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June 25, 2007

VIA HAND DELIVERY

Hon. Jaclyn A. Brillling
Secretary
New York State Public Service Commission
Executive Office 14th Floor
3 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
Reply Comments

Dear Secretary Brillling:

Enclosed are the original and ten copies of the Reply Comments of AES Eastern Energy, L.P., Dynegy Power Corporation, Inc., Entergy Nuclear Power Marketing, LLC, and the Mirant Parties in the above-referenced proceeding.

Please date stamp the enclosed copy of this letter and return it to our messenger as proof of filing. If you have any questions with respect to this filing, please call or email me.

Very truly yours,

GREENBERG TRAUIG, LLP



Doreen U. Saia

DUS/aaw

Enclosures

cc: Official Service List (via U.S Mail & email; w/enc.)

ALB 1106933v1 6/19/2007

**NEW YORK STATE
PUBLIC SERVICE COMMISSION**

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

**REPLY COMMENTS OF AES EASTERN ENERGY, L.P., DYNEGY
POWER CORPORATION, INC., ENTERGY NUCLEAR POWER
MARKETING, LLC AND THE MIRANT PARTIES**

June 25, 2007

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PUBLIC SERVICE COMMISSION**

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In accordance with the schedule established by this Commission in its “Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II To Address Long-Term Issues” (“Long Term Contracts Order”) issued in the above-captioned proceeding, AES Eastern Energy, L.P., Dynegy Power Corporation, Inc., Entergy Nuclear Power Marketing, LLC and the Mirant Parties¹ (“New York Suppliers”) hereby submit their Reply Comments.^{2,3}

As discussed in detail, infra, the New York Suppliers support the Initial Comments submitted by the vast majority of parties that there is no basis to substantially alter the course away from the competitive market framework that this Commission adopted a decade ago. Thus, the New York Suppliers urge the Commission to proceed with due deliberation in this proceeding as it considers whether any further changes are needed to these markets. Commission action should be guided by the following principles: (i) any changes must first be

¹ The Mirant Parties are comprised of Mirant Bowline, LLC, Mirant Lovett, LLC and Mirant New York, Inc.

² The New York Suppliers hereby reserve all their rights to raise any issues in the future, including, but not limited to, those associated with jurisdiction.

³ The New York Suppliers fully support the Reply Comments being submitted contemporaneously in this proceeding by the Independent Power Producers of New York, Inc. and Astoria Generating Company, L.P., a US Power Generating Company.

fully and fairly considered in a collaborative process involving all interested stakeholders; (ii) any changes must be compatible with, and not otherwise undermine, the competitive markets that already are in place; (iii) market responses must be the preferred response to satisfy both reliability needs and any carefully targeted, narrowly tailored public policy goal; and (iv) in the absence of sufficient market based solutions, regulated projects must go forward through open and competitive solicitation processes.

I. EXECUTIVE SUMMARY

Faced with generating facilities being run inefficiently, mounting stranded generation investment costs and increasing electric costs, this Commission issued Opinion No. 96-12, abandoning the failed cost of service, vertically integrated utility structure in favor of disaggregation and retail competition in the electric markets.⁴ In so doing, the Commission emphasized that merchant competitors -- which would have no captive ratepayers on which to rely to support their operations or to fund their mistakes -- would have a greater incentive to operate more efficiently and minimize costs than utilities under the cost of service ratemaking structure. (See Competitive Opportunities Order at 30.) The Commission further focused on the fact that merchant generators -- and their respective shareholders alone -- would be required to bear the risk of investment decisions; New York's consumers would no longer be held captive to such investments. (*Id.* at 31.)

The concepts underlying competitive markets are straightforward. Merchant markets require two critical components: (i) an efficient market design free of major regulatory risk; and (ii) a level playing field. Merchant parties then use their best business judgment to make

⁴ See PSC Case 94-E-0952, In the Matter of Competitive Opportunities Regarding Electric Service, "Opinion and Order Regarding Competitive Opportunities For Electric Service" (issued May 20, 1996) (hereinafter "Competitive Opportunities Order").

investments in these markets. And, they bet their shareholders' money to do it. When making investment decisions, merchant parties will consider technology and fuel type, including associated environmental costs. In a refined, locational based, marginal clearing price market such as that in place in New York, merchant parties also will consider location of assets. Lastly, merchant parties will take steps to build new units more economically and operate existing units more efficiently. All of these steps are aimed at competing successfully against other merchant parties to supply the energy, capacity and ancillary services to meet the electric needs of New York's consumers.

The New York Suppliers must respond herein to three arguments raised in the Initial Comments submitted in this proceeding because, in each instance, the argument made violates the core competitive market tenet that a level playing field must be maintained. First, the New York Suppliers strongly oppose the Dynamic Electric Planning Process and the obvious return to a "command and control" regulatory scheme proposed by the Staff of the New York State Department of Public Service ("DPS Staff"). Second, the New York Suppliers oppose the proposal included in the comments of a number of utilities that they are best poised, and thus, should be permitted to re-enter the generation business in lieu of entering into contracts with merchant parties to construct needed facilities. Third, the New York Suppliers oppose the premise advanced by Multiple Intervenors and the City of New York that load side mitigation measures are not necessary⁵ because generators were always on notice that new facilities --

⁵ Because these parties have raised the load side mitigation issue in this proceeding, the New York Suppliers are responding to it herein. However, resource adequacy issues, including this load side mitigation issue, are squarely FERC jurisdictional issues. In fact, in the proceeding to consider the New York City capacity markets currently pending before the FERC ("FERC In City ICAP Proceeding"), several parties have raised the need to incorporate load side mitigation provisions into the New York Independent System Operator, Inc. ("NYISO") tariffs. See FERC Docket No. ER07-360-000, New York Independent System Operator, Inc., "Protest of the NRG Companies" (dated January 24, 2007) at 5; see also, FERC Docket No. ER07-360-000, supra, "Protest of KeySpan Ravenswood, LLC to New York Independent System Operator, Inc.'s Tariff Revisions To Modify Installed Capacity Market Mitigation Measures Applicable to Certain In-City Generating Units" (dated January 24, 2007) at 4-5.

apparently, even government sponsored, uncompetitive ones that artificially suppress market clearing prices -- would be added to the system.

If implemented, any of these proposals will destroy the level playing field for all other parties and further chill investment. Forced to operate under such a skewed structure, merchant parties are likely to require additional support to replace what will have been stripped from the altered market. One “band-aid” solution will likely beget another band-aid solution to address the next shortfall, further skewing the playing field. And so on. In the end, the incentives that otherwise would be produced under a well functioning, fair competitive market structure will be lost.⁶ Thus, as demonstrated, *infra*, each of these proposals must be rejected.

II. REPLY TO INITIAL COMMENTS

A. **Any Commission Action in this Proceeding Should Be Measured and Should First Be Reviewed in a Full Collaborative Process Designed To Identify Unaddressed Issues in the NYISO Process, if Any, and the Manner in Which To Resolve Them**

As clearly reflected in the initial comments, the vast majority of parties believe that wholesale changes to the competitive market structure are not needed and re-regulation -- either in form, or equally important, substance -- is not warranted.⁷ Most parties balked at the premise that there could or would be a return to the good old days, painfully remembering that such days were not, in fact, so good.⁸ Importantly, the parties sharing this view span across all market

⁶ Con Edison raises similar concerns in its Comments, stating, “Indeed, one could be left with a ‘market’ where there are new generators that have long-term contracts to operate, existing generators with reliability contracts, and very few generators left that operate in a purely competitive manner.” (See Con Edison Comments at 18.)

⁷ See, e.g., “Initial Comments of Niagara Mohawk Power Corporation”; “Initial Comments of the National Energy Marketers Association”; “Comments of Constellation Energy Commodities Group, Inc. and Constellation Newenergy, Inc.”

⁸ See, e.g., NMPC Initial Comments at 7-8; “Initial Comments of Multiple Intervenors on Phase II Issues” at 5-7.

sectors and often have different -- and, on occasion, vastly different -- economic and other interests.

Specifically, there was a general consensus among the commenting parties that the existing NYISO Comprehensive Reliability Planning (“CRP”) process adequately identifies reliability needs on the New York system over a ten year time frame. Thus, to the extent any process by this Commission is necessary at all, most parties agreed that the Commission’s efforts must be measured, narrowly tailored and structured to act as a complement to, not in lieu of, the NYISO CRP process.⁹

In addition, given the magnitude of issues highlighted in this Commission’s eleven questions in this proceeding and their potentially far-reaching impacts, both Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. (collectively, “Con Edison”) and Niagara Mohawk Power Corporation (“Niagara Mohawk”) urged in their respective Initial Comments that the Commission conduct a thorough collaborative proceeding to first determine whether there are specific State public policy goals that are not being achieved. (See CE Initial Comments at 1-2; NMPC Initial Comments at 5.) In support of its position, Con Edison pointed to past major Commission initiatives, including the Competitive Opportunities Proceeding. (*Id.*) The New York Suppliers fully support this request.

As reflected in the NYISO’s 2007 Reliability Needs Assessment, significant reliability needs are projected on the New York system by 2011. New York State must attract the capital necessary to fund this new infrastructure. Adjoining regions also are facing tight capacity situations that are projected to occur in the same general time frame. Thus, New York is currently competing for a finite stream of investment dollars. In its Competitive Opportunities

⁹ See, e.g., NMPC Initial Comments at 29-30; “Comments of the Long Island Power Authority” at 2; MI Initial Comments at 3-4.

Order, this Commission stressed that it “expect[ed] to see market-based solutions to public policy issues rather than regulatory mandates.” (See Competitive Opportunities Order at 30.) In the Long Term Contracts Order, this Commission reaffirmed its commitment to competitive markets. (See Long Term Contracts Order at 29.) There is no basis to change course now. The Commission’s actions in this proceeding must endorse -- not speak louder than -- its words.

Thus, given the scope of issues identified by the Commission, a proceeding solely on paper to decide these issues is wholly insufficient. These issues must be fairly and comprehensively addressed in open, collaborative proceedings to allow all parties to provide input and feedback into the process and monitor its outcome. Indeed, ruling by regulatory fiat based only on paper submissions is likely to further breed the very regulatory uncertainty that has stymied past investment. This would be true under any circumstances. The indisputable need to attract investment dollars now makes the need for a full and open collaborative proceeding all the more compelling.

To the extent that it is ultimately determined at the culmination of the collaborative process that some additional Commission action is needed, care must be taken to limit its impacts on the competitive markets.¹⁰ Any appearance that the competitive market playing field will be unduly tilted will chill the stream of needed future investment dollars. As many parties with divergent interests concurred in their respective initial comments,¹¹ to the degree that it is determined that the Commission should go forward in the future to address public policy goals,

¹⁰ Niagara Mohawk emphasized the same concerns, stating, “Obviously, any resource adequacy mechanism the Commission adopts must be tailored carefully to hold to a minimum such distortions of competitive market price signals, and to avoid undercutting the viability of merchant generators or to creating disincentives for construction of sufficient transmission in needed locations.” See NMPC Initial Comments at 10.

¹¹ See, e.g., “Comments of the New York Power Authority” at 5; “Responses of the New York Independent System Operator, Inc.” at 3; NMPC Initial Comments at 23; “Comments of the New York State Consumer Protection Board” at 9.

the Renewable Portfolio Standards proceeding structure provides an appropriate template to use as a starting point for narrowly tailoring such efforts to avoid unintended impacts to the competitive markets.¹²

Given the potential impacts of this proceeding, one final issue must be raised concerning its structure. Since the time that initial comments were submitted, this Commission issued a notice concerning its SEQRA Environmental Assessment Form in a generic proceeding that was instituted shortly after the Long Term Contracts Order was issued.¹³ As its name suggests, the Energy Efficiency Proceeding will address this Commission's proposed action to establish an electric and natural gas energy efficiency portfolio standard in New York State and, potentially, the implementation measures for such portfolio standards. (See EAF Notice at 1.) Previously, this Commission has satisfied the SEQRA requirements when it instituted other major initiatives, e.g., the Competitive Opportunities Proceeding.¹⁴ As was true in these cases, here, too, the Commission must demonstrate that it has fully met the SEQRA requirements.

B. DPS Staff's Dynamic Electric Planning Process Proposal, Together With Its Arbitrarily Condensed Time Line To Implement an Interim Plan, Must Be Rejected

In its Initial Comments, DPS Staff envisions a role for this Commission that is far broader than supported by almost any other party.¹⁵ Waxing over the successes produced by

¹² See PSC Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard (hereinafter, "RPS Proceeding").

¹³ See PSC Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard (hereinafter "Energy Efficiency Proceeding").

¹⁴ In the Competitive Opportunities Proceeding, the Commission, acting as lead SEQRA agency, issued a positive declaration concerning the potential for environmental impacts. It subsequently issued a Final Generic Environmental Impact Statement shortly before the Competitive Opportunities Order was issued. The Commission then addressed its SEQRA findings at length in the Competitive Opportunities Order. (See Competitive Opportunities Order at 83-89.)

¹⁵ Adopting such a far-reaching approach only was supported by a small number of parties -- the New York State Consumer Protection Board, the City of New York, NUCOR Steel Auburn, Inc. and Central Hudson.

competitive markets and the fact that limited new generation has been constructed to date due to a number of factors, including current surplus conditions and past regulatory uncertainty,¹⁶ DPS Staff baldly pronounces that an extensive, two-track planning process, called the “Dynamic Electric Planning Process” or “DEPP,” must be implemented in New York State.¹⁷ (See DPS Staff Initial Comments at 2.) Under this thinly veiled command and control process, the Commission will decide the type, amount and location of new resources that will be added to the system; the utilities then will be required to submit plans ensuring such resources are constructed. (*Id.* at 6-8.) As proposed by DPS Staff, DEPP implementation will begin with an “expedited interim” plan for all electric utilities to address “higher priority procurement efforts.” Per DPS Staff, this process will be completed within four months of Commission issuance of an order in this proceeding. (*Id.* at 6.)

As clearly reflected throughout DPS Staff’s comments, the basis for the Commission to direct resources to be added to the system will go beyond -- and perhaps, well beyond -- meeting reliability needs. A plethora of public policy goals also may be advanced, including, but apparently not limited to, improving fuel diversity, mitigating market power, enhancing demand response, adding energy efficiency resources or furthering any number of environmental policies. (*Id.* at 9.) Summarily stating that a long term contract process is better suited than FERC-approved ISO capacity arrangements to ensure reliability and advance public policy

¹⁶ As established in the New York Suppliers’ Initial Comments, regulatory uncertainty today is largely limited to the number of new environmental initiatives under consideration. The New York Suppliers reiterate that, going forward, a balanced approach must be adopted that carefully aligns environmental, energy and economic development interests together.

¹⁷ For Track 1, a process will be conducted every three years to evaluate long term policy directions and strategies over a 15 to 20 year period. For Track 2, a process will be conducted annually focusing on a 5 year planning horizon with utilities expected to produce five year plans annually for Commission review and approval.

goals,¹⁸ DPS Staff further asserts that their DEPP will ensure needed resources can be targeted and obtained at “reasonable prices.” (Id. at 24.) Acknowledging that such an approach may very well crash the capacity markets -- which, in fact, appears to be one of the main goals -- DPS Staff asserts that the solution will be to enter into cost-based long term contracts with existing generators.¹⁹ (Id. at 25.) The promise of a contract award, however, comes with two significant caveats: (i) disputes over the legitimacy of costs must be resolved; and (ii) decisions must be made if a generator should not receive a contract because its facility is somehow deemed to lack “long-term value” to New York City consumers.^{20,21} (Id.)

As demonstrated herein, in the New York Suppliers’ Initial Comments and the initial comments submitted by the vast majority of the parties in this proceeding, there is no basis for the Commission to adopt such an extensive process. Indeed, such an extreme step is likely to revive and exacerbate regulatory uncertainty concerns, just as the market rules largely have stabilized. This will unnecessarily chill future investment in New York at the very time it is needed. In addition, notwithstanding DPS Staff’s unsupported but certainly extremely

¹⁸ In this part of its Initial Comments, DPS Staff appears to acknowledge that issues associated with capacity pricing may be FERC jurisdictional. (See DPS Staff Initial Comments at 23.) Capacity pricing issues do, in fact, fall squarely within FERC’s jurisdiction.

¹⁹ As a “second best solution,” DPS Staff proposes to adopt cost-based rates, rather than market rates, for all In City generators. However, given that the In City generators have been granted market based rate authority by the FERC, it is unclear what statutory vehicle the Commission jurisdictionally could use to accomplish this result.

²⁰ The intended scope of DPS Staff’s capacity proposal is confusing at best. In some parts of this discussion, it appears that their statements are intended to be applied statewide. Other sentences specifically reference New York City resources. At the conclusion of this section, DPS Staff acknowledges that “Existing capacity market pricing arrangements in upstate New York (the NYISO Statewide or Rest of State market), however, appear to be working well. Staff does not recommend modification to the operation of those markets.” (See DPS Staff Initial Comments at 25-26.) DPS Staff’s statements are at best overly simplistic. As DPS Staff well knows, the three capacity markets in New York are solved simultaneously. Thus, collapsing the In City capacity market will have a significant impact on the NYCA capacity market.

²¹ The order in which each capacity resource is considered will significantly affect any determination of “long term value.” If a generation resource is evaluated early in the process and deemed to lack “long term value,” the remaining capacity resources in that region will likely be deemed to provide greater “long term value.”

aggressive time line, actions as significant as those being contemplated by DPS Staff simply cannot be fully or fairly vetted in a four month process. Lastly, DPS Staff's blatant attempt to eviscerate the FERC-approved capacity markets is neither warranted nor defensible.²² Thus, DPS Staff's DEPP proposal should be soundly rejected.²³

1. DPS Staff's Proposed DEPP Ignores the Pronounced Failure of Similar Processes Implemented in the Past

In its Initial Comments, DPS Staff states that the Track 1 Plan and the utility plans to implement it will be subject to review and approval by the Commission. (See DPS Staff Initial Comments at 7-8.) Per DPS Staff, regulatory oversight would be accomplished through these processes leading to the achievement of least cost planning commensurate with the mix of resources desired. (Id. at 13, 15.) However, in proposing this return to a command and control approach, DPS Staff conveniently appears to have forgotten that similar processes in the past have failed.

As many parties to this proceeding warned, New York State's track record with respect to mandating the facilities to be built has been abysmal. In fact, a major factor driving this Commission's decision to move to competitive markets was to protect captive ratepayers from the kind of risk -- and ultimately significant financial exposure -- that resulted from the generation investment decisions that were made under the cost of service structure. (See Competitive Opportunities Order at 30-31.) In today's markets, such risks are borne by

²² The New York Suppliers support the separate reply comments contemporaneously being submitted in this proceeding by Astoria Generating Company, L.P. addressing in more detail the capacity issues that have been raised by DPS Staff and other parties.

²³ As its last point, DPS Staff argues that if sites are an issue, a utility should secure all necessary permits for a site it selects and subsequently make them part of the RFP process. (See DPS Staff Initial Comments at 26.) To obtain such permits, stipulations or agreements must be reached concerning major project issues such as fuel type, water usage, emissions levels, run times for dual fuel capability, etc. It is inappropriate for the utility to make determinations concerning project restrictions for a future owner.

merchant generators and their shareholders alone. There is no basis to shift that risk back to captive ratepayers.

Nor is such a command and control approach likely to produce efficient results or to square with the existing competitive markets.²⁴ Indeed, to the extent a significant amount of mandated generation is superimposed on the competitive markets, it may improperly alter the dispatch patterns and artificially suppress market clearing prices. Thus, rather than supporting competitive markets at the very time that new investment is needed, such actions are likely to torpedo them.

2. A Comprehensive Analysis of the Issues Presented in this Proceeding Cannot Be Accomplished in DPS Staff's Proposed Four Month Expedited Period

In its Initial Comments, DPS Staff proposes to implement their proposed DEPP approach by beginning with an expedited interim plan to be completed within four months of the Commission's order in this proceeding. Even if DPS Staff's proposal were prudent -- which, as demonstrated herein, it is not -- this abbreviated time line is simply not feasible. As discussed, supra, given the scope of issues raised in this proceeding, this Commission must institute a full collaborative process. By way of comparison, the Competitive Opportunities Proceeding included a significant number of meetings, the issuance of a Recommended Decision and the issuance of this Commission's Competitive Opportunities Order over a period of time that spanned two years. While this proceeding may not require the same amount of time, a similar, comprehensive collaborative structure must be applied to ensure that the issues identified in this proceeding are resolved.

²⁴ In fact, as correctly noted in NMPC's Initial Comments, "A return to IRP would mean abandonment of competitive markets and likely an eventual return to full regulation." (See NMPC Initial Comments at 29.)

3. Addressing Market Power By Artificially Flooding the Market With Capacity That Is Not Otherwise Supported By Competitive Market Prices Is An Inefficient Approach That Marks A Drastic Departure from the Competitive Market Structure

Ignoring the fact that the NYISO markets include a FERC-approved, comprehensive Market Monitoring and Mitigation Plan, DPS Staff takes the position in its Initial Comments that “To the extent market power issues arise, they can be addressed in the resource procurement process, which can be tailored to avoid the creation of market power or to mitigate market power impacts. These goals can include eliminating or reducing the effect of specific load-pocket constraints.” (See DPS Staff Initial Comments at 15-16.) However, as discussed at length in the New York Suppliers’ Initial Comments, market power mitigation within wholesale power markets appropriately falls within the FERC’s Federal Power Act conferred province.

Specifically, by FERC order, the NYISO is responsible for monitoring for, and mitigating, the exercise of market power in the markets that it administers and controls.²⁵ To do so, the NYISO developed its Market Monitoring and Mitigation Plan which sets forth clearly defined mitigation measures that are designed to effectively address any market power concerns. The Market Monitoring and Mitigation Plan -- not contracts for additional capacity that, without appropriate load side market monitoring and mitigation measures, will only lead to artificial price suppression and other issues²⁶ -- is the best vehicle for effectively addressing market power issues in wholesale markets.

²⁵ See, e.g., FERC Docket Nos. ER97-1523-000, et al., Central Hudson Gas & Electric Corporation, et al., “Order Conditionally Accepting Tariff and Market Rules, Approving Market-Based Rates, and Establishing Hearing and Settlement Judge Procedures,” 86 FERC ¶ 61,062 (1999).

²⁶ Central Hudson takes the position that government mandated projects should go beyond reliability “to embrace economics.” (See CHG&E Initial Comments at 5.) CPB, MI and the City of New York also support adding excess capacity to lower prices. (See MI Initial Comments at 8; CPB Initial Comments at 5; NYC Initial Comments at 2.) However as demonstrated by Niagara Mohawk in its Initial Comments, taking such ill-advised steps will have a devastating impact on the continued viability of the markets, stating, “One important restriction that the Commission

Moreover, to the extent that new issues arise concerning the exercise of market power, the FERC addresses them. For example, in response to proposed tariff changes recently submitted to the FERC alleging market power concerns, the FERC initiated the In City ICAP Proceeding.²⁷ As DPS Staff acknowledges (see Initial Comments at 22), this investigation is expected to comprehensively address all supply side and load side mitigation issues. Thus, market power issues should continue to be addressed through the NYISO Market Monitoring and Mitigation Plan pursuant to FERC oversight.

C. Utilities Must Not Be Permitted To Tilt the Level Playing Field By Using Regulated Dollars To Re-enter the Generation Business and “Compete” With Merchant Parties

In their respective Initial Comments, New York State Electric & Gas Corporation and Rochester Gas & Electric Corporation (collectively, “Energy East”), Con Edison and Central Hudson Gas & Electric Corporation (“Central Hudson”) all take the position that the utilities must be given the opportunity to build new generation facilities. (See EE Initial Comments at 7-9; CE Initial Comments at 11; CHG&E Initial Comments at 16-23.) Specifically, asserting that it is prepared to invest in new rate-based generation assets under “appropriate regulatory conditions”²⁸ and it has the financial strength to do so,²⁹ Energy East summarily states that it

should enforce under any mechanism in which it may be relevant is a prohibition against intentional overbuilding for the purpose of driving down prices for existing units. Efforts to crowd out existing units by promoting the construction of excessive new facilities would be uneconomic and would impact future capacity investments once new facility bidders begin to wonder how long it will be before attempts are made to undercut prices in order to crowd out their (now ‘existing’) units.” (See NMPC Initial Comments at 38.) The NYISO concurs, stating, “... uneconomic contracting, for the purpose only of increasing supply, would drive out private investment risks and costs from suppliers to consumers. (See NYISO Initial Comments at 11.)

²⁷ See FERC Docket Nos. ER07-360-000, EL07-39-000, New York Independent System Operator, Inc. “Order Rejecting Proposed Tariff Revision and Instituting Hearing and Settlement Judge Procedures,” 118 FERC ¶61,182 (2007).

²⁸ As evidenced in press releases issued earlier this spring, Energy East already has proposed to go forward with two generation proposals: (i) a \$500 million repowering of the Russell generating facility; and (ii) a \$20 million investment to upgrade two of its hydroelectric facilities. See “Energy East Announces Public Offering of Common Shares” (dated March 19, 2007); see also “Energy East To Upgrade Hydroelectric Facilities” (dated April 6, 2007).

should not be precluded from owning generation to meet future reliability and energy needs. (See EE Initial Comments at 8.) Likewise, pointing to increased operational flexibility and increased stability and reliability derived from creditworthy owners, Con Edison argues that it should have the opportunity to repower facilities in its service territory.³⁰ (See CE Initial Comments at 11.) Lastly, Central Hudson argues that merchant generators will require a number of incentives to enter into contracts that will not otherwise be required by the regulated utilities. (See CHG&E Initial Comments at 16-18.) Thus, according to Central Hudson, a comparable policy to facilitate the regulatory utility-build option must be simultaneously considered in this proceeding. (*Id.* at 20-21.)

Glaringly absent is any acknowledgement whatsoever that what the utilities propose to do is to eliminate a key benefit identified by this Commission in its Competitive Opportunities Order -- namely, in competitive markets, a private party's shareholders, not captive ratepayers, bear the risks for generation investments. Put simply, the utilities seek to get back into the

While not expressly stated in either press release, it appears from the April 27, 2007 letter submitted to this Commission by Energy East in PSC Case 07-E-0435 that Energy East intends to proceed with these projects on a fully regulated basis.

²⁹ Following the issuance of this Commission's order in its most recent rate case last year, NYSEG hit the presses hard with dire warnings of layoffs that would adversely affect reliability and projected downgrades from rating agencies that would substantially limit its ability to access capital to upgrade its transmission and distribution facilities on acceptable terms thereby further adversely affecting reliability. See NYSEG News Room, "PSC Adopts Decision in NYSEG Rate Case Which Will Lead to a Deterioration in Customer Service" (issued August 23, 2006). Yet, just ten months later, Energy East now claims sufficient financial strength to not only maintain its ongoing transmission and distribution operations but to construct a major generating facility.

³⁰ Throughout its filing in its pending electric rate case, Con Edison emphasizes the need to approve a very substantial rate increase to its customers exceeding \$1 billion dollars, in part, to maintain its "strong financial standing" to assure that it is able to access the extraordinary amount of capital needed on attractive terms to fund its major transmission and distribution system projects. (See Con Edison May 4, 2007 Filing Letter at 2.) In fact, Robert Hoglund, Con Edison's Senior Vice President and Chief Financial Officer expressly cautions in his testimony against continuing equity returns in New York State that "have been consistently below average and have been declining faster than in other States." (See Hoglund Testimony at 7-8.) The unprecedented level of transmission and distribution investment that Con Edison intends to make -- and the return on equity proposed to "maintain" its financial standing to allow for such investment -- raises the obvious question as to the level of additional rate increase and return on equity that Con Edison will seek from its captive ratepayers to go forward with a major generating project.

business of betting other people's money to support their generation construction efforts while they receive assured rates of return. Rather than allowing the forces of competition to establish the returns of generators (with appropriate NYISO and FERC market power monitoring and mitigation oversight in place), the utilities desire a return to the good old days where rate of return experts battled over the appropriate level of return -- the very approach that previously failed.

As evidenced by recent history concerning utility build projects, including the experience here in New York, permitting the utilities to re-enter this business can expose ratepayers to substantial cost overruns and project delays. Unlike their utility counterparts, merchant generators are willing to accept the risks associated with bringing new units on line and are the parties that are best suited to go forward with generation projects efficiently and cost effectively. Moreover, permitting the utilities to re-enter the generation business gives rise to the very vertical market power concerns that were sought to be avoided by this Commission. Lastly, depending upon the market and regulatory structures ultimately put into place, forcing merchant parties to "compete" against parties funded with lower risk, regulated dollars may skew the dispatch of the system and lead to artificially suppressed market clearing prices. Thus, the proposal to allow utilities to build new generation must only be permitted in the event that there is no sufficient market response and a competitive solicitation otherwise fails to produce a solution.³¹

³¹ As discussed in detail in our Initial Comments, the New York Suppliers reiterate that New York must provide regulatory certainty to attract necessary financing dollars. With the market design largely well in place, proposed environmental changes need to be addressed in a manner that balances energy, environmental and economic development interests. In addition, when considering investments to address reliability needs, New York State must consider the type of resources that it needs to bring on line to address, *inter alia*, fuel diversity and the associated time line needed to do so.

1. Merchant Projects Shield Captive Ratepayers from Cost Overruns and Unsuccessful Investment Decisions

In its Competitive Opportunities Order, this Commission emphasized the fact that market forces would produce rates that, over time, were lower than under the regulated environment. (See Competitive Opportunities Order at 28.) As established, supra, competitive markets produce these results because merchant parties are required to put efficient and cost effective practices into place to compete successfully against others to supply energy, capacity and ancillary services to New York's consumers. As recognized by this Commission in its Competitive Opportunities Order, a core factor policing this discipline is that merchant parties -- and their shareholders alone -- bear the risks of generation investment decisions, not captive ratepayers. (Id. at 30-31.)

In trying to make their case to be allowed back into the generation business, the utilities obfuscate this fact. Based upon a review of the most recent forays of utilities back into the generation business, the reason is obvious. Cost overruns have been enormous. For example, the initial public estimate for the Con Edison East River Repowering Project was \$360 million. The final cost, however, was more than 100% higher, with this Commission recently authorizing \$788.3 million in the first rate year and a potentially higher capital cost in the second rate year. Likewise, Duke Energy Indiana, Inc. has proposed to construct a 630 MW IGCC facility in Indiana. Its initial cost estimate was \$1.3 billion. Two months later, this estimate had nearly doubled to \$2.6 billion with the utility seeking full cost recovery plus a 200 basis point adder to its return on equity over the life of the project. Given this track record, prudence counsels against exposing ratepayers to these kind of significant cost increases at the hands of the utilities

in the future unless no other solution comes forward. Whenever possible, the construction of new generation facilities should continue to be done by merchant parties.³²

2. Central Hudson's Position Concerning the Requirements That Merchant Parties Will Impose To Enter Into Contracts Are Without Basis

In its Initial Comments, Central Hudson summarily states that it is apparent that independent power producers will require additional economic benefits relative to what is currently available to enter into long-term contracts to bring new resources on line. (See CHG&E Comments at 17.) Specifically, Central Hudson asserts, *inter alia*, that: (i) independent power producers will require contracts that exceed the forward price curves; (ii) independent power producers will seek to retain all profits but shift the risk of loss to the utilities; and (iii) sufficient efficiencies do not exist to offset the utility's lower financing costs. (*Id.* at 16-18.) Central Hudson's claims lack merit.

First, while financial institutions may require contracts to be in place for some portion of the asset's output for some predetermined period of time to ensure a known stream of revenue from the asset, such contracts are not, as Central Hudson asserts, necessarily required to be at a premium. As noted below, a properly constructed competitive solicitation process ensures that competitive pressures will reduce pricing terms to competitive, economically efficient levels. Indeed, paying a premium for an asset without appropriately reflecting such values in the more generally applicable markets is exactly the type of uneconomic contract that can be used to artificially skew market clearing prices as established in more detail in Point II.D., *infra*. The

³² In its Comments, CPB asserts that existing generators are inherently opposed to adding new supply. (See CPB Initial Comments at 4.) Nucor Steel takes a similar position. (See Nucor Initial Comments at 11-12.) However, such statements are belied by actual experience. Both Entergy and Constellation have made investments to uprate their nuclear facilities thereby increasing their capacity. Orion Power brought its Astoria Unit 2 back into service. KeySpan Ravenswood added 250 MW to the New York City system. Lastly, generators as a whole have vastly improved forced outage rates, and thus, increased the amount of capacity available for sale from existing units.

New York Suppliers oppose such arrangements without proper market mechanisms being put into place as antithetical to the further development of competitive markets in New York State.

Central Hudson's remaining contentions are similarly unavailing. As stated in both its Initial Comments and these Reply Comments, the New York Suppliers support requiring open, competitive solicitation processes for the award of long term contracts. Such processes, by design, would eliminate the "heads generators win, tails consumers lose" contract structure presupposed by Central Hudson. Indeed, by utilizing a properly designed, open and competitive process, the most economically efficient solution will result.

Finally, efficiencies in competitive markets can be achieved in a number of ways including: location of the asset, fuel type, cost of construction and operating efficiencies. In light of the significant cost over-runs that utilities have posted when constructing generation projects, it appears certain that significant benefits likely can be gained through the fair consideration of proposals offered by independent power producers under a properly constructed competitive solicitation process as compared to the investment decisions and management thereof made by the utility sector.

3. Permitting Utilities To Re-Enter the Generation Business Exposes the Market to Significant Vertical Market Power Concerns

In its Competitive Opportunities Order, this Commission emphasized that "critical to a movement toward a restructured industry is the need to avoid undue concentration of market power and particularly the use of monopoly power on the distribution side to unduly restrict choice on the generation side." (See Competitive Opportunities Order at 64.) To avoid the exercise of vertical market power, the Commission "strongly encourage[d]" divestiture of generating facilities. (*Id.* at 65.) Generation divestiture proposals were agreed upon in the utility

rate and restructuring proceedings thereby eliminating the need for a Commission directive concerning divestiture. Generation divestiture proceeded successfully in New York.

Today, with limited exceptions primarily to address identified In City steam needs, generation facilities are owned by merchant generators that fully bear the financial risks to own and operate them. Permitting any of the utilities to now proceed with plans to use regulated dollars to “compete” with merchant generators is directly contrary to the structure that has been put in place for the past ten years and will open up the system to the very market power concerns that were sought to be avoided. This is particularly true given that at least two of the utilities are proposing to bring new generation facilities on line in their own service territories³³ thereby exacerbating the potential for the exercise of vertical market power to the maximum degree possible.³⁴ Thus, unless there is no other viable alternative, the utilities must not be permitted to re-enter the generation market.

4. Permitting Utilities To Re-Enter the Generation Business May Improperly Skew the Dispatch of the System and Artificially Suppress Market Clearing Prices

As discussed at length herein, merchant parties are required to compete with each other to supply energy, capacity and ancillary services to the New York system. As reflected in this

³³ Specifically, as noted *supra*, Energy East has made public proposals to repower and upgrade generation facilities in its own RG&E service territory in Western New York. Likewise, in its Initial Comments in this proceeding, Con Edison references repowering facilities in its service territory in the City. (See CE Initial Comments at 11.) IPPNY has requested that the Commission initiate an investigation concerning Energy East’s proposal. On June 18, 2007, the New York Suppliers submitted letter comments in response to the New York State Register Notice of Proposed Rulemaking (SAPA Notice I.D. No. PSC-18-07-00010-P) supporting the need to grant IPPNY’s request.

³⁴ In its electric rate proceeding currently pending before the Commission, Con Edison proposes to invest billions of dollars of ratepayer money in new transmission and distribution system infrastructure over the next three years. During overview presentations to parties in that proceeding, Con Edison representatives established that decisions concerning which facilities to upgrade may involve transferring load from one substation to another to optimize the system. (See Consolidated Edison Company of New York, Inc. Presentation, “Con Edison: Building for New York’s Future - Electric Rate Case” (presented on June 18, 2007).) Allowing Con Edison to re-engage substantially in the generation business may serve to skew its interpretation of an “optimized” transmission system. This is but one of the concerns that will arise if the utilities were permitted to engage in new builds in their own service territories.

Commission's Competitive Opportunities Order, this structure produces significant benefits because it "encourages efficiency and induces suppliers to charge prices approximating marginal costs." (See Competitive Opportunities Order at n.98.) From the comments submitted to date in this proceeding, however, it appears that the utilities do not propose to compete on this same basis. Rather, it appears that the utilities seek a regulated rate of return for such efforts. Doing so, however, completely insulates the unit from the disciplines of competitive markets in direct contravention of this Commission's past efforts.

Specifically, as established in the New York Suppliers' Initial Comments, the Commission's efforts with respect to its RPS Proceeding present a helpful framework for bringing new facilities on line to address a targeted, narrowly defined, public policy concern. Mindful of the need to remain as consistent as possible with competitive markets, the RPS incentive carefully was tailored to be a premium, extra market payment. Thus, the RPS recipients, by program design, stand in the same shoes as other suppliers in the primary electric power markets and remain fully vested in ensuring that a market structure remains in place that produces efficient market clearing prices. Absent securing such prices, these recipients -- like all other suppliers -- may face revenue shortfalls.

In direct contrast, the utilities are proposing to shield themselves entirely from any market exposure. Thus, unlike every other supplier, they will have no reason to ensure efficient and competitive market results. Indeed, depending upon their load serving position, they may seek just the opposite result. If the competitive markets are going to continue to develop with associated benefits redounding to New York's consumers, such a proposal cannot be countenanced.³⁵

³⁵ The NYISO raised similar concerns, stating, "Because some market participants operate in both competitive and regulated markets, care must be taken to ensure that a competitive environment is preserved. Regulated entities

D. Merchant Parties Must Not Be Required To Compete Against Uneconomic, Government Sponsored Contracts

Arguing that generators previously have also benefited from changes in market rules such as the ICAP Demand Curve rule changes, Multiple Intervenors asserts that “when existing generators purchased or constructed their facilities, they did so assuming a certain level of regulatory and business risk that includes, inter alia, the adoption of new policies by the Commission and/or the construction of additional generation projects.” (See MI Initial Comments at 21-22.) Given that the addition of new facilities was always presumed, Multiple Intervenors asserts that generators should not now be “shielded” from the impacts of regulatory policies designed to ensure “adequate” generation is developed in New York. (Id. at 22.) Moreover, pointing to the fact that new generation is not likely to be added to the system for a number of years, Multiple Intervenors further asserts that it would be “premature” to address market rule changes at this time. (Id. at 21.)

The City of New York takes a similar position, arguing that, because generators act in their self-interest in deciding whether to add or retire capacity at their facilities, it is only equitable that the load side act in its own economic interest as well. (See NYC Initial Comments at 18.) However, where, as here, a market design flaw exists, it cannot be permitted to continue - - notwithstanding that it may be perceived favorably by consumers as saving them money at least, in the short run.

Initially, it must be noted that the New York Suppliers collectively have invested billions of dollars in assets in New York State and stood ready then -- as they do today -- to compete with both new and existing suppliers to meet New York’s energy needs. However, such competition must take place on fair and equitable terms. To provide safe and adequate service at just and

should be precluded from shifting contestable market costs into their regulated business. (See NYISO Initial Comments at 10.)

reasonable rates, competition requires that a level playing field exist. In fact, the wholesale market structure has evolved over the past ten years by addressing market design flaws to ensure that an as fair, economically efficient and level playing field as possible developed. Multiple Intervenors' position notwithstanding, neither the New York Suppliers nor any other supplier can be put at a competitive disadvantage by regulatory fiat and then told to compete anyway.³⁶ Yet absent the implementation of load side mitigation provisions on the federal level to guard against uneconomic contracts being used as a tool to artificially suppress market prices that is exactly what all suppliers will be asked to do.

Multiple Intervenors' reference to the Demand Curve market rule changes is equally unavailing -- in fact, if anything, it actually supports implementation of load side mitigation changes. In 2003, the ICAP Demand Curve mechanism was adopted to correct an identified flaw in the then vertical curve based capacity market structure. This change was made not because it benefited generators but rather because it corrected a market design flaw. So, too, is the case with load side bid mitigation. By virtue of the addition of 1,000 MW of new capacity in New York City in the past year, a new design flaw has been revealed, i.e., the ability for a large load serving entity to enter into an above-market contract but then self-certify the capacity and thereby reduce the market clearing price that it must pay in the capacity spot market auctions for the remainder of its load. Like the now replaced vertical curve based capacity market structure, this design flaw also must be corrected to ensure that a properly structured, level playing field continues in the future.

³⁶ The NYISO expressed its significant concern with using government mandated contracts as the vehicle to bring uneconomic projects on line, warning, "The NYISO strongly recommends that the State not adopt the use of long term contracts by governmental entities such as NYPA and LIPA as the principal mechanism for implementing its policy objectives. Contracts for investments that would have been uneconomic in the wholesale markets can shift substantial costs and risk to consumers over the long term. (See NYISO Initial Comments at 8.)

Nor is Multiple Intervenors' "let's just wait and see if we actually need rule changes" argument compelling. Multiple Intervenors is correct that the construction of new facilities will not be completed for a number of years. However, because permitting and construction of new electric system infrastructure requires several years, the decision whether to finance the new facility so that shovels can be put into the ground is being made now for facilities to be in service in 2011. That decision will be guided by the rules now in place and under contemplation. Thus, this tariff shortcoming must be addressed immediately.

Lastly, turning to New York City's contentions concerning economic self-interest, a hallmark of competitive markets is that these markets allow all parties -- both load side and supply side -- to be best able to act in their respective economic self-interest. For example, the market structure rewards efficient operations. Thus, suppliers strive to make themselves more competitive vis-à-vis other competitors, e.g., by improving the heat rate at a facility. Likewise, the market structure provides the load side with a number of mechanisms to control their costs. For example, load serving entities are able to submit price capped load bids to identify the price above which they are unwilling to take service. All of these mechanisms are perfectly appropriate and acceptable.

However, what is neither appropriate nor acceptable is for any party to exercise its dominant position to produce an artificial outcome. That is not competition; it is market power. As discussed at length in the New York Suppliers' Initial Comments, since the inception of the NYISO's markets, clear market monitoring and mitigation rules applicable to suppliers have been in place. As part of the FERC In City ICAP Proceeding, additional market power mitigation rules are under consideration. Because mitigation is inherently a two-sided coin, both

the supply side and the load side rules are expected to be fully considered. Only then can it be assured that the markets will continue to go forward on a level playing field.

III. CONCLUSION

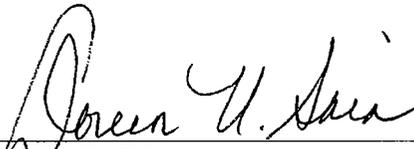
The competitive market structure approved by this Commission eleven years ago has served New Yorkers well. Today, New York is well-recognized as having the most complete and efficient set of wholesale competitive markets in the country. This premier structure provides substantial benefits to New York's consumers with electricity needs met at the lowest cost.³⁷

While some work remains -- particularly in carefully considering, and if ultimately implemented, integrating any new environmental initiatives into the markets in an efficient way - - major modifications to the market structures are not warranted at this time. Accordingly, the New York Suppliers respectfully urge the Commission to proceed with caution in this proceeding guided by the following principles: (i) any proposed changes must first be considered in a comprehensive collaborative process involving all interested stakeholders; (ii) any changes must be structured to be compatible with, and not otherwise undermine, the existing competitive markets; (iii) market responses must be the preferred response to satisfy both

³⁷ See Dr. David Patton, "State of the Markets Report" (issued May, 2007) at 2-3; see also, generally, New York State Department of Public Service, "Staff Report on the State of Competitive Energy Markets: Progress To Date and Future Opportunities" (issued March 2, 2006).

reliability needs and any carefully targeted, narrowly tailored public policy goal; and (iv) in the absence of sufficient market based solutions, regulated projects must go forward by utilizing open, competitive solicitation processes.

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