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VIA HAND DELIVERY

Honorable Jaclyn A. Brillling  
Secretary  
State of New York  
Public Service Commission  
Three Empire State Plaza  
Albany, New York 12223-1350

Re: 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.

Dear Secretary Brillling:

Pursuant to the Commission's Order Requiring Development of Utility-Specific Guidelines For Electric Commodity Supply Portfolios and Instituting A Phase II to Address Longer-Term Issues, issued on April 19, 2007, in the above-referenced proceeding, Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. hereby file an original and ten copies of their reply comments.

Please contact me if you have any questions regarding this matter.

Very truly yours,

/s/

Richard B. Miller

cc: Active Parties (via e-mail)

**NEW YORK STATE PUBLIC SERVICE COMMISSION**

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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. :  
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**REPLY COMMENTS OF CONSOLIDATED EDISON COMPANY OF NEW YORK, INC. AND ORANGE AND ROCKLAND UTILITIES, INC. CONCERNING PHASE II ISSUES**

Consolidated Edison Company of New York, Inc. (“Con Edison”) and Orange and Rockland Utilities, Inc. (“O&R”) (collectively, the “Companies”) hereby submit these reply comments in response to the Commission’s April 19, 2007 Order (“Order”) in the above-captioned proceeding. The Companies respond principally to the initial comments of Department of Public Service Staff (“Staff”) concerning integrated resource planning (“IRP”) and long term contracts.

**Preliminary Statement**

In their initial comments, the Companies requested the Commission to refrain from mandating long term utility contracts and that, to the extent such contracts are needed to satisfy a reliability need when there is no other alternative available, the Commission should provide an appropriate balance between cost recovery assurance and incentives for the risks inherent in such contracts.

In essence, the Staff initial comments propose that the Commission undertake a major change in policy that would reverse the continuing development of competitive markets. Staff’s comments are contrary to the Commission’s statement in the Order (at 29-30) that it

has consistently found that the development of competitive markets, where feasible, will assist in assuring the provision of safe and adequate utility services at just and reasonable costs. We have consistently endorsed competition where it is more effective than regulation, but also realize that markets alone may not automatically satisfy a broad range of public policy needs and goals.

The Commission should continue to allow competitive markets to mature and develop. Indeed, most parties filing initial comments support the continuation of competitive markets. Moreover, the markets, and especially the potential improvements to the markets (such as a forward capacity market), must be given time to more fully develop, which can only take place in the absence of regulatory proceedings that contemplate changes in market structure and otherwise undercut market development.<sup>1</sup> Accordingly, the Commission should also reject the Staff proposal for expedited interim utility planning proceedings that would result in procurement plans to be completed within four months of the issuance of the Commission's order in this proceeding.

To the extent long term contracts are necessary on a last resort basis to satisfy an identified reliability need, the Companies support the Staff proposal to have the Commission pre-approve such contracts for cost recovery. But, even with pre-approval, the Commission must recognize that long term contracts will have a financial impact on utilities, which would most likely have these contracts imputed as utility debt. Finally, to the extent that utility involvement in resource procurement is required, a utility's ability to build generation as an alternative should be an option. The Commission should accordingly reject the proposal of the Independent Power Producers of New York ("IPPNY") that the alternative for a utility to build a needed project can only be an option

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<sup>1</sup> The Companies believe that the Governor's goals for a clean and efficient electricity system can be best achieved through working with the wholesale competitive market structure, coupled with Commission supported initiatives and policies such as with respect to energy efficiency.

after other competitive alternatives are exhausted. The Commission should preserve its flexibility in this regard by recognizing that such decisions should be made on a case-by-case basis.

The Staff comments raise important questions concerning the continuation of the competitive wholesale market. The Staff comments, to the extent they indicate the Commission is considering embarking on a significant change in direction on its policies regarding competition and resource acquisition, should be subject to in depth discussion and analysis. The Company respectfully recommends that the Commission give stakeholders a full opportunity to provide input regarding such a significant change, including the opportunity to participate in technical conferences with the Staff and/or Commissioners and for oral presentations to the Commission so as to provide the greatest likelihood that important changes such as those suggested in the Staff comments are fully considered.

## **Discussion**

### **1. The Commission Should Decline to Adopt the Staff Proposal to Change to a Regulatory Regime in which Utility-Specific IRPs and Long Term Contracts Are Used in the First Instance to Finance New Infrastructure.**

In its initial comments, Staff proposes that the Commission adopt a dynamic electric planning process (“DEPP”) that would be aimed at having utilities file procurement plans to meet established energy goals that have been approved by the Commission. Specific utility plans, once approved by the Commission, would then be implemented to achieve the DEPP goals. The Commission should refrain from adopting this Staff proposal for several reasons. First and foremost, the proposal should be rejected because it is contrary to the Commission’s policy that competitive markets

should be the first choice for achieving reliability, environmental and economic goals. Second, the DEPP would run in parallel with the NYISO comprehensive reliability planning process (“CRPP”) and would likely supplant the NYISO process. Third, Staff’s emphasis on long term contracts as an option for meeting energy goals is misplaced. The Commission should also decline to adopt Staff’s two specific proposals for Con Edison’s service territory, that: (1) existing generators “harmed” by long term contracts should be eligible for cost-based capacity contracts; and (2) Con Edison should be required to obtain environmental permits in advance of issuing any request for proposals (“RFP”) to ensure sufficient participation by merchant generators.

Staff claims that its proposed DEPP can be coordinated with the NYISO CRPP, but the DEPP as described by Staff would effectively become the means by which all new resources are procured, whether for reliability or public policy needs, supplanting efforts by other developers to implement new projects. It is, in fact, difficult to discern a need for the NYISO CRPP if the Staff proposal were adopted. As explained in their initial comments, the Companies support a role for the Commission in the CRPP, as embodied in the Joint Proposal that underlies Con Edison’s existing rate plan. Specifically, the rate plan provides that, if there is a reliability need and no viable merchant solution exists, Con Edison would make a filing with the Commission before proceeding with a project to maintain reliability.<sup>2</sup> This procedure is consistent with the competitive market principles articulated in the Order -- Staff’s proposal is not.

The Staff proposal to implement expedited, interim utility procurement plans should also be rejected. Staff does not provide a justification for this expedited procedure. Staff asserts (at 6) that it is necessary to ensure that “higher priority

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<sup>2</sup> Case 04-E-0572, *Order Adopting Three-Year Rate Plan*, \_App., p. 75 (March 24, 2005).

procurement efforts are commenced promptly,” but it does not identify any such “higher priority” projects. As the Companies explained in their initial comments, if the Commission desires making a substantial change in policy direction, it should order a thorough investigation to first determine whether there are specific State public policy goals that are not currently being achieved and whether there is a need for development of specific mechanisms to achieve those goals. Moreover, Staff’s proposed expedited procedure would occur at the same time the Commission is proposing to implement other new policies (*e.g.*, an energy efficiency portfolio standard) on an expedited basis. The Commission should act in a deliberate fashion before making any significant changes to procurement practices when the need for any generation or transmission could be affected by increased energy efficiency and/or demand response.

With respect to long term contracts, Staff’s comments assume that such contracts are the preferred option for financing new infrastructure, but Staff fails to address the difficulties with long term contracts. A thorough discussion is warranted, among other reasons, because long term contracts raise the potential that, once again, utilities and their customers could be saddled with long term uneconomic contracts that were based on forecasted market conditions, similar to what happened under the contracts mandated by PURPA and the State’s “six cents law.”

Long term contracts will also likely have a negative financial impact on utilities. As the Companies explained in their initial comments, under Financial Accounting Standards Board issued Interpretation No. 46 Revised (FIN 46R), Consolidation of Variable Interest Entities, long term contracts may be treated as utility debt. As Staff itself states (at 18), “providing cost recovery assurances will act to minimize the potential

for rating agency imputations of a contract's costs as debt to a utility, " but it will not eliminate all risk for utilities, financial and otherwise. There still would be a substantial risk for utilities, even with contract pre-approval, although pre-approval of long term contracts is essential and supported by the Companies because pre-approval would at least mitigate disputes about cost responsibility and prudence regarding such contracts.

Staff comments also erroneously assume that an RFP process for long term contracts would be straightforward and easy to administer. The Companies' experience has been otherwise. Typically, in order to avail itself of market creativity, the utility would be required to employ a broad and open-ended process, specifying only those items that must be provided to meet the minimum requirements of a need that is otherwise not met by the market. A pre-determined and highly quantified evaluation algorithm only encourages gaming and restricts creativity that could reduce risk to utilities and their customers. These broad requirements, however, lead to complex evaluations in the area of price and risk to customers, relative reliability impacts of projects, environmental and other public policy objectives, and risk to utility shareholders. It should not be assumed that evaluating offers will be a simple "apples-to-apples" comparison. Staff's examples (at 14) of successful RFPs are temporary transition contracts the utilities entered into with the divested generators. These are not the same RFPs that would be required for new electric infrastructure, which will be much more complex.

A further challenge will be balancing the need for commercial confidentiality with the public's demand for information during and after the process. If the utility divulges too much information, it could be impaired from obtaining the most appropriate

terms. Finally, the process to find a competitive supplier may not result in a viable, cost-competitive project, which can result in substantial delay when speed is essential.<sup>3</sup>

The problem with Staff's position is further demonstrated by its proposal to compensate existing units for capacity through cost-based rates. As the Companies cautioned in their initial comments (at 18), long term contracts for new facilities could result in the need to provide financial support to existing generators. To address this issue, Staff is willing to accept a return to cost-of-service regulation, stating (at 25) that "cost-based long term contracts could be entered into with existing generators so that they can meet their fixed costs." But, as Staff readily concedes (at 25), this will result in complex proceedings: "Admittedly, disputes over the legitimacy of those costs would have to be resolved in order to price the contracts, and it would have to be decided if a generator should not receive a contract because its facility lacks long term value to the City and its residents." In addition, determining the capacity revenue requirement for existing generators will not be easy even if they are willing to divulge financial information; *e.g.*, energy market revenues can change year to year and any agreement for fixed cost compensation on capacity must be net of revenue contributions from energy markets.<sup>4</sup>

The Staff proposal to have Con Edison acquire permits prior to any RFP is inappropriate and should also be rejected. First, entities other than Con Edison have been successful in acquiring permits for construction in the New York City area. Second,

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<sup>3</sup> Cases 96-S-1065, 96-S-1121, *Order Concerning Phase II Steam Plan Report*, at 11 (Dec. 2, 1999) ("Con Edison will not be required to issue an RFP or to provide rate impacts relating to the repowering of East River because such requirements would unnecessarily delay the divestiture of Waterside").

<sup>4</sup> The Federal Energy Regulatory Commission has stated that reliability must run agreements are contrary to competitive market principles and should be used as a last resort only. *E.g.*, *Blumenthal v. ISO New England, Inc.*, 117 FERC ¶ 61,038, at P 58 (2006).

there is no way to know whether the permits that Con Edison would acquire would be the ones that the developers would desire or need, and recovery of Con Edison's permitting costs, whether they lead to a successful project or not, would unnecessarily burden ratepayers and potentially result in a misallocation of finite company, governmental and other stakeholder resources.<sup>5</sup>

**2. Utilities Should Have the Flexibility to Acquire Resources in the Manner Determined to be Reasonable and the Commission Should Reject the IPPNY Proposal to Adopt Formal Rules Governing When a Utility Can Build Generation.**

As the Companies explained (at 11) in their initial comments, the option for a utility to construct a project needed for reliability may be more straightforward and otherwise desirable. In addition, a utility built project can often be competitively bid because the utility could competitively bid engineering, procurement or construction. The Commission should reject the implication in the IPPNY comments that this alternative is necessarily inferior to long term contracts.<sup>6</sup> In other words, the utility should have the discretion to propose development of a generation facility, transmission enhancement, energy efficiency or a joint venture with other entities.

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<sup>5</sup> If the State or City desires to pre-designate specific sites or locations for generation development, such as a "generation empowerment zone," they can seek to do so by establishing an expedited or abbreviated process for siting in those areas.

<sup>6</sup> IPPNY suggests (at 10) that Con Edison's East River Repowering Project ("ERRP") had excess costs. As discussed in Con Edison's System Reliability Assurance Study, which was completed pursuant to the Company's electric rate plan adopted in Case 04-E-0572, ERRP is in the same range of capital costs on a dollar per kilowatt basis as the costs of the new KeySpan-Ravenswood plant, the new NYPA-Poletti plant, as well as a new generic combined-cycle plant in New York City. Moreover, ERRP was built in Manhattan in an existing generating plant. IPPNY also fails to note that a utility built generating facility provides customers with long term benefits in the form of lower energy costs because the utility would likely be required to bid its "to-go" costs.

IPPNY asserts that a formal process should be adopted that requires a utility RFP for competitive providers before a utility may build on its own. The Commission should not adopt such a rigid rule. The better process to follow is the flexible one provided for in the current Con Edison electric rate plan. As described above, the electric rate plan provides that, if there is a reliability need and there is no proposed merchant project to satisfy the need, then Con Edison would make a filing with the Commission that contains its proposal on how to proceed. Other stakeholders will have the opportunity to comment. Further, under the NYISO process, any stakeholder with a specific alternative could suggest its project for consideration as an alternative regulated solution, and if such an alternative can meet the identified reliability need as determined by the NYISO, the stakeholder can provide that information to the Commission as part of its comments.<sup>7</sup> IPPNY specifically supported this provision of the Con Edison electric rate plan because it “ensures that the Commission will receive a full airing of the solutions – and processes – proposed by the company.”<sup>8</sup> The Con Edison electric rate plan process will preserve the Commission’s flexibility, while the IPPNY proposal, if adopted, would unnecessarily constrain the Commission’s discretion. This is especially important when it concerns projects to maintain reliability. Finally, there may well be other circumstances where utility initiative would be beneficial and it should not unduly constrained by adoption of the IPPNY proposal.

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<sup>7</sup> Under the NYISO process, developers may submit alternative regulated proposals to the Commission at any time for review. Stakeholder discussions have indicated a preference for the NYISO process to defer to the Commission if more than one regulated alternative is presented to solve a reliability need, so that the Commission may determine which project is most suitable to meet that need. Instead of introducing a planning process independent of the NYISO’s, the Commission should consider enhancing the NYISO process by establishing a specific mechanism to choose the most appropriate solution when more than one project exists.

<sup>8</sup> IPPNY Letter Comments in Support of Joint Proposal (December 15, 2004).

