STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case No. 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 OF HESS CORPORATION

INTRODUCTION

Hess Corporation ("Hess") submits these reply comments in response to the Commission's Order, issued on April 19, 2007, instituting a Phase II of this proceeding ("Phase II Order").[1] In Phase II, the Commission has sought comments on whether it should mandate the use of long-term supply contracts between utilities or other load-serving entities ("LSEs") and electric generation entities.[2] In addition, the Commission has sought comments on whether it should re-institute a centralized, integrated resource planning ("IRP") process that was a hallmark of New York's electric regulation policy prior to the restructuring of the State's electric industry.[3] Hess, along with approximately 27 other parties, filed initial comments in Phase II of this proceeding on June 5, 2007.[4]

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[1] Case No. 06-M-1017, *Order Requiring Development of Utility-Specific Guidelines For Electric Commodity Supply Portfolios and Instituting A Phase II To Address Longer-Term Issues* (Apr. 19, 2007) ("Phase II Order").

[2] Phase II Order at 38.

[3] *Id.*

[4] Case No. 06-M-1017, Comments of Hess Corporation (June 5, 2007) ("Hess Initial Comments").

PRELIMINARY STATEMENT

In its initial comments, Hess set forth its position that the Commission should not re-institute an IRP process nor should it mandate or otherwise require utilities or other LSEs to enter into long-term supply contracts with generation entities. In support of this position, Hess discussed in detail that it was both unnecessary and dangerous for the Commission to establish IRP and long-term contract policies for four critical reasons. First, these policies would harm consumers as they had when they were implemented during the pre-restructuring era. Second, these policies cannot and will not remove existing up-front barriers to meaningful electric infrastructure development, which is a key goal of these proposals. Third, these policies will distort the market-reflective price signals necessary for Hess and other competitive energy service companies ("ESCOs") to develop the value-added products and services that, to date, over 1.3 million customers have sought and received – including the provision of "green power" products from renewable energy sources. Fourth, these policies would interfere with the Administration's ambitious "15 by 15" goal of decreasing the demand for electricity by 15 percent by 2015 by virtue of these policies' interference with consumers' ability to receive and respond to market-reflective price signals.[5]

The initial comments filed by proponents of the re-institution of IRP and the establishment of long-term contract policies are unresponsive to the above concerns outlined by Hess in its initial comments. Indeed, the proposals presented by these parties, if implemented, will cause the very harms to consumers, retail markets, electric infrastructure development and energy efficiency initiatives that Hess outlined in its

[5] Hess Initial Comments at 2-4.

initial comments. Moreover, the IRP and long-term contract proponents fail to take into account the cost impacts associated with these policies, which will expose customers to billions of dollars in additional costs while, simultaneously, eroding a retail market that shifts the risk of uneconomic investments away from customers and to ESCOs competing for customers' business.

For all of these reasons, Hess respectfully urges adoption of policies consistent with the positions and recommendations contained in its initial comments filed in Phase II of this proceeding.

DISCUSSION

I. INTEGRATED RESOURCE PLANNING PROPONENTS FAIL TO ACKNOWLEDGE THEIR HARMFUL IMPACTS ON CUSTOMERS AND RETAIL ELECTRIC MARKETS OR EXPLAIN HOW THEY WILL RESULT IN MEANINGFUL ELECTRIC INFRASTRUCTURE DEVELOPMENT

In its initial comments, Staff proposes the introduction of a Dynamic Energy Planning Process ("DEPP"), which contains many features similar to the failed IRP process established during the pre-restructuring era in New York that resulted in the imposition on customers of billions of dollars in stranded costs.[6] In advocating this proposal, Staff neither acknowledges nor attempts to address the substantial concerns associated with a centralized energy planning structure. Specifically, Staff and other IRP proponents fail to acknowledge New York's historical experience with IRP and its legacy of imposing billions of dollars of stranded costs on consumers as a result of uneconomic supply acquisitions that were spurred by inaccurate forecasting of New York's long-term electric needs.

[6] Case No. 06-M-1017, Staff Initial Comments (June 5, 2007) ("Staff Initial Comments") at 5-17.

In addition, Staff and the other IRP proponents fail to adequately explain how institution of the DEPP and other proposed IRP mechanisms would protect consumers from the mistakes of the past. Such discussion is critical where, as here, an IRP process that fails to utilize accurate market-reflective price signals creates the serious potential for the State to engage in uneconomic supply acquisitions that will result in the same consumer harms that the prior IRP policies produced. Missing, however, from Staff's and other parties' proposals is any explanation as to how DEPP or other proposed IRP mechanisms will avoid the same forecasting and planning flaws that produced for consumers over $6 billion in costs stemming from the failed Shoreham nuclear plant, as well as billions of dollars in additional costs imposed under the State's "six-cent law." [7]

Furthermore, Staff in its description of the DEPP process and other IRP proponents in their proposals fail to ascertain the cost impacts arising from implementation of an IRP planning process. The issue of rising costs has become a critical issue for the State especially at a time when the Commission is considering numerous ambitious proposals that, if implemented, will expose consumers to billions of dollars in additional costs on top of the billions of dollars in potential risks for uneconomic supply acquisitions under a new IRP regime. For example, the Commission has opened a proceeding to explore implementation of an Energy Efficiency Portfolio Standard ("EEPS")[8] that Staff estimates could cost approximately $5 billion to implement.[9] In addition, Con Edison is seeking to increase its electric distribution rates

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[7] *See* Hess Initial Comments at 6-8.

[8] Case No. 07-M-0548, *Order Instituting Proceeding* (May 16, 2007) ("EEPS Order").

[9] *See* Case No. 07-M-0548, *Preliminary Staff Analysis: Benefits and Costs of Bill Impacts of Energy Efficiency Program for 15 percent Reduction in Electricity Usage by 2015* (June 1, 2007) at 4.

by $1.2 billion due in large measure, according to Con Edison, to needed enhancements of its electric distribution infrastructure.[10] In the coming years, almost every electric utility can be expected to request substantial rate increases to support installation of requisite electric distribution infrastructure – increases that can no longer be substantially mitigated from assets from the sale of electric generation facilities. In addition, the achievement of the Commission's Renewable Portfolio Standard ("RPS") goals will require further increases in costs on an annual basis through 2011.[11]

The proposed re-institution of IRP cannot and should not be considered in isolation from the high-rising cost environment that consumers will be exposed to in the coming years. It is therefore imperative for the Commission, prior to any decision to commit to an IRP process, to thoroughly and accurately take into account the potential cost impact of IRP on ratepayers within the context of the billions of dollars in potential costs resulting from existing and anticipated Commission and utility proposals.

Finally, the IRP proponents fail to explain how the re-institution of IRP mechanisms will overcome the existing up-front barriers to electric infrastructure development. These parties also fail to explain how IRP will not undermine the robust competitive retail electric market structure already in place in New York. First, it is notable that virtually every commenting party in Phase II identifies the lack of an Article X generation plant siting process as an existing barrier to meaningful electric infrastructure development in New York. The IRP proponents fail, however, to explain

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[10] *See* Case No. 07-E-0523, *Petition and Exhibits of Con Edison in Support of its Proposal To Increase the Charges of its Electricity Service and Make Other Changes*, Direct Testimony of the Infrastructure Investment Panel (May 4, 2007).

[11] *See* Case No. 03-E-0188, *Order Approving Renewable Portfolio Standard Policy* (Sept. 24, 2004) ("RPS Order").

how their proposals will overcome this hurdle absent the reinstatement of Article X. Second, the IRP proponents fail to discuss how displacement of the accurate market-reflective price signals produced by the current retail market structure with long-term forecasts of what prices may or may not look like 5, 10, 15 or 20 years into the future will not undermine the competitive retail electric market structure in New York. These missing elements from the IRP proponents' arguments and proposals suggest that a different approach than IRP is needed for electric infrastructure development in New York. Hess therefore reiterates its recommendation to initiate the comprehensive three-step process outlined in its initial comments.[12]

[12] Hess Initial Comments at 8-17.

II. LONG-TERM CONTRACT PROPONENTS FAIL TO ACKNOWLEDGE THEIR HARMFUL IMPACTS ON CUSTOMERS AND RETAIL ELECTRIC MARKETS OR EXPLAIN HOW THEY WILL RESULT IN MEANINGFUL ELECTRIC INFRASTRUCTURE DEVELOPMENT

The parties supporting the increased use of long-term contracts between utilities/other LSEs and generation entities overlook both the significant risks and costs associated with this approach to procuring electric supply as well as their harmful impacts on competitive retail electric markets. As discussed at length in Hess' initial comments, long-term contracts that produce prices that do not reflect actual market conditions will substantially undermine and impair the robust retail electric market structures already in place in New York.[13] Moreover, long-term contracts have exposed and will expose customers to the risk of significant stranded cost burdens totaling well into the billions of dollars.[14]

Under the retail market structure that the Commission has helped to foster, customers are able to shop for an energy product that is tailored to their specific individual needs from among a wide field of ESCOs competing against one another to provide that customer-specific product. In competing to develop customer-tailored product offerings, ESCOs – unlike New York's incumbent utilities – assume the risk of their investments; that is, if an ESCO makes an uneconomic decision in participating in the New York retail markets then the ESCO absorbs the cost and not their customers. By contrast, New York's incumbent utilities are able to recover from ratepayers the costs of

[13] *See* Hess Initial Comments at 18-24.

[14] *See, e.g.*, Case No. 94-E-0098, *Opinion and Order Adopting Terms of Settlement Agreement Subject to Modification and Clarification*, Opinion No. 98-8 (March 20, 1998) (in which Niagara Mohawk was required to absorb to the detriment of its ratepayers $2 billion over a five-year period to address the stranded costs associated with its above-market IPP contracts); Case No. 06-M-0002, *Order Authorizing Deferral and Recovery of Expenses* (Oct. 6, 2006) (in which Orange & Rockland was authorized to defer and recover from ratepayers approximately $1.2 million for termination of an above-market NUG contract).

their investment decisions as long as the investment is deemed by the Commission to be prudent at the time the investment was made, even if that investment later turns out to be uneconomic.

Thus, the twin advantages of retail markets are their ability, if structured properly, to provide customers with the custom-tailored products they specifically need while in the process shifting the risk of uneconomic decisions away from ratepayers and towards companies competing for the customers' business. In fostering such markets, New York has been identified in both government[15] and independent[16] studies as a national leader in providing the following benefits to customers: (1) increasing supply choices through value-added products and services; (2) placing downward pressure on prices; and (3) reducing stranded costs for ratepayers.

The flipside to the benefits retail markets can produce is the harm that is caused by policies that interfere with the market-reflective price signals that enable customers to know their true costs of electric consumption and enable ESCOs to develop custom-tailored product offerings. The proponents of long-term contracts, while asserting their necessity in order to spur the construction of additional electric infrastructure, fail to acknowledge that movement away from market-reflective price signals will undermine the robust competitive retail markets that have developed in New York. In so doing,

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[15] *See* The Electric Energy Market Competition Task Force, *Report To Congress on Competition in Wholesale and Retail Energy Markets For Electric Energy* (April 6, 2007) at 6-7, 84-108. The federal Energy Policy Act of 2005 required a task force to conduct an analysis of competition within the wholesale and retail electric markets in the United States and submit their findings in a report to Congress. The five-member task force was comprised of representatives from the Federal Energy Regulatory Commission, Federal Trade Commission, U.S. Department of Energy, U.S. Department of Justice, and U.S. Department of Agriculture.

[16] *See* Capitol Hill Research Center, *Retail Electric Competition in New York: Benefits for the Present, Promise for the Future – An Examination of Progress of Electric Market Restructuring in New York State, 1995 – Present* (May 1, 2007) <http://www.resausa.org/NY/pdf/NY_WhitePaper.pdf>.

these proponents seek removal from the picture of a policy long supported by the Commission that shifts substantial costs and risks away from customers and to ESCOs competing for customers' business.

Furthermore, the long-term contract proponents fail to present any evidence supporting the proposition that long-term contracts are necessary to overcome alleged barriers to the development of new electric infrastructure.[17] Compounded by this omission is a failure on the part of these proponents to address how long-term contracts could overcome existing and substantial up-front barriers to electric infrastructure development such as the lack of an Article X siting process, the current and expected modifications to New York Independent System Operator ("NYISO") electric transmission interconnection rules, and the lack of sufficient economic development initiatives.[18]

By contrast, it is notable that all of the major electric utilities in New York – including Con Edison, Orange & Rockland ("O&R"), National Grid, New York State Electric and Gas ("NYSEG"), and Rochester Gas and Electric ("RG&E") – oppose mandatory long-term contract policies.[19] In opposing mandatory long-term contract policies, these major electric utilities all draw from their substantial firsthand experience to explain how use of such mechanisms can harm consumers and utilities in the form of billions of dollars of stranded costs.[20] The Commission would be wise to consider the

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[17] *See, e.g.*, Case No. 06-M-1017, Staff Initial Comments at 8, Comments of the Consumer Protection Board ("CPB") (June 5, 2007) at 2, Comments of the City of New York (June 5, 2007) at 5.

[18] *See* Hess Initial Comments at 30-35.

[19] *See* Case No. 06-M-1017, Comments of Con Edison/O&R (June 5, 2007) at 8, Comments of NYSEG/RG&E (June 5, 2007) at 2, Comments of National Grid (June 5, 2007) at 32.

[20] *Id.*

experience these utilities and New York ratepayers have had with long-term contracts rather than solely rely on the unsupported assertions of Staff, CPB, the City of New York and others regarding the necessity of long-term contracts for producing additional electric infrastructure.

In summary, the proponents of long-term contracts have failed to demonstrate in their initial comments that imposition or encouragement of long-term contracts between utilities and electric generation entities will: (1) remove the existing up-front barriers to electric infrastructure development, namely the lack of an Article X siting process and NYISO interconnection rules; (2) not expose customers to the substantial risk of billions of dollars in additional stranded costs; and (3) not fatally undermine competitive retail markets that shift the risks of these substantial costs away from customers and to ESCOs competing for the customers' business. Under these circumstances, it would be counterproductive for the Commission to implement these policies in any form of an expedited basis. At minimum, the Commission should undertake a full and thorough consideration of the potential harmful impacts of IRP and mandatory long-term contract policies on consumers, retail electric markets and electric infrastructure and energy efficiency development. In this context, Hess reiterates its recommendation to initiate the comprehensive three-step process set forth in its initial comments.[21]

[21] Hess Initial Comments at 8-17.

CONCLUSION

Hess appreciates the opportunity to have presented its views on the important issues raised in the Phase II Order. For the reasons set forth in its initial comments and these reply comments, Hess recommends adoption of policies consistent with the positions and recommendations set forth in Hess' initial comments filed in Phase II of this proceeding.

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