

**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**

City of New York

Reply Comments

June 25, 2007

I. Introduction

On June 5, 2007, a number of parties filed initial comments in response to the Commission's April 19, 2007 order in this proceeding. The City of New York ("City") is encouraged by these initial comments, as it appears that the overwhelming majority of respondents support reliance on long-term integrated resource planning, along with procurement of economically beneficial long-term contracts for new market resources. Moreover, there appears to be widespread support for the City's position that a long-term integrated planning process should be designed and implemented in accordance with the following basic principles:

- 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.
- 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*.

The following comments address issues raised in the June 5, 2007 initial comments in opposition to implementation of a statewide long-term planning process or procurement of economically beneficial long-term contracts.¹

¹ Initial comments were filed individually by a number of retail suppliers and collectively as the Retail Energy Supply Association. In large part, these individual and collective comments repeat the same arguments, and in some instances rely on *verbatim* text. As such, the City's reply comments refer collectively to these entities as "Retail Suppliers," except in those instances where an individual retailer raises a unique or distinct issue.

II. Need for Statewide Planning Process

Some parties dispute the need for, or benefits from, implementation of a statewide or utility-specific long-term planning process. Specifically, these parties argue that an integrated planning process would be duplicative of existing NYISO planning practices and could be harmful to ratepayers.

Consolidated Edison and Orange and Rockland (collectively “Con Edison”) and Retail Suppliers argue that a Commission-implemented long-term planning process would be largely duplicative of the New York Independent System Operator’s (“NYISO”) Comprehensive Reliability Planning (“CRP”) process. These parties note that the CRP process provides for a ten-year forecast of reliability needs, and thus argue that the CRP process already provides for the long-term planning process envisioned in the Commission’s April 19, 2007 Order.

The City’s position is that the statewide CRP process is not sufficient to ensure a healthy power market in Southeast New York. The CRP process is narrowly focused on reliability needs, and does not address the large-scale investments in supply and demand resources that will be needed to upgrade and modernize the City’s power infrastructure and promote other public policy goals.

The 2007 CRP process is a case in point. The City has called for the addition of 2,000-3,000 megawatts of new supply by 2015, and for the diversification and expansion of the City’s natural gas supply. In contrast, the reliability-driven CRP process merely identifies a need for 750 “compensatory megawatts” in that year, and does not address fuel supply requirements at all.

As was discussed at length in the City’s initial comments, a long-term integrated planning process can be designed to complement, not duplicate, the current CRP process. The CRP process is by design limited in its scope and remedies. It 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. Moreover, the design of the CRP process does not allow for consideration of public-policy goals, such as mitigating market power, improving environmental and health quality, or increasing fuel diversity. In contrast, a long-term integrated planning process can build on the NYISO’s reliability planning, identifying resource options that not only maintain reliability, but also minimize costs and advance public-policy goals.

While acknowledging these gaps in the CRP process, Con Edison asserts that Commission action would be premature at this time. Instead, Con Edison argues for a

wait-and-see approach, in order to allow time for the NYISO and market participants to refine the current CRP process and to develop new procedures in response to the Federal Energy Regulatory Commission's ("FERC") general directive in its recently issued Order 890 to expand the CRP process to include economic considerations.

Merely waiting and hoping for the best is not a prudent course of action. As noted in the City's initial comments herein, the NYISO has identified a need for new capacity in New York City starting in 2011, and determined that the market response has not been adequate to meet this identified need. It is simply not reasonable to expect that CRP procedures will be modified in an appropriate fashion and in time to identify and procure those resource options that meet immediate and longer-term reliability needs, minimize costs, and advance the State's other legitimate public-policy goals.² It would require fundamental changes in the core mission of the NYISO and in the mindsets of a majority of the market participants who participate in the development of its planning procedures.

Con Edison also contends that public policy issues are best addressed on a statewide basis, rather than a local basis.³ This might be appropriate if every part of the State faced the same challenges. However, as the City demonstrated in its initial comments, New York City faces a more urgent need for power market improvements and a different set of challenges than the rest of the State, and therefore needs a specific plan tailored to its needs.

Accordingly, the City in its recently issued *PlaNYC* proposed the creation of a local entity, the New York City Energy Planning Board ("Board"), to address both the supply and demand-side needs of New York City.⁴ The Board would include representatives of New York City, the State, and local utilities, and would primarily have the following responsibilities:

² Indeed, after more than five years of stakeholder deliberations, PJM has yet to implement an economic planning process. In the meantime, PJM has all but abandoned its original "market-based" economic expansion process that attempted to elicit market responses by providing data on hedged and unhedged congestion costs to market participants.

³ Although, as discussed above, Con Edison opposes a statewide integrated planning process outside of the NYISO.

⁴ *PlaNYC*, Energy Initiative 1, at pp. 105-106 (issued April 22, 2007), accessible at nyc.gov/html/planyc2030/html/home/home.shtml

- Reviewing and approving the long-range energy plans submitted by the local electric, gas, and steam utilities.
- Setting demand reduction and supply targets for New York City and monitoring the progress in achieving those targets.
- Participating in the process of developing solicitations for long-term power purchase agreements to meet energy supply needs.
- Recommending to the Commission appropriate funding levels for implementing the utilities' plans.

As conceived by the City, the proposed Board would not conflict with the Commission's proper role in oversight and approval of utility integrated plans and resource solicitations, and in developing strategic goals in collaboration with affected stakeholders. A number of such steps were recommended in the Comments submitted by Staff of the Department of Public Service in this matter on June 5, and the City supports the views expressed therein.

As was noted in the *PlaNYC* discussion of the subject, creation of such a Board will require legislative and/or regulatory action. The former is of course not within the Commission's control, and any legislative outcome remains uncertain.⁵ However, even in the absence of a statutory measure, the principles supporting the creation of such a Board – most notably the need for specialized planning in the State's largest and most critical load pocket – retain their force, and deserve consideration for implementation by the Commission.

⁵ A bill incorporating the *PlaNYC* provisions was introduced in the State Senate (as S.6068), but was not enacted in the regular 2007 legislative session.

Retail Suppliers argue that a long-term planning process is not only duplicative, but inherently harmful to competition and thus ratepayers. According to the Retail Energy Supply Association:

A centralized energy planning structure designed to replicate or displace market forces distorts the clarity of market signals, may undermine the efficient operation of competitive markets, and can harm consumers. Due to the inherent uncertainty of forecasting, projecting future electric requirements, and identifying long term electricity resource needs may result in uneconomic and inefficient decisions. Instead of relying upon a “command and control” centralized planning process that is burdened with constricting long-term contracts, the Commission should follow a more finely tuned flexible policy that seeks to discern discrete problems and formulate market based solutions and policies.⁶

Retail Suppliers’ arguments against long-term planning fall short in several respects. First, while in theory centralized planning is an inefficient substitute for market forces, the reality, at least in New York City, is that the market has not responded to clear market signals for new capacity. As documented at length in the City’s initial comments, there has been very little merchant resource development in the City, despite high energy and capacity prices signaling the profitability of such investments. It would not be reasonable for the Commission to fashion policy around theoretical constructs that clearly do not comport with the facts.

Second, there is an apparent contradiction between Retail Suppliers’ opposition to long-term planning and its support of the CRP process, since both processes suffer from the “inherent uncertainty of forecasting, projecting future electric requirements, and identifying long term electricity resource needs.” The fact is that any reasonable planning process, whether conducted for reliability or economic purposes, involves long-term forecasting with its attendant uncertainties. A long-term planning process should therefore be designed to account for forecast uncertainty in long-range projections, and to incorporate flexibility in resource plans to allow modifications to such plans as events unfold in the future.

Finally, Retail Suppliers mischaracterize long-term integrated resource planning as a rigid “command and control” process that ignores uncertainty, is inflexible, and mandates procurement of specific resources. In fact, as proposed in the City’s initial comments, a

⁶ *Initial Comments of the Retail Energy Supply Association and Small Customer Market Coalition*, Case 06-M-1017, at p. 4 (June 5, 2007)

long-term planning process would establish procurement targets for resource additions, not prescriptive limits on the types or amounts of capacity to be procured. In addition, a long-term planning and procurement process would rely to the extent feasible on market mechanisms, such as competitive procurements of long-term contracts to meet capacity and energy needs.

III. Need for Long-Term Contracts

Con Edison and Retail Suppliers oppose procurement of long-term contracts, because such contracts shift the risk of uneconomic investments from investors to ratepayers.⁷

According to Con Edison:

There should be no mandated long-term contracts for investor owned utilities. Requiring utility long-term contracts would substantially eliminate one of the principal objectives in adopting a competitive market policy – that the risk of infrastructure investments should be borne by investors of project developers and not by utility customers.⁸

Risk-shifting may have been the objective of the Commission’s competitive policy, but it has not been the outcome, at least with regard to investment in new capacity in New York City. As noted above, and as discussed at length in the City’s initial comments, developers apparently have been unwilling to fully assume the risk that investments in new generation in New York City will prove profitable over the long life of the asset. In fact, only a small portion of the new capacity added in recent years was developed on a merchant basis. Clearly, long-term contracts will be needed to spur investment in new generation (and transmission) in New York City.

Direct Energy Services (“Direct”) disputes the need for long-term contracting in the New York City market, arguing that competitive markets will respond without the need for government intervention. Direct supports its argument with an analysis of capacity

⁷ In the event that the Commission does support procurement of long-term contracts, Con Edison and New York State Electric and Gas, and Rochester Gas and Electric propose that utility investment in new generation be considered as an alternative to such contracts. The City generally supports consideration of utility-owned generation as a long-term resource option in cases where there may be compelling cost savings, or environmental or other benefits, *e.g.* in repowering Con Edison’s cogeneration facilities.

⁸ *Initial Comments of Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. Concerning Long-Term Contracts*, Case 06-M-1017, at p. 8 (June 5, 2007)

additions from 1998 to 2005 in three restructured state markets (Pennsylvania, Texas, and New York) and several foreign restructured markets. According to Direct:

This analysis shows that each of these restructured markets has seen robust investment in new capacity without resorting to extraordinary market interventions. As a result, we conclude that government intervention through mechanisms such as mandated long term contracts is not necessary to secure adequate investment in new generating capacity in restructured electricity markets.⁹

Direct's broad conclusion, particularly when applied to the New York City market, is not reasonably supported by its somewhat simplistic analysis of market response to industry restructuring. That analysis of restructured state markets overstates market response by including additions of capacity that were already under construction prior to restructuring. Market response in restructured states is also overstated by simply assuming that all capacity additions from 1998 to 2005 were developed on a merchant basis, ignoring the fact that a significant portion of these additions were utility-owned or contracted. Finally, Direct's claims regarding market response between 1998 and 2005 are largely inapplicable to the current market environment, since much of the growth in capacity occurred prior to the collapse of Enron and the consequent tightening of capital markets.

Direct also asserts that long-term contracting is unnecessary, because reliability needs can be met with dynamic pricing. Direct bases this argument on a forecast of the potential peak reduction from dynamic pricing in the New York City market. However, Direct's analysis is seriously flawed: the analysis forecasts a peak load for the "New York City Area" that is 50% greater than the peak load for the entire New York Control Area ("NYCA").¹⁰ As a result, Direct's analysis dramatically overstates the potential for peak reduction in New York City, since the analysis estimates potential peak reduction as a percentage of peak demand.

Although generally supportive of the use of long-term contracts to overcome market failures, Consolidated Edison Solutions and Consolidated Edison Energy also suggest that long-term contracts may prove to be unnecessary:

⁹ *Verified Statement of Drs. L. Lynne Kiesling and Andrew N. Kleit Addressing Long Term Contract Issues*, Case 06-M-1017, at p. 7 (June 5, 2007)

¹⁰ Inexplicably, Direct's analysis estimates load for the New York City area as the sum of load for NYCA as a whole, load for Zone J, and that for Zone K. *Id.* at p.18, Table captioned "New York City Area (NYCA+J+K)"

[T]he NYISO is considering alternatives to its capacity construct. If it adopts a forward market design along the lines of ISO-NE's Forward Capacity Market, that may provide a market mechanism to attract new resources. Such a market mechanism, coupled with the concurrent investment in energy efficiency and demand response measures, may be sufficient to obviate the need for mandated long-term contracts and other non-market solutions.¹¹

Claims such as this regarding the potential impact of a forward capacity market should be viewed with considerable skepticism. Indeed, similar predictions of robust market entry activity were made with respect to the May 2003 implementation of the costly demand curves in the NYISO capacity market, yet no new merchant projects have been built in New York City since the demand curve implementation. With the stakeholder process in its very earliest stages, the design of such a forward capacity market, or even the prospects for such a radical change to the existing capacity market, are uncertain at this time. Moreover, there is currently no evidence from either ISO New England or PJM that implementation of forward capacity markets in these regions has attracted new investment.

In contrast to Direct, Liberty Power ("Liberty") and Hess Corporation ("Hess") acknowledge the need for government intervention to secure investment in new capacity in New York City. However, like Direct, Liberty and Hess argue that long-term contracting is not the appropriate solution. Instead, Liberty claims that the only barrier to private investment is the lack of a comprehensive siting process:

Once siting problems are addressed, market solutions to New York's capacity needs will appear and will make any discussion of the need for long term utility contracting moot.¹²

Hess also claims that the lack of a comprehensive siting process (along with potentially discriminatory interconnection standards and the lack of economic-development funding) is:

... more relevant and significant to whether new and cleaner electric generation can be constructed in or interconnected into New York than any absence of long-term contracts.¹³

¹¹ *Comments of Consolidated Edison Solutions, Inc. and Consolidated Edison Energy, Inc.*, Case 06-M-1017 at p. 8 (June 5, 2007)

¹² *Initial Comments of Liberty Power*, Case 06-M-1017, at p. 5 (June 5, 2007)

¹³ *Comments of Hess Corporation*, Case 06-M-1017, at p. 26 (June 5, 2007)

The lack of a comprehensive siting process may well be a significant barrier to new entry in New York. However, neither Liberty nor Hess offers any evidence to substantiate their claim that the resolution of siting problems will obviate the need for long-term contracts in New York City. In fact, as discussed in the City’s initial comments, there are generation projects in New York City that have had siting approval under PSL Article X for several years, but have not moved forward (*e.g.*, the Astoria Repowering project) or moved forward with construction only after entering into a long-term contract (*e.g.*, SCS Astoria Energy Phase I, which has obtained a long-term PPA with Con Edison).¹⁴

Finally, Retail Suppliers argue that utility pricing of long-term contracts may harm retail competition:

[I]f the utility’s default price for electricity is to be set in any way incorporating the pricing in the long term contract it would result in prices that are not market reflective and thereby impair the competitive retail market. The longer the term over which prices are “fixed” through contract, the greater the probability that the price will diverge from the market – when contract exceeds market customers will over-pay for their usage or, when market exceeds contract, consumers will receive a price signal that their power is less expensive than it actually is, resulting in over-use.¹⁵

In its initial comments, the City proposed a competitively neutral mechanism for recovery of long-term contract costs that renders this argument moot.¹⁶ Under the City’s proposal, long-term contract costs would be collected in two pieces: (1) the market-equivalent portion; and (2) the portfolio-differential portion. The market-equivalent portion would be priced at a “market” rate and charged to customers taking default supply from the utility. The portfolio-differential portion would be set at the difference between contract cost and the market-equivalent rate and charged to all delivery customers. This two-part pricing mechanism would provide efficient market-price

¹⁴ It is telling that SCS Astoria Energy Phase II, which has obtained an Article X permit but has *not* obtained a PPA, has not been built to date.

¹⁵ *Initial Comments of the Retail Energy Supply Association and Small Customer Market Coalition*, at p. 13 (June 5, 2007)

¹⁶ Hess raises a related issue that long-term contracting introduces the potential for rate shock when a contract expires. Rate shock is unlikely to be a problem, since the price impact from expiration of one contract within a broad portfolio of varying-term contracts would likely be minimal. Nevertheless, the City’s pricing proposal would also eliminate the risk of rate shock.

signals to utility default customers, while allowing all customers to share in the risks and rewards of long-term contract costs through the portfolio-differential portion.

IV. Impact on Existing Capacity

IPPNY generally supports consideration of long-term contracts, but argues for limited application due to concerns over the impact of such contracts on installed-capacity (“ICAP”) revenues for existing capacity. IPPNY’s specific concern appears to be that procurement of capacity in excess of reliability requirements – in order to reduce ratepayer costs or to achieve public-policy goals – will depress ICAP market prices paid to existing generators. IPPNY apparently believes that this price decline could be substantial if the entity procuring capacity under long-term contract offers that bilateral contract into the ICAP auctions as a price taker, *i.e.*, at a zero price.¹⁷

In light of this concern, IPPNY recommends that utilities not be allowed to procure capacity through long-term contracts in excess of that required to meet reliability needs, as those needs are identified through the CRPP and to the extent that such needs are not met with market-based solutions. IPPNY also recommends that such contracts be procured through what it styles as “non-discriminatory” solicitations that are open to both existing and new resources, apparently so that existing resources can offer and receive contract prices comparable to those of new resources. If solicitations are closed to existing resources, IPPNY recommends in the alternative that utilities be required to bid contracts with new resources into the ICAP market at the prices that reflect contract costs.

IPPNY’s recommendations are unreasonable and, at least according to Con Edison, contrary to the intent of FERC as expressed in Order 890. Limiting procurement to capacity needed for reliability would arbitrarily and needlessly foreclose opportunities to minimize ratepayer costs, mitigate price volatility, improve environmental and health quality, and advance other public-policy goals. As FERC determined in Order 890 with regard to transmission planning:

¹⁷ The NYISO allows buyers of bilateral contracts to offer such contracts in at zero price, reflecting the fact that it is economically rational for the buyer to participate as a price taker.

Although planning to maintain reliability is a critical priority, it is not the only one. Planning involves both reliability and economic considerations. When planning to serve native load customers, a prudent vertically integrated transmission provider will plan not only to maintain reliability, but also consider whether transmission upgrades or other investments can reduce the overall costs of serving native load.¹⁸

Most troubling is the fact that IPPNY's recommendations would allow existing generators to continue to profitably withhold capacity and thereby maintain high prices in the New York City ICAP market. ICAP prices in New York City have stubbornly remained at elevated levels, even with implementation of the demand curve, and the addition of 1,000 MW of new capacity in 2006. IPPNY's proposal to limit the procurement of long-term contracts in order to preserve these non-competitive prices is clearly contrary to the public interest.

IPPNY's proposal to allow long-term contracts with existing resources will likely yield the same unreasonable outcome – elevated ICAP revenues flowing to existing generation sources through other means.¹⁹ This proposal would allow existing generators to price their capacity at the cost of new capacity, or well above their actual incremental costs. As a result, existing capacity would receive contract revenues comparable to or even greater than that expected from the ICAP auction.

IPPNY's proposal to require contracts with new resources to be bid into the ICAP market at contract cost may also harm ratepayers. As discussed in initial comments by Con Edison and Staff of the Department of Public Service, ratepayers could end up paying twice for this contract capacity if the market clears below the contract cost and the contract does not clear in the market. In this case, the utility (and thus ratepayers) would have to buy capacity through the auction at the market-clearing price to cover the contract capacity that did not clear, while also paying the contract price for that contract capacity.

More generally, IPPNY's proposal would require that a new resource under long-term contract be bid in to the ICAP market at a price that exceeds its marginal capacity cost. In other words, IPPNY's proposal would force such resources to set their offers above

¹⁸ FERC Case Nos. RM05-17-000, RM05-25-000, *Order 890*, ¶ 542 (issued February 15, 2007)

¹⁹ As noted in its initial Comments, the City supports consideration of separate solicitations for short-term contracts with existing capacity in New York City, provided that adequate safeguards are in place to ensure that such contracts do not provide an opportunity for divested generators to circumvent existing price caps.

economically rational levels, and possibly force the market to clear above competitive levels. Such an outcome would distort price signals, provide windfall profits to existing resources, and needlessly increase capacity costs to utilities and their customers.

V. Conclusion

For all the reasons set forth herein and in the foregoing comments of the City of New York submitted in this matter on June 5, 2007, the Commission should undertake the revisions to the commodity supply process proposed by Staff, and such amendments thereto as were suggested by the City.

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Respectfully submitted,

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