BRICKFIELD BURCHETTE
RITTS & STONE, PC

June 5, 2007

Honorable Jaclyn A. Brilling, Secretary
New York State Public Service Commission
3 Empire State Plaza
Albany, NY 12223-1350

Re: Case No. 06-M-1017 - Proceeding on Motion of the Commissioner as to the Policies, Practices and Procedures for Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers

Dear Secretary Brilling:

Enclosed for filing in the above-referenced case, please find an original and ten (10) copies of the *Comments of Nucor Steel Auburn, Inc. on Phase II Issues.*

Very truly yours,

James W. Brew

Attorneys for Nucor Steel Auburn, Inc.

Enclosure

Cc: All Active Parties

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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

COMMENTS OF NUCOR STEEL AUBURN, INC.
ON PHASE II ISSUES

The Commission initiated this assessment of long term resource planning questions in its *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 (the "Phase II order"). In brief, Nucor Steel Auburn, Inc. (Nucor) supports the Commission's effort in this regard. A comprehensive re-assessment of New York's energy planning practices is overdue, as is reflected in Nucor's comments to the Commission's questions that are provided below.

A. Background

New York's electric energy policy in the 1980s and early 1990s had a strong central planning element that was captured in a state-wide energy master planning process. Utilities justified planned generation and transmission additions based on their individual load and supply assessments, including long term contracts with merchant generation, with due consideration to fuel diversity, environmental and other factors addressed in the state-side energy plans, but that planning process otherwise had little force or effect. Over the past decade, that approach has given way to reliance on (1) the NYISO reliability needs assessment process; and (2) market based investment decisions.

The NYISO process disavows making recommendations concerning "economic" transmission or generation resource needs.

New York's effort at competitive power markets has been underway for more than a decade. The bottom line, as Governor Spitzer noted in April of this year, is that New York electricity prices are now the highest in the nation, excepting only the island state of Hawaii.[1] Moreover, from a resource perspective, as noted in the Phase II Order, notwithstanding very high location based marginal prices ("LMPs") and a NYISO Reliability Needs Assessment that points to a looming infrastructure crisis in the New York City metropolitan area,[2] existing NYISO policies have not stimulated timely investment in needed generation and transmission.

This circumstance is not unique to New York, but appears to be a common feature of LMP based markets that are directed by FERC "organized" market pricing policies. In fact, a 2003 EPRI report entitled "Electricity Sector Framework for the Future" quoted this succinct observation from one interviewed stakeholder:

> In the old public service model, it was always better to be 100 megawatts oversupplied rather than one kilowatt undersupplied. Today the reverse is true, and the incentive for system improvement has been lost.

Stated another way, the old regulatory model required a reasonable level of excess capacity while the new paradigm seeks as much scarcity as FERC or the Commission will tolerate.

---

1 See, Governor Spitzer's April 19, 2007 speech, "15 by 15," A Clean Energy Strategy for New York.

2 Phase II Order at 30.

The prevailing NYISO practices, when combined with insufficient price response from loads (and particularly weather sensitive loads that drive system peak demands) produces a dysfunctional market that persistently tests the regulatory tolerance for scarcity rather than pursuing sustainable energy solutions. To date, the Commission has relied upon the NYISO and FERC to develop various administrative "repairs" to prevent market abuses (e.g., reliability must run contracts and price caps), and to ensure that an adequate level of capacity resources are available (e.g., demand curve adjusted capacity payments). These actions, however, seem to have institutionalized the scarcity incentive and reliance on regulatory intervention rather than market forces premised on a continuous interaction of supply and demand.

For these reasons, although competitive commodity markets are consumer oriented (i.e., focused on consumer needs and preferences) electric markets in New York remain "regulator-oriented" (i.e., market participants focus on securing favorable Commission, NYISO and FERC policies). Consequently, voting sector alignment among NYISO market participants currently has a greater impact on state resource decisions than many Commission policy directives.

Also, consistent with its previous comments in this docket, the New York City recently announced its "PLANYC" energy plan that includes establishing a NYC Energy Planning Board as well as energy efficiency, infrastructure and long-term energy supply goals. PLANYC calls for state-wide energy planning and localized plans for various segments of the State as well. NYC correctly recognizes that there are, in fact, sharp distinctions between the energy requirements of New York City and Long Island (steady peak load growth driven by weather sensitive usage with significant load pocket,

transmission congestion, strategic generation and new facility siting limitations) and most Upstate areas (low or stagnant load growth restrained by manufacturing job flight, adequate local generation supply).[3] These distinct needs should be addressed in any state-wide energy planning process.

Finally, as the Phase II Order recognized, broader economic and environmental factors, such as the chronic upstate job flight associated with high energy prices and climate change concerns described in Governor Spitzer's "15 by 15" speech, are not addressed by the NYISO/FERC planning or market practices at all.[4] The Commission has begun to pursue some of these factors in parallel with the NYISO markets. For example, the Commission has adopted a renewable portfolio standard for electric energy supply, it recently directed utilities to file revenue decoupling plans as a premise for greater utility promotion of energy efficiency,[5] and it has initiated a proceeding to pursue an energy efficiency portfolio standard.[6] These are policies the State intends to pursue regardless of resource actions that otherwise would occur through the NYISO/ FERC markets, but there is no articulated strategy linking the Commission and NYISO/ FERC actions.

Governor Spitzer's clean energy strategy for New York aims to provide that comprehensive link and confront and overcome the three great challenges of "rising

---

3 *See* Phase II Order at p. 35, fn. 30.

4 See Order at p. 32.

5 Cases 03-E-0640 and 06-G-0746, *Order Requiring Proposals for Revenue Decoupling Mechanisms*, issued April 20, 2007.

6 Case 07-M-0548, Proceeding on Motion of the Commission regarding an Energy Efficiency Portfolio Standard, *Order Instituting Proceeding*, issued May 16, 2007.

energy bills, rising global temperatures and a rising tide of young people leaving New York for opportunity elsewhere." This overarching state energy directive cannot be accomplished by NYISO market policies that do not aim even to address those goals.

B. Overview and Basic Assessment

The collective effect of the NYISO/ FERC market programs and piecemeal New York initiatives has been sustained high and uncompetitive electricity prices, on-going uncertainty concerning resource additions that inevitably leads to short lead time (natural gas fired) investments, remarkably little price responsive load, and alternative energy savings programs (RPS) that require rate surcharges to finance. The NYISO's most recent "Power Trends 2007" report describes a looming need for significant energy infrastructure (generation, transmission and demand response) in the New York metropolitan area.[7] The NYISO also observed that the state has become excessively reliant on natural gas to fuel electric generation, and that there is no sign of this trend abating.

Other states have recognized that FERC's market-based policies are not producing power prices or resources that square with state energy and economic development objectives. Connecticut has been exploring legislative changes to its restructuring program that may provide for long-term contracting and possibly permit utilities to build generation plants. Pennsylvania is considering a slate of energy policies

---

[7] *See* Order at p. 35.

("Energy Independence Strategy")[8] that bears many of the efficiency, clean energy and economic development objectives outlined in Governor Spitzer's energy speech. The Pennsylvania strategy notably includes a goal to make Pennsylvania more economically competitive in part by encouraging "large energy consumers to enter into long-term contracts with stable, cheaper prices with their energy provider".[9]

In response to widespread criticism of its wholesale power market policies, FERC also has been conducting a series of technical conferences on various wholesale power market issues. At a May 8, 2007, technical conference on demand response in wholesale markets, Harvard professor William W. Hogan observed:

> In regulating wholesale electricity markets there are at least three conditions that appear necessary to guide and precipitate timely action. First, we need to decide who is in a position to act, or we must create someone if there is a vacuum. Second, we need a framework for integrating what will be necessarily a set of related decisions and actions rather than shooting a single silver bullet. Third, there has to be a well-defined problem statement with understandable actions available that could address the issue; diagnosis without prescription presents only a circumstance, not a problem.[10]

Dr. Hogan's observation seems an appropriate place to begin the Commission's assessment of its Phase II questions in this proceeding.

---

8 www.depweb.state.pas.us/energyindepent/site/default.asp

9 *See* February 1, 2007 press release of Pennsylvania Governor Rendell. New York began its exploration of electric industry restructuring in similar fashion in 1994 by promoting flex rate contracts for commercially at-risk manufacturing loads. *See* Case 93-M-0229, *Competitive Opportunities Available to Customers of Electric and Gas Service,* Opinion No. 94-15, issued July 11, 1994.

10 "Acting in Time: Regulating Wholesale Electricity Markets," Comments of William W. Hogan, May 8, 2007 in FERC docket No. AD07-7-000

New York needs to direct its electricity infrastructure development with clearly articulated economic development, reliability and environmental priorities. The NYISO/FERC reliability planning and market policies are inadequate for this purpose. In fact, it has been established that the LMP based organized markets are uniformly deficient in addressing resource adequacy concerns. The State should not abdicate this responsibility to a federally regulated process in any event, and it cannot effectively pursue a reasoned energy strategy on a piecemeal basis. Thus, there should be a state resource planning process.

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 should establish a comprehensive and integrated electricity resource planning process. The purposes of the state-wide energy planning process must be three-fold:

1. Establish State energy resource, economic development (attraction and retention of quality jobs) and environmental priorities;
2. Align regulatory policies and those priorities; and
3. Integrate regulatory and market practices to achieve those priorities.

An integrated energy planning process that does not aim to cure the deficiencies observed in the NYISO reliability planning process[11] is not worth undertaking. Similarly, a process that focuses only on promoting discrete (e.g., low-carbon) technologies without aligning the resources being pursued with New York's power system requirements will not be sustainable. The principal distinction between the new energy planning process and its IRP and state energy planning predecessors is that the findings and priorities resulting from the new planning process should serve as a formal guide for Commission generation, transmission, demand response and renewable energy policies as well as utility procurement actions.

The energy resource planning process should be conducted by the Commission biennially for the Upstate and Downstate regions and should invite participation by all interested parties. This process should incorporate the results of the most recent NYISO reliability needs and regional transmission planning studies as appropriate.

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?

Long-term contracting with supply, demand-side or renewable resources is not a fungible silver bullet for the all of the State's resource needs and concerns. New York has long experience with long-term contracting for generation resources that should be

---

[11] Order at pp. 32-33.

considered before fashioning any overarching State policy, and that experience argues strongly against a uniform pronouncement of procurement policy. Historically, regulated utility additions to rate base reflected the lowest risk to investors for generation and transmission investment. This approach provided for a return of and on all prudently invested capital over the life of the assets, and provided a stable return to investors for transmission, baseload and peaking generation. Notwithstanding a small number of spectacularly over budget projects (*e.g.*, Shoreham and Nine Mile Point Unit No. 2), prudence disallowances were a rare occurrence. If minimizing risks to investors were the sole consideration, arguments could be made for a return to cost of service or performance based regulation for generation supply. As the Phase II Order notes, however, the Commission continues to support reliance on market forces where "feasible." (Order at p. 29).

Next, the Commission in the past has required utilities to enter into long-term contracts (up to twenty years) with qualified non-utility generators at guaranteed prices based on long run avoided cost estimates under a legislatively mandated policy (Section 66-C of the Public Service Law) that aimed to promote non-utility generation development. This 1980s policy certainly jump-started investments in non-utility projects, but it produced excessive levels of uneconomic purchased power costs for utilities that remain a burden on consumers today.

Finally, with the divestiture of generation assets in the late 1990s, utilities typically received relatively long-term (up to ten years) agreements for capacity, energy or both from the asset buyers. Those contracts have served as a principal source of hedged supply for several utilities.

The above long term contracting arrangements are instructive from both investor and consumer perspectives. Learning from that experience, the Commission's policy consideration in this docket should not begin by asking whether merchant generators want long term contract price assurances to assuage investor risk. The responses from consumer and investor interests will be predictable but not particularly useful. Instead, the Commission should begin with a defined set of state energy priorities that integrate economic development, reliability, and environmental considerations. It should then consider the menu of contracting, performance requirements and related considerations that will best realize those objectives. A presumptive solution (long-term contracting) not tied to defined State goals can hardly be expected to achieve those objectives. As seen from historic experience, all resource contracting policies contain elements of risk for consumers as well as project developers. Contracts for projects (supply, transmission, peak load reduction, etc.) that meet a defined goal, however, can be crafted to balance investor and consumer risks and benefits.

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?**

All load serving facilities in the State should be encouraged to enter into resource arrangements that advance the State's economic development, reliability and environment goals.

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

As the Phase II Order notes,[12] there are substantial differences between the Upstate and Downstate resource requirements. Efforts to perform resource procurement on a coordinated, state-wide basis, likely will provoke unnecessary complications and fail to accommodate those basic differences. A more practical approach would include separate Upstate and Downstate assessments and priorities.

5. What barriers, if any, exist that discourage long-term contracts for development of new electricity resources? What 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?

Most competitive commodity markets promote a blend of short and longer term procurement based on the dynamics of the interaction of supply and demand. This rarely happens in electricity markets because there is little meaningful energy storage or load response to changing supply conditions. As a result, the NYISO/FERC market policies create a compelling incentive for short term contracting (the profit potential inherent in vertical price curves) that is mitigated somewhat by price caps and market power mitigation efforts.

Key barriers to the development of new electricity resources include a general reluctance of many NYISO market participants to relieve congestion, create generation surpluses, promote significant price responsive load, or take any other action that would

---

[12] Order, p. 35, fn. 30.

lower market prices. Since those market participants are "regulator-oriented" rather than consumer-oriented, uncertainty in regulatory policies (economic and environmental) is a key barrier to the development of new resources. For example, investors might reasonably wonder what level of natural gas prices would prompt a State policy shift from decisively gas-oriented to encouraging clean coal or new generation nuclear technologies in order to serve growing electric demand. Clarifying State energy priorities and practices should precede the development of special incentives for particular resources.

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?

There is no apparent reason for promoting long-term contracts for existing resources. By the same token, there is no need in a generic policy docket to disqualify any form of generation, transmission, or demand response resource that could meet the State's objectives.

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?

The Commission should not micro-manage resource procurement practices so long as the practices are aligned with the State's defined objectives.

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?

The Commission should address recovery of long term contract costs from consumers that can purchase hedged commodity products in utility rate cases. Recovery mechanisms should consider a variety of cost, risk and performance factors.

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

There is a considerable spectrum of investor and consumer risk issues running from investments based on locational pricing to contract cost estimate pre-approval. These are best addressed by the Commission in utility rate cases or special proceedings.

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 Commission must make a threshold determination either to follow NYISO/FERC market pricing policies or to lead them. As the Phase II Order accurately notes, the NYISO RNA process does not address numerous significant State energy concerns, and the prevailing NYISO/FERC energy and capacity markets have failed to keep prices competitive or induce timely infrastructure investments. Perhaps the NYISO will move toward a forward capacity pricing model along lines similar to the New England RTO and PJM. It does not appear, however, that adopting this type of market

feature will mitigate the negative influence of such mechanisms on transmission upgrades or encourage fuel diversity (though it may promote greater demand response). In short, a forward capacity pricing mechanism will not answer most of the Commission's Phase II questions.

The Commission first should establish its energy policies and priorities, then consider whether and how the NYISO/FERC market practices support or impede those goals, and finally pursue any changes in the NYISO process that are needed to help the State accomplish its objectives.

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

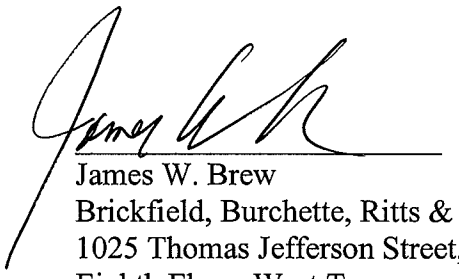
New York faces a great challenge in securing energy prices that are more competitive while achieving environmental goals or mandates. Under any reasonable circumstances, the State's reliance on natural gas-fired generation is going to continue to increase. Significant clean coal or nuclear additions, even if favored by State policies, would require many years to develop. Absent substantial energy storage developments, emerging wind power developments will not make much of a dent in satisfying growing Downstate peak load growth. These circumstances strongly argue for aggressive Commission policies to promote price response behavior, especially by weather sensitive loads in constrained Downstate areas. There is, however, significant unfinished work in the Commission's smart metering, portfolio hedging, and mandatory real-time pricing policies that requires a hard look and determined action. Existing policies seem content to expose large manufacturing loads to market prices to promote more efficient consumption while shielding weather sensitive loads that actually drive New York's

system peak demands from those price signals. Addressing this inconsistent disconnect in Commission policy represents the State's greatest opportunity in the short term for economically efficient, reliability enhancing and emission reducing change.

Conclusion

For the reasons stated above, Nucor Steel Auburn, Inc. urges the Commission to establish a comprehensive energy planning process that will direct New York's energy resource decisions and policies.

Respectfully submitted,



James W. Brew
Brickfield, Burchette, Ritts & Stone, P.C.
1025 Thomas Jefferson Street, N.W.
Eighth Floor, West Tower
Washington, D.C. 20007
Tel: (202)342-0800
Fax: (202) 342-0807
jbrew@bbrslaw.com

Attorneys for Nucor Steel Auburn, Inc.

June 5, 2007