**STATE OF NEW YORK**
**PUBLIC SERVICE COMMISSION**

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| **PROCEEDING ON MOTION OF THE COMMISSION AS TO THE POLICIES, PRACTICES AND PORCEDURES FOR UTIITY COMMODITY SUPPLY SERVICE TO RESIDENTIAL AND SMALL COMMERCIAL AND INDUSTRIAL CUSTOMERS** | **:** | **Case No. 06-M-1017** |

**REPLY COMMENTS OF**
**CONSTELLATION ENERGY COMMODITIES GROUP, INC.**
**AND CONSTELLATION NEWENERGY, INC.**

## INTRODUCTION

Pursuant to the New York Public Service Commission's ("Commission" or "PSC") directives in its April 19, 2007 Order[1] in the above docketed proceeding, Constellation Energy Commodities Group, Inc. ("CCG") and Constellation NewEnergy, Inc. ("CNE") (collectively, "Constellation") hereby submit their reply to parties' initial comments to the Commission's questions regarding the use of long term contracts and other means to facilitate the entry of new resources ("PSC Questions").[2]

Constellation in its initial comments argued that New York's utilities should not become engaged in integrated resource planning ("IRP") processes or active portfolio management in order to obtain new generation resources.[3] Furthermore, Constellation argued that competition in New York's energy market should recognize the changing consumer environment and transfer financial and other risks from customers to entities (and their shareholders) who are capable of best managing price and delivery risk. Constellation moreover urged the Commission to refrain

1 *Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II to Address Longer-Term Issues,* Commission Case No. 06-M-1017 (issued Apr. 19, 2007) ("April 19 Order).

2 April 19 Order at pp.36-37.

3 *See, generally, Comments of Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc.*, Commission Case No. 06-M-1017 (filed June 5, 2007) ("Constellation Initial Comments").

from implementing long term contracts, but recommended that if the Commission orders their use, it should limit their use only for investment in special circumstances.

In these reply comments, Constellation responds mainly to certain proposals offered by the Commission Staff ("Staff") in its initial comments.[4] Constellation specifically urges the Commission to: (1) reject Staff's proposed "Dynamic Energy Planning Process";[5] and (2) reject Staff's proposal for utilities to enter into cost-based long term contracts.[6] Implementation of Staff's proposals would constitute a step backwards and in effect incorrectly render competition in New York a failure.[7] Constellation instead maintains that the best way to encourage long term contracting and resource planning is through improving existing market constructs as well as new, market-based programs to encourage resource investment.

## CONSTELLATION REPLY COMMENTS

*PSC Question **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*

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4 *See, generally, Staff Initial Comment*, Commission Case No. 06-M-1017 (filed June 5, 2007) ("Staff Comments").

5 *See* Staff Comments at pp.4-8.

6 *See* Staff Comments at pp.

7 *See, e.g., Verified Statement of Drs. L. Lynne Kiesling and Andrew N. Kleit Addressing Long Term Contract Issues*, Commission Case No. 06-M-1017 (filed June 5, 2007) ("Direct Energy Statements") at p.12 (stating that "[t]he thrust of this proceeding . . . is to abandon market forces and return to precisely the regulated structure that created the stranded cost problem in the first place. We strongly recommend that the Commission not take these steps. Rather, we suggest that any relevant problems can be addressed without abandoning market processes and their self-correcting tendencies, and the benefits those market forces bring to society as a whole"); *see also Initial Comments of Independent Power Producers of New York, Inc.*, Commission Case No. 06-M-1017 (filed June 5, 2007) ("IPPNY Comments") at p.3 (stating that "[t]he Commission should not lose confidence in the competitive market . . . [and] should do everything possible to ensure that market forces, instead of regulatory intervention, achieve the required level of resource adequacy and other public policy goals in New York"); *see also Initial Comments of Niagara Mohawk Power Corporation*, Commission Case No. 06-M-1017 (filed June 5, 2007) ("NiMo Comments") at pp.28-29 (stating that "National Grid believes that a regulated [IRP] process would move the State back towards a process that was used when vertically integrated utilities were heavily regulated . . . [and a] return to IRP would mean abandonment of competitive markets and likely an eventual return to full regulation"); *see also Initial Comments of the Retail Energy Supply Association and Small Customer Market Coalition*, Commission Case No. 06-M-1017 (filed June 5, 2007) at p.2 (stating that "the 'new' policies are little more than old wine in a new bottle – a veritable throwback to the highly controlled and static regulatory structure that epitomized the electric industry in earlier decades. This approach did not achieve much success in the past and is less likely to prove useful in the current competitive wholesale and retail energy market").

> *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?*

Staff in its initial comments proposed a two track IRP process which it deems a "Dynamic Energy Planning Process" ("DEPP"): Track I would evaluate long term energy planning over a 15- to 20-year horizon, and would be conducted every three years; Track II would evaluate energy planning over a five-year period, and would be conducted annually.[8] As was the case historically with IRPs, Staff proposed that through the DEPP, a resource procurement plan would be developed to "accommodate various public policy goals established by the Commission or propounded by the stakeholders, and would be submitted to the Commission for its review and approval."[9] Utilities would then have to "implement specific recommendations through targeted procurement mechanisms" including through long term contracts.[10] Staff would "monitor implementation of the various planning efforts" and would issue "progress reports" which would "[monitor] progress towards acquiring previously-identified resources."[11]

Constellation at the outset notes that the "Dynamic" in "DEPP" is a mischaracterization of Staff's IRP process. The term "dynamic" implies a process that constantly adjusts to reflect changing characteristics of and circumstances in the marketplace; there is nothing "dynamic"

8 *See* Staff Comments at pp.5-6.

9 Staff Comments at p.2.

10 Staff Comments at p.3.

11 Staff Comments at p.6.

about a process which makes decisions based on five- to 20-year planning horizons, even if the process attempts to re-evaluate its decisions annually for its five-year IRP and every three years for its 15- to 20-year IRP.

Constellation in its initial comments provided the Commission with seven clear reasons why an IRP process is not the appropriate approach to meet resource adequacy, environmental, resource diversity and other policy goals. Constellation below reiterates and applies those arguments to a *non*-dynamic IRP process, specifically to Staff's proposed DEPP:

(1) While well-intentioned, IRP such as that provided by Staff's proposed DEPP provides little ultimate value as it is based on incorrect assumptions that central planning and government-run procurement processes can outperform the market, and only provides for prescriptive lists of actions which will tend to be outdated shortly after being written, despite Staff's referring to such process as "dynamic." A five-year plan may be out of date in less than one year given market changes due, for instance, to shifts in policy at a federal, regional, state or agency levels; a 15- to 20-year plan may very well be out of date within three years, as new technologies rapidly develop and become increasingly cost-effective from year-to-year, making previous technologies or previous iterations of the same technologies and their costs obsolete.

(2) A more effective way to achieve environmental and resource diversity goals is, as several other commenters suggested, to implement new, market-based programs – *e.g.*, Renewable Portfolio Standards and cap and trade programs – rather than use of command and control edicts characteristic of IRP processes such as Staff's proposed DEPP.[12] Environmental standards have had a tendency to change over short time

[12] *See, e.g.*, Direct Energy Statements at pp.12-21 (discussing "appropriate solutions" that address the problems "through means other than state-mandated long term contracts"); *see also*, IPPNY Comments at p.3 (stating that

periods; a particular resource technology has a tendency to both develop and/or become outdated quickly as new technologies arise; and costs for both environmental compliance and new resource technologies change rapidly. Given such examples of market characteristics which change quickly, it is evident that plans under the DEPP's command and control regime will always be out of date and trying to catch up to the market, whereas market participants left to their own devices will constantly – and *truly* dynamically – adapt and account for market changes and will reflect such changes in any responses to market-based incentive, portfolio standard or cap and trade systems.

(3) Though Staff proposed "progress reports" to monitor "progress towards acquiring previously-identified resources,"[13] Staff has not explained, with even a modicum of detail, how it may be possible for Staff to make such evaluations and reports. Staff has not outlined the standards of progress it will apply or the questions it will ask to evaluate the success of a particular resource plan. Moreover, any progress reports on plans that by the time of review already are outdated, brings into question any real world value of such an IRP process in a changing marketplace.

(4) IRP such as that proposed through Staff's DEPP has failed in the past, and such failures of past IRP policies were major drivers for restructuring the electric industry towards reliance upon competitive and market-driven structures. As Niagara

meeting New York's policy goals "can best be achieved with properly designed and functioning wholesale markets"); *see also* NiMo Comments at p.6 (stating that "[t]he Commission should begin its deliberations in this proceeding by searching for solutions within the competitive markets themselves to address its resource adequacy and public policy concerns").

13 Staff Comments at p.6.

Mohawk Power Corporation d/b/a National Grid ("NiMo") cautioned in its initial comments:

> [i]t should be recalled that the State abandoned this very process in favor of markets, which the State believed would provide better results at lower costs to customers . . . [NiMo] does not believe that such extreme measures are warranted or desirable . . . relatively modest adjustments to the current market regime are likely to accomplish the desired results better and more cheaply.[14]

(5) Staff's DEPP would have utilities ordered to enter into certain long term contracts and support particular types of resources, perhaps including new technologies, and would place the ultimate responsibility for the costs of such decisions on the utilities' customers, as was the case under past IRP processes. As argued jointly by Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. ("ConEd-O&R"), with regard to such long term contracts:

> There can be no question that one of the major factors that led to industry restructuring was the extreme dissatisfaction with long-term contracts that were mandated in the 1980's and 1990's . . . . As the Commission explained when it started electric industry restructuring, ". . . [Under restructuring, competitive] providers (generators and energy service companies) would bear more of the risk of investment decisions, and customers less, than under regulation."[15]

The future risk of procurement and investment decisions in the State has already been and should continue to be appropriately placed on market players and not with utility ratepayers.

(6) The proposed DEPP would be redundant – and not complimentary as suggested by Staff – to a number of established planning tools already employed by policy makers in New York, including NYISO's Comprehensive Reliability Planning Process

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14 NiMo Comments at p.29.

15 *Initial Comments of Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. Concerning Long-Term Contracts*, Commission Case No. 06-M-1017 (filed June 5, 2007) ("ConEd-O&R Comments") at pp.8-9, *quoting* Commission Opinion No. 96-12 (May 20, 1996) at pp.30-31.

("CRPP"), which identifies generation and transmission resources needed to maintain statewide reliability standards. ConEd-O&R explained in their initial comments that they "recognize the role that informed policy input can play in ensuring that the competitive market achieves overall policy goals and objectives *in the most cost-effective manner*, and the CRPP allows for that input."[16]

(7) Finally, a reintroduction of IRP through Staff's proposed DEPP may be perceived as a statement by the Commission that electric industry restructuring has failed, though countless studies, some of which are identified in Constellation's initial comments, have proven otherwise. Indeed, NiMo noted that "[a] return to IRP would mean abandonment of competitive markets and likely an eventual return to full regulation."[17]

Staff argued that "New York needs [an IRP] to ensure that electric infrastructure needs are met on a cost-effective basis consistent with adequate protections for the environment and achievement of public policy goals."[18] Constellation reiterates, however, that IRP has been tried and has failed in the past, and that the most "cost-effective" method of achieving these laudable goals is instead through support of the State's decision to transition to competitive markets by improving on existing market constructs and implementing additional market-based initiatives.

16 ConEd-O&R Comments at p.6 (*emph. added*).

17 NiMo Comments at p.29.

18 Staff Comments at p.4.

*PSC Question* ***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?*

In addition to its DEPP, Staff proposed in its initial comments that "entry into long-term contracts [by utilities] should be *facilitated* so that infrastructure needs are met and public policies are advanced."[19] As Drs. Kiesling and Kleit pointed out in their testimony submitted on behalf of Direct Energy, LLC, the supply resources within New York are more than ample to meet reliability needs until at least 2014 outside of New York City and Long Island.[20] In addition, they indicated that it is not at all clear that long term contracts or IRP processes will have any effect at all in addressing the real impediments to bringing additional power supply into those heavily populated areas. What is clear from their testimony, however, is that restructured markets can and do induce investment in diverse supply resources without the need for central planning and without long term contracts.[21]

Staff went on, however, to state that "it is now *necessary* to rely upon [long term contracts by utilities] to bring forth the resources needed to meet reliability and public policy needs."[22] While Constellation in its initial comments made several pro-competitive, market-based proposals which would help *facilitate* the entry of long term contracts by market participants, it strongly recommended against *requiring* utilities to enter into such contracts. In addition to the arguments made by Constellation, NiMo noted that:

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19 Staff Comments at p.9 (*emph. added*).

20 *See, generally,* Direct Energy Statements at pp.4-10.

21 *See* Direct Energy Statements at pp.4-10.

22 Staff Comments at p.18 (*emph. added*).

> as now recognized by states such as California that have required delivery utilities to enter into long-term contracts, such an approach is incompatible with retail access . . . . Mandatory long-term contracting also severely limits flexibility to make a smooth transition to a competitive capacity market . . . as no such transition may be made until the contracts lapse.
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> Regulatory cost recovery with mandatory long-term contracts introduces distortions and perverse incentives into the markets . . . .
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> Finally, the potential for discouraging the construction of adequate transmission capacity to load pocket problems is particularly severe under the long-term contracting approach . . . .[23]

NiMo adds that "the disadvantages of long-term contracting far outweigh their advantages, as has been the experience in a number of states, including New York with its PURPA contracts and California with its forward energy contracts."[24]

*PSC Question 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?*

Staff pointed out in its comments that there are barriers to the entry of long term contracts by parties, including: (1) regulatory uncertainty; (2) siting obstacles; and (3) financial and credit ratings risks. Staff incorrectly seemed to cite that financial considerations with respect to credit risks and regulatory risks are the main obstacle to overcome, and therefore went on to suggest guaranteed cost-based recovery by utilities for long term contracts. Constellation, however, noted in its initial comments and maintains that, with respect to nearly all renewable and traditional fossil based resources, *siting* rather than financing is the major impediment to new

[23] NiMo Comments at pp.27-28.

[24] NiMo Comments at p.32.

investment.[25] This point was further buttressed by the comments of the Hess Corporation describing a new generation plant it has proposed to constructi in Bayonne, New Jersey, which will inject power into Zone J.[26] Hess stated that:

> In developing this project, Hess' concern is not whether or not there is an absence of IRP or long-term contracts. Rather, Hess' concern as to this project is the imposition of expected interconnection deliverability requirements to be proposed by the NYISO in June 2007.[27]

*PSC Question **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?*

As noted above, Staff suggested in its comments that utilities be guaranteed recovery of the costs of any long term contracts in which they are ordered to enter into. Staff explained that "providing cost recovery assurances [to utilities] will act to minimize the potential for rating agency imputations of a contract's costs as debt to a utility, relieving financial pressures on utilities that might discourage them from entering into such contracts."[28] Constellation itself noted that *if* utilities are ordered to enter into long term contracts, "the Commission should assure that utilities' customers pay in their retail rates all of the costs that the utility incurs as their service provider,"[29] and Constellation cannot argue with the statement that 'guaranteeing recovery by utilities of the costs of long term contracts relieves financial pressure on utilities.' However, guaranteeing such recovery *shifts* all of the financial pressure and risk to such utilities'

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[25] Constellation explained, however, that, there are perhaps some resources whose development may require some form of long term commitment. The only example of such a resource which Constellation presently is convinced may require such long term commitment is investment in nuclear power, as nuclear plants require a very long lead time for development, with significant capital costs, as well as a very long time period over which capital outlays must be recovered.

[26] *See Comments of Hess Corporation*, Commission Case No. 06-M-1017 (filed June 5, 2007) ("Hess Comments") at p.3.

[27] Hess Comments at p.3.

[28] Staff Comments at p.18.

[29] Constellation Initial Comments at p.18.

ratepayers. In fact, adopting Staff's proposed policy of cost-based long term contracts will be akin to the State's movement back to full vertical integration and regulation. ConEd-O&R correctly pointed out in their initial comments that returning to such long term contracts, in this way:

> would substantially eliminate one of the principal objectives in adopting a competitive market policy – that the risk of infrastructure investments should be borne by the investors of project developers and not by utility customers.[30]

## CONCLUSION

Constellation reiterates its Conclusion from its initial comments that New York's utilities should not become engaged in IRP processes such as Staff's proposed DEPP or active portfolio management in order to obtain new generation resources. It is more appropriate to transfer risks from customers to entities (and their shareholders) who are capable of best managing price and delivery risk. Moreover, the Commission should refrain from implementing long term contracts, but, if the Commission orders their use, it should limit their use only to support "backstop solutions" as part of the NYISO's CRPP or for investment under other unique and compelling circumstances. Implementation of Staff's proposed DEPP and use of cost-based long term contracts will, in effect, turn New York back to the days of full regulation and vertical integration and, in turn, will take the burden of risks of investment away from the competitive market's participants and place it squarely on the backs of New York's consumers. Constellation appreciates the opportunity to submit both its initial and reply comments in response to the PSC Questions presented in the April 19 Order, and looks forward to continued dialogue regarding all of the issues presented in the above docketed proceeding.

[30] ConEd-O&R Comments at p.8.

Respectfully Submitted,

/s/

Divesh Gupta, Esq.
Constellation Energy Group, Inc.
111 Market Place, Suite 500
Baltimore, Maryland 21202
(410) 468-3468
divesh.gupta@constellation.com

*On Behalf of*
*Constellation Energy Commodities Group, Inc. and*
*Constellation NewEnergy, Inc.*

**Dated: June 25, 2007**

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that I have served on this 25th day of June, 2007 the foregoing document by electronic mail to all parties on the Service List for this proceeding.

/s/

Divesh Gupta