generation and transmission market additions were always contemplated as an implicit part of the deregulated marketplace.

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

The City has no comments in this regard.

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