

NEW YORK STATE  
PUBLIC SERVICE COMMISSION

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 OF INDEPENDENT  
POWER PRODUCERS OF NEW YORK, INC.

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**I. INTRODUCTION**

Pursuant to the New York State Public Service Commission’s (“Commission’s”) April 19, 2007 Order in the captioned proceeding (“Order”),<sup>1</sup> Independent Power Producers of New York, Inc. (“IPPNY”) hereby offers reply comments to the initial comments filed by several parties to this proceeding. The Order had essentially requested comments on two matters: whether there was a need for an integrated resource planning (“IRP”) process for electric system infrastructure development and meeting public policy goals; and the proper role of long-term contracts in facilitating new entry and achievement of such goals.

In its Initial Comments, filed June 5, 2007, IPPNY stressed that any evolving Commission policies on IRP and long-term contracts must be complementary to the continued functioning of efficient, reliable, non-discriminatory, competitive wholesale electricity markets in New York State.<sup>2</sup> IPPNY offered specific recommendations that favored non-discriminatory

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<sup>1</sup> 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*, Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II to Address Longer-Term Issues (April 19, 2007).

<sup>2</sup> IPPNY Initial Comments, at 3-4.

market solutions over command and control regulatory intervention.<sup>3</sup> Thus, IPPNY proposed, *inter alia*, that any regulatory IRP process be limited to identifying for market participants' consideration desirable goods and services and providing input at NYISO committee and working group meetings to facilitate the development of market rules that will send the requisite price signals for the competitive procurement of these desired goods and services. In addition, IPPNY recommended that if the NYISO's Reliability Needs Assessment ("RNA") identified a reliability need and sufficient merchant solutions were not forthcoming, the Commission should direct the affected utility to hold a non-discriminatory competitive solicitation for resources to meet that reliability need, and then electric utilities should be assured of cost recovery for the contracts associated with these solicitations.<sup>4</sup> IPPNY also urged the Commission to encourage, but not require, electric utilities to enter into long-term supply contracts selected through fair, open and non-discriminatory competitive solicitations available to both existing and new resources to meet reliability needs not addressed by the merchant market.<sup>5</sup> IPPNY noted that the Commission already has in place policies and programs to meet non-reliability goals such as fuel diversity, energy efficiency and environmental protection, and cautioned that requiring utilities "to select resources for reasons other than meeting reliability needs, not otherwise satisfied by the competitive market at the lowest cost, will do more harm than good to the electric industry and consumers in New York."<sup>6</sup>

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<sup>3</sup> *Id.*, at 4-5.

<sup>4</sup> Only if the non-discriminatory competitive solicitation fails would the utility construct its own facility pursuant to cost-based recovery approved by the Commission.

<sup>5</sup> *Id.*, at 4-6.

In sharp contrast to the initial comments of IPPNY and the vast majority of the other parties<sup>7</sup> urging that the Commission continue its more than decade-long support for competitive electricity markets, Department of Public Service Staff's ("Staff's") Initial Comments propose a dramatic reversal of the Commission's policies and orders that would significantly harm and possibly destroy those markets. Staff's proposed Dynamic Energy Planning Process ("DEPP") -- consisting of (i) a triennial Track I evaluation of long-term policy directions and strategies over 15-20 years, and (ii) a Track II resource procurement process, with each utility submitting an annual 5-year plan built upon Commission decisions in Track I -- and its proposed return to cost-based ratemaking for New York City capacity rates, constitutes the type of failed command and control measures properly supplanted by the Commission in the mid -1990's when it adopted competitive wholesale markets. The Commission recognized then -- and has reiterated its views many times since -- that competition offers the most efficient means of procuring new resources, and is far superior to a centrally planned administrative process.

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<sup>7</sup> Many parties, including purchasers of energy products with other interests, strongly supported the continued operation of the wholesale competitive markets. *See* Comments of Hess Corporation, at 3-4; Initial Comments of KeySpan Corporation, at 4-5; Initial comments filed by Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. Concerning Long-Term Contracts, at 4; Comments of Constellation, Energy Commodities Group, Inc. and Constellation NewEnergy, Inc., at 13-16; Initial Comments of Suez Energy, North America, Inc., at 3-4; Direct Energy Services, LLC -- Verified Statement of Drs. L Lynne Kiesling and Andrew N. Kleit, at 2-3; Initial Comments of AES Eastern Energy, L.P., Dynegy Power Corporation, Inc., Energy Nuclear Power Marketing, LLC, The Mirant Parties and US Power Generating Company, LLC, at 5, 14; Initial Comments of the National Energy Marketers Association, at 3, 15-18; Comments of Consolidated Edison Solutions, Inc. and Consolidated Edison Energy, Inc., at 1-2, 4; Initial Comments of the Retail Energy Supply Association and Small Customer Marketer Coalition, at 2-3; Comments of the Long Island Power Authority, at 4-5; Initial Comments of Liberty Power, at 11; Comments of Niagara Mohawk Power Corporation d/b/a National Grid, at 2-3, 6; Comments of the New York Independent System Operator, at 3.

The Commission found that one of the primary benefits of competitive electricity markets is that investment risks are shifted from captive utility ratepayers to private investors.<sup>8</sup> Over the past two decades, the Commission has taken great care to design public policy programs, such as the Renewable Portfolio Standard (“RPS”), to be as consistent as possible with competitive markets. Most recently, the Commission reaffirmed its commitment to the competitive markets, stating in its April 19, 2007 Order that it “has consistently found that the development of competitive markets, where feasible, will assist in assuring the provision of safe and adequate utility services at just and reasonable costs.”<sup>9</sup>

Staff proposes a return to cost-based ratemaking regimes to determine whether a resource should receive a long-term contract and to ensure the legitimacy of the resource’s costs. It contends the capacity market is not operating competitively in New York City and therefore proposes as a second-best solution a return to cost-based ratemaking for all New York City capacity rates.<sup>10</sup> It also proposes a procurement regime that would require the development of favored types of generation that are not necessary to meet reliability without concern for the associated significant adverse impacts on merchant investments, the competitive markets and, ultimately, the cost of service to consumers.

For example, Staff would employ long-term contracts “to improve fuel diversity, to mitigate market power, to enhance demand response, to add to energy efficiency resources, or to

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<sup>8</sup> Cases 94-E-0952 *et al.*, *In the Matter of Competitive Opportunities Regarding Electric Service*, Opinion and Order Regarding Competitive Opportunities for Electric Service, Opinion 96-12 (May 20, 1996) at 30-31 (“Opinion 96-12”).

<sup>9</sup> April 19 Order, at 29-30.

<sup>10</sup> Staff suggests that FERC-approved capacity markets may be jurisdictionally deficient. IPPNY reserves all of its rights to address all jurisdictional issues at the Commission, at FERC and in the courts with respect to adequacy of capacity markets and jurisdictional boundaries related thereto.

further any number of environmental policies.”<sup>11</sup> Staff, however, fails to acknowledge that these “preferred” contract-based resources would wreak havoc on the competitive markets, undermine existing supplier investments and undercut potential new merchant entrants that did not meet a purported “preference.”

Staff’s proposals would turn the Commission’s long-standing pro-competitive policy on its head. As IPPNY and other parties, many of whom have diverse interests, demonstrated in their initial comments, any requirement imposed on electric utilities to procure resources beyond those needed to maintain reliability, and any move to compensate resources based on regulated cost of service rates, will have a devastating impact on the competitive electricity market. IPPNY explained in its Initial Comments that the Commission can devise means (as it did in the RPS proceeding) and rely on other State programs to further State policy goals that do not unduly disrupt competitive markets. Further, Staff’s proposals would effectively return the electricity market in New York City to a cost-based rate regulated regime in which investment risks would be shifted back to ratepayers from private investors.

The Commission’s April 19 Order contemplated an expedited proceeding to resolve the issues concerning long-term contracts and IRP. The issues raised by Staff’s comments would so severely harm competitive markets and so radically alter Commission policy that an expedited process is not possible. If the Commission considers adopting Staff’s proposals, then -- as it did in the Competitive Opportunities case, the RPS and other major policy/restructuring cases -- the Commission must employ collaborative processes for a comprehensive evaluation of the issues. Further, depending on the outcome of the collaborative processes, hearings may be required to address specific issues.

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<sup>11</sup> Staff Initial Comments, at 9.

In addition, an expedited process would not provide the necessary time to conduct an environmental review of the impacts of Staff's proposals. In particular, the Commission should direct Staff, pursuant to the State Environmental Quality Review Act ("SEQRA"), to prepare a draft environmental impact statement ("DEIS"). Staff's proposal, which would change the mix of electricity infrastructure in New York, would undoubtedly have a significant impact on the environment, and, by law, such impacts must be evaluated and appropriate mitigation measures adopted. The Commission has required an EIS in other similar cases where significant infrastructure and policy changes were contemplated, such as the Competitive Opportunities and RPS cases.<sup>12</sup>

**II. STAFF'S PROPOSED DEPP AND PROPOSED USE OF LONG-TERM CONTRACTS ARE CONTRARY TO YEARS OF COMMISSION POLICIES FAVORING COMPETITIVE MARKETS AND WOULD STIFLE, IF NOT DESTROY, EXISTING WHOLESALE COMPETITIVE MARKETS.**

Contending that there is a planning gap because the NYISO's Comprehensive Reliability Planning Process ("CRPP") does not evaluate the cost-effectiveness of projects or address public policy issues, Staff would institute its proposed DEPP, a comprehensive command and control regulatory initiative ostensibly designed to close the gap.<sup>13</sup> Track I would evaluate long-term policy directions and strategies over 15-20 years and would direct the type, amount and location

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<sup>12</sup> In the RPS case, the Commission recognized that its proposed action involved changes in policy, practices and economic arrangements affecting the choice and development of new sources of electric generation, and therefore promptly began the preparation of a draft environmental impact statement. Case 03-E-0188, *Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard*, Notice of Completion of Draft Generic Environmental Impact Statement (April 8, 2004). *See also*, Case 03-E-0188, Notice of Determination of Significance (issued March 18, 2003). The Commission had commenced the proceeding on February 19, 2003. Indisputably, the scope of issues raised in its 11 questions is more far-reaching than those contemplated by the RPS proceeding.

<sup>13</sup> Staff Initial Comments, at 5.

of resources needed to be procured to effectuate those strategies.<sup>14</sup> Under Track II, each electric utility would file plans with a five-year horizon, building upon the decisions made in Track I, and would address the selection of the resources needed to meet the goals established in the plan.<sup>15</sup> To implement this process, Staff proposes to begin by supervising the development of an interim plan for all electric utilities, which would “ensure that higher priority procurement efforts are commenced promptly,” within four months of the Order in this proceeding.<sup>16</sup>

This type of comprehensive resource planning (albeit not as detailed as Staff’s proposal) has been tried – and abandoned upon failure – in the past. The essential flaw in Staff’s approach is that procurement decisions would be made without regard to their impact on competitive wholesale markets. Staff argues that its proposed long-term contracting and IRP process is superior to the NYISO capacity market in both ensuring resource adequacy and advancing public policy goals.<sup>17</sup> In its Initial Comments, IPPNY urged the Commission to support efforts to enhance the competitive ICAP market to ensure the market will provide economic signals sufficient to retain needed existing facilities and to site new resources in New York when they are needed. Yet Staff summarily rejects any notion that capacity markets can be enhanced to ensure needed resources are built. It concludes, without providing any supporting evidence, that enhancements such as voluntary or mandatory forward capacity markets cannot feasibly meet public policy considerations.

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<sup>14</sup> *Id.*

<sup>15</sup> *Id.*, at 6-7.

<sup>16</sup> *Id.*, at 6.

<sup>17</sup> *Id.*, at 24.

Staff's proposal presumes that market forces have failed -- an assertion belied by the NYISO's market monitor and Staff's own analyses of the significant benefits that competition has produced for New York's consumers issued less than one year ago<sup>18</sup> -- and the DEPP's implementation would surely and inevitably make its unsupported conclusion self-fulfilling. Its comprehensive management of the selection and procurement of competitive supplies would create a privileged group of supply or demand side resources immune from competitive market forces and, over time, this group would undercut existing and potentially new competitive market suppliers and fatally disrupt existing competitive markets. In addition, Staff's proposal puts it squarely at odds with the Federal Energy Regulatory Commission ("FERC") in that it assumes that it will be able to suppress the In-City market through bilateral contracts and cost-of-service agreements, free from federal intervention. It is FERC, however, and not this Commission, that has exclusive jurisdiction over the wholesale market, and all wholesale power rates and charges, including any rule, regulation practice or contract affecting them, and the responsibility for ensuring that all such rates are just and reasonable and not unduly discriminatory.<sup>19</sup> Furthermore, FERC has determined that it has the ultimate authority over the determination of all matters affecting the rate of capacity, including the allocation of capacity obligations among LSEs and the amount of capacity required to be procured.<sup>20</sup> As we will explain below, there are better and proven means to achieve policy objectives that do not eviscerate competitive markets.

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<sup>18</sup> David B. Patton, Independent Market Advisor, 2006 State of the Market Report New York Electricity Markets (May 2007) at 4; New York State Department of Public Service, Staff Report on the State of Competitive Energy Markets: Progress to Date and Future Opportunities (March 2, 2006) at 1-3.

<sup>19</sup> *ISO New England Inc.*, 119 FERC ¶ 61,161, at P 19 (May 18, 2007).

<sup>20</sup> *Id.* at PP 22-24.

Indeed, Staff's approach would flood the market with excess capacity by requiring the T&D utilities to satisfy public policy goals by procuring new resources beyond the minimum amount necessary to meet reliability needs. As Staff recognizes, this may cause market prices to drop below levels necessary to sustain existing generators needed to assure reliability. Staff's proposed remedy to this concern will cause even more harm to the competitive market. It proposes cost-based long-term contracts with existing generators in New York City that are harmed by its procurement proposal to ensure the generators' continued operation to meet reliability. Essentially, Staff is proposing the introduction of reliability-must-run ("RMR") contracts to New York.

Other competitive wholesale markets where these RMR contracts have been used, such as ISO New England, have recognized the harm these contracts cause to the competitive markets and have spent years correcting the market design flaws that led to the need for RMR contracts. When it addressed ISO New England's use of RMR contracts, FERC found that the proliferation of such contracts is not in the best interest of the competitive market as they adversely affect other suppliers.<sup>21</sup>

FERC stated that RMR contracts should only be used as a last resort. It found that RMR contracts suppress market-clearing prices, making it difficult for new generators to enter the market profitably. It explained that RMR contracts provide expensive generators greater revenues than new entrants and other existing resources, who receive lower revenues from suppressed spot market prices. In addition, FERC found that "suppressed market clearing prices further erode the ability of other generators to earn competitive revenues in the market and increase the likelihood that additional units will also require RMR agreements to remain

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<sup>21</sup> *Devon Power LLC*, 103 FERC ¶ 61,082 at P 31 (April 25, 2003).

profitable.”<sup>22</sup> FERC’s concerns came to fruition. By 2006, approximately 6,000 MWs were under RMR arrangements in New England.<sup>23</sup> To mitigate the harmful impacts of RMR agreements that were to be used as a last resort, FERC directed ISO New England to incorporate the effect of the RMR agreements into a market-type mechanism. In its Initial Comments, IPPNY proposed the same approach for contracts resulting from Discriminatory Procurement.<sup>24</sup>

IPPNY advocated that long-term contracts selected pursuant to Discriminatory Procurement should be subject to market protection mechanisms to ensure that they are not a vehicle for creating a bifurcated market that harms all resources that are unable to obtain “favored treatment” status and secure long-term contracts. Staff opposes the use of one such market protection mechanism that would require load serving entities to bid capacity of generation acquired via Discriminatory Procurement at a percentage of the net cost of new entry (“Discriminatory Procurement Protection Mechanism”, or “DPPM”). Staff argues that such an approach would effectively create a floor for market clearing prices in the capacity market and could require market participants to pay for capacity twice under certain circumstances.

Staff fails to acknowledge that a rationally structured DPPM will not operate as a floor price in the capacity market unless LSEs who otherwise will receive cost recovery attempt to depress capacity market prices by entering into above-market long-term contracts to bring into the market inefficient amounts of excess capacity. A requirement that certain capacity be bid at, for example, no less than 80% of the net cost of new entry (“CONE”) before being subject to

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<sup>22</sup> *Id.*, at P 29.

<sup>23</sup> ISO New England Inc.; Informational Filing of Annual Markets Report, FERC Docket No. ZZ07-4-000 (filed June 14, 2007) at 98 (“As of December 31, 2006, Reliability Agreements were in effect for 14 generating stations, comprising 6,294 MW of capacity.”).

<sup>24</sup> IPPNY Initial Comments, at 6.

market monitoring review and potential market power mitigation, similar to the requirement that applies in ISO New England, would only constitute a floor and cause an LSE to pay twice for capacity if a substantial surplus results from the LSE's procurement activity. However, if a substantial surplus would result, then there should be no reason, other than price suppression, for an LSE to seek to bring such a large amount of additional capacity to the market.

The economic principles which underlie the ICAP demand curve dictate that the market should, over the long run, reach and maintain price equilibrium at the competitive cost of new entry, whereby the supply available in the market fluctuates in a relatively small band around the minimum capacity requirement. At the minimum requirement, the demand curve is designed to ensure that a capacity resource will recover the net CONE. Thus, by setting the DPPM bid requirement at, for example, 80% of the net CONE, a significant amount of capacity in excess of the minimum requirement can be bid in at the DPPM value and still clear in the capacity market. The DPPM would act to prevent the new capacity from receiving compensation in the capacity market only if a very large surplus were present. However, this is the intended purpose of the buyer-side mitigation measure, to protect existing resources from LSE attempts to reduce prices through abuse of their market power by driving the market inefficiently long.

Finally, Staff's assertion that a DPPM would constitute a "floor" on capacity prices is simply erroneous.<sup>25</sup> Such a mechanism would merely ensure that LSEs cannot manipulate the market via new entry to depress prices for existing capacity. It does not establish a floor. If, as currently is the case in the rest-of-state region, surplus capacity exists that is not a result of Discriminatory Procurement (or if, for some reason, additional surplus merchant capacity materialized during periods of significant excess), the existence of that surplus still will drive

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<sup>25</sup> Staff Initial Comments, at 22.

clearing prices lower via the demand curve mechanism. The clearing price may be higher than it otherwise would have been in the absence of the DPPM, in situations where new inefficient amounts of capacity are added via Discriminatory Procurement, but the existence of the DPPM would not establish any floor price because it would only apply to Discriminatory Procurement capacity, not all capacity.

A further flaw in Staff's approach is its reliance on long-term contracts, rather than the marketplace, "to improve fuel diversity, to mitigate market power, to enhance demand response, to add to energy efficiency resources, or to further any number of environmental policies."<sup>26</sup> Staff's proposed DEPP is precisely the type of discriminatory, out-of-market procurement that IPPNY warned against in its Initial Comments and constitutes a very severe threat to competition. The utilities would be required to procure long-term capacity not just to meet reliability needs, but to meet these various public policy goals.

Staff proposes a process whereby utilities are guaranteed cost recovery only for resources procured through narrowly targeted solicitations. Staff's approach imposes an even greater disincentive than exists currently for utilities to enter into non-discriminatory contracts selected pursuant to solicitations that are open to all resources. When faced with the choice between a process that provides pre-approval versus one that affords no pre-approval of cost recovery, the utilities will rationally pick the process that ensures cost recovery. This will likely negate any chance for non-discriminatory long-term contracts that might be selected outside Staff's narrowly targeted and discriminatory procurement process. Coupled with Staff's recommended Commission approval of each policy objective and the procurement process of each electric utility, and pre-approval of contract costs recovery by the utility, Staff's proposal would likely

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<sup>26</sup> *Id.*, at 9.

foreclose any other “non-preference” developer from obtaining a long-term contract to facilitate financing and construction of a merchant project.

Staff would employ its procurement processes and contract pre-approvals for any type of facility or action selected in the DEPP process. Staff observes that its approach would remove many of the obstacles to new entry, an objective IPPNY shares in concept, but it fails to acknowledge the societal costs of its particular approach: “preferred” projects would draw capital and investment away from competitive market suppliers and ruin the competitive markets; risks would be shifted from entrepreneurial investors to captive ratepayers; competitive markets would wither; and top-down, centralized energy planning – with government decision trumping the marketplace – would reign supreme. The Commission should bear in mind that ratepayers’ bills still reflect – two to three decades later – the costs of well-intentioned government decisions sustaining utilities’ massive nuclear construction programs and the costs of high priced contracts approved pursuant to the Public Utility Regulatory Policies Act (“PURPA”) and the State Six Cent Law. Staff’s DEPP fails to reflect any awareness of the pitfalls of these past policies and how the DEPP would be destined to repeat them. Making commitment decisions based on public policy goals and assumptions of resource needs 15 to 20 years forward is fraught with peril, as was demonstrated when the Commission’s avoided cost estimates in the 1980’s were proven wrong.

Therefore, the Commission should not establish the DEPP recommended by Staff and its involvement in any IRP process should be limited to setting up a collaborative process<sup>27</sup> that

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<sup>27</sup> Like National Grid, Con Edison/Orange and Rockland, and NYSEG/RGE, IPPNY does not support initiation of a comprehensive integrated resource planning process. Comments of Niagara Mohawk Power Corporation d/b/a National Grid, at 28-29; Initial Comments of Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. Concerning Long-Term Contracts, at 5; Initial Comments of New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation, at 6, 8; IPPNY Initial Comments, at 5.

would identify the policy options that serve the State's energy goals and then provide input through NYISO working groups and committees for the development of market rules and procedures, if any, that are needed to send the price signals for the development of desired resources. Further, the Commission should encourage, but not require, utilities to enter into long-term contracts selected through fair, open and non-discriminatory solicitations available to new and existing resources to meet reliability needs not addressed by the merchant market.

As noted in our Initial Comments,<sup>28</sup> the Commission already has policies in place to further fuel diversity, energy efficiency and environmental policies, which have been designed to construct thousands of MWs of wind facilities, and care has been taken to ensure certain financial and regulatory incentives do not adversely affect competitive markets. The Commission's System Benefits Charge provides hundreds of millions of dollars to promote energy efficiency and other public benefit programs. Indeed, the Commission has just initiated a proceeding concerning an energy efficiency portfolio standard,<sup>29</sup> based in part on the results of the RPS case. In addition, existing and forthcoming stringent environmental requirements will mean that any new generating facilities should be clean and efficient, furthering environmental policies. Finally, there are more efficient methods to realize environmental goals outside of the Commission's regulatory domain. Cap and trade programs, if done correctly, can meet CO2 goals much more efficiently than a complicated, time-consuming Commission process that tries to decide which facilities, and when and where such facilities, should be built, at the least cost.

Staff provided no empirical support for its concerns. It has failed to explain why it intends to suddenly abandon the current system that is based on the NYISO's planning process

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<sup>28</sup> IPPNY Initial Comments, at 8.

<sup>29</sup> Case 07-M-0548, *Energy Efficiency Portfolio Standard*, Order Instituting Proceeding (issued May 16, 2007).

and utility investment for reliability reasons. In the March 2, 2006 Staff Report on the State of Competition in New York's Electricity Markets, Staff found:

New York's wholesale electricity markets are operated by the New York Independent System Operator (NYISO). An evaluation of New York's wholesale electricity markets under several metrics (i.e., price, robustness of spot and forward markets, generation and transmission infrastructure, demand side response programs, and generator performance) indicates that New York's wholesale markets are among the most advanced in the nation and that wholesale competition has led to significant efficiencies. The total real (i.e., inflation-adjusted) electric price for a typical residential retail customer in New York, including supply and delivery charges, has dropped by an average of approximately 16% between 1996 and 2004. Most commercial and industrial customers have seen decreases in their real energy bills as well. While nominal wholesale commodity prices have gone up, reflecting increases in natural gas prices, on a fuel-price-adjusted basis, wholesale commodity prices generally stayed flat during the period 2000-2005. The overall cost of supply embedded in retail rates in upstate New York was \$50/MWh in 1996, prior to restructuring, and the all-in cost of supply in the upstate wholesale market was also \$50/Mwh during 2002-2004, post-restructuring.

At the same time, new generation is being proposed and constructed in load areas where electric energy and capacity prices indicate a need for additional supply. Since the inception of the NYISO, over 4,000 MW of new generation has been put into service while slightly more than 600 MW has been retired. Also, over 1,000 MW of additional capacity is being imported into the New York market. Nearly 1,000 MW of transmission capacity into the state has been added or is in the process of being added between New York and other control areas. Material progress has also been made in promoting greater demand elasticity with over 1,000 MW participating in the NYISO Special Case Resource programs, and increased implementation of mandatory hourly pricing for large electric utility customers. Generator availability has increased since the inception of the NYISO, and capacity factors of nuclear units have increased. Most importantly, the safety and reliability of the bulk power system has been preserved.<sup>30</sup>

Having made such positive findings about the wholesale markets in New York, it is incumbent on Staff to provide clear and convincing evidence as to why suddenly the competitive framework that has delivered these results must be put at risk with proposals that will harm wholesale markets.

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<sup>30</sup> Staff Report, *supra*, at 1-2.

### **III. THE COMMISSION SHOULD REJECT THE T&D UTILITIES' PROPOSALS TO BUILD NEW OR REPOWER UTILITY-OWNED GENERATION AND RECEIVE RATE-BASED TREATMENT**

Most of the T&D utilities proposed that they be allowed to re-enter the generation business.<sup>31</sup> While IPPNY concurs with most, if not all, of the utilities expressing strong support for continued commitment to competitive markets, the utilities' proposal to re-enter the generation market conflicts with one of the Commission's most significant policies to ensure a fair and efficient competitive wholesale electricity market in New York. The Commission recognized in its Opinion 96-12 that the most efficient means of selecting new resources is via the competitive market. Indeed, as expressly stated by the Commission, one of the primary benefits of competitive electricity markets is that investment risks are shifted from captive utility ratepayers to private investors.

As IPPNY explained in its Initial Comments, the Commission should not abandon its policy of keeping generation separate from T&D. If permitted to construct new generation using regulated dollars, T&D utilities will have an advantage over developers of market-based solutions because their prudent utility costs are recoverable from captive ratepayers while non-utility developers and investors have no such guarantee of recovery for prudently incurred costs.<sup>32</sup> The Commission's policy is clear that T&D utilities should construct new generation only if non-utility generation is unavailable to meet a reliability need in a timely manner.

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<sup>31</sup> Central Hudson Initial Comments, at 13; Initial Comments of Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. Concerning Long-Term Contracts, at 11; New York State Electric & Gas Corporation's and Rochester Gas and Electric Corporation's Initial Comments on the Use of Long-Term Contracts and Other Means to Facilitate the Entry of New Resources, at 2, 8.

<sup>32</sup> Indeed, a less costly merchant supplier would be at risk while a more expensive rate-based investment would be protected and assured a return of, and on, investment. In addition, T&D utilities subject to cost of service regulation have an incentive to drive up the costs of their infrastructure so they may earn a return on a larger base.

In its Initial Comments, IPPNY suggested that to the extent sufficient, purely market-based solutions are not proposed to address identified reliability needs, regulated solutions sponsored by independent power producers or T&D utilities would be required. IPPNY recommended that the Commission encourage electric utilities to enter into long-term contracts selected pursuant to non-discriminatory competitive solicitations to help ensure reliability needs are met at the lowest cost and to discourage electric utilities from building their own, potentially more costly resources.

IPPNY proposed that if a reliability need is identified in the RNA and no merchant solutions come forth by a specified time, the Commission should direct the electric utility in whose service territory the need arises to hold an open, competitive solicitation for new resources to meet the reliability need. The Commission should coordinate with the NYISO, electric utilities and other market participants to develop procedures that ensure that the competitive solicitations are fair and non-discriminatory and appropriately designed to yield the necessary resource(s). Responses to the solicitation process should be subject to Commission review akin to the process used when the T&D utility generation assets were divested.

The procedures should also ensure the price signal from the solicitation is reflected in the market and accommodate any bidding rules in place in the wholesale competitive markets. These procedures should set forth the criteria that will be used to evaluate, on a consistent and equal basis, the electric utility's regulated backstop solution against proposals submitted in response to the solicitation, for the purpose of selecting the optimal solution to the reliability need. Only if a properly structured solicitation fails to produce a solution that can meet the reliability need in a timely manner should the utility be authorized to proceed with a regulated backstop solution that utilizes its own project.

IPPNY's proposal is consistent with the Commission's policy that encouraged and authorized T&D utilities to acquire needed electric capacity through competitive bidding.<sup>33</sup> In its Competitive Bidding Order, the Commission discouraged cost-recovery for construction of new generation capacity by T&D utilities unless a competitive bidding process failed to provide sufficient capacity to meet the utility's needs.<sup>34</sup>

Thus, the Commission should require utilities to hold competitive solicitations for new resources to satisfy their obligations to procure a regulated backstop or alternative regulatory solution to meet the reliability need if no adequate market-based solutions are developed. Utilities should be authorized to proceed with construction of generation only if there are no adequate market-based solutions and a properly structured solicitation fails to produce an adequate solution.

The Commission should not be persuaded by arguments, such as those made by Central Hudson, that utility construction of new generation should be preferred over long-term contracts because utilities can construct new generation more efficiently and at lower costs than private developers. First, most of the T&D utilities in New York have lost the expertise to manage the construction and operation of electric generating facilities. They have been out of this business for many years as PURPA plants were added to the generation fleet and T&D utilities divested their generation. Second, the argument that utilities can build at lower cost because their costs of capital are less is belied by the long history of costly overruns that ratepayers have been required

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<sup>33</sup> Case 29409, *Plans for Meeting Future Electricity Needs in New York State*, Opinion and Order Concerning Bidding, Avoided-Cost Pricing, and Wheeling Issues, Opinion No. 88-15, 28 N.Y. P.S.C. 839 (June 3, 1988) ("Competitive Bidding Order").

<sup>34</sup> *Id.* at 843.

to bear for the construction of utility generation.<sup>35</sup> Indeed, a fair comparison between a T&D utility's estimated costs of constructing new generation with a private developer's bid for new generation is difficult, if not impossible, due to the likelihood that the T&D utility will be allowed to recover its cost overruns post construction. Unless utilities agree to accept cost recovery based on a pre-determined, fixed amount and forego cost recovery on any cost overruns, they should not be heard to complain that ratepayers pay more when generation needs are met by the private market.

#### **IV. THE COMMISSION SHOULD CONDUCT A REVIEW OF STAFF'S AND OTHER PARTIES' PROPOSALS UNDER THE STATE ENVIRONMENTAL QUALITY REVIEW ACT.**

SEQRA and its implementing regulations (6 NYCRR, Part 617 and 16 NYCRR, Part 7) are designed to incorporate consideration of environmental factors into the existing planning review and decision-making process of state, regional, and local government agencies at the earliest possible date. SEQRA requires that agencies determine whether the actions they are requested to approve may have a significant impact on the environment. Generally, if it is determined that an action may have a significant adverse impact, a DEIS is prepared for review and comment, and a final EIS, addressing, among other things, likely impacts and suitable mitigation measures, is prepared and accepted before the agency takes action.

In this proceeding, Staff is seeking a dramatic reversal of prior Commission policies for procuring resources to satisfy reliability needs, enhance fuel diversity, inhibit market power, add energy efficiency resources and pursue any number of environmental policies. Indeed, Staff's

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<sup>35</sup> With extensive construction cost overruns, purported savings via discounts to cost of capital would be dwarfed by the adjusted overall return for the utility.

plan is, arguably, the most far-reaching set of changed policies and actions for obtaining energy supplies since the Competitive Opportunities Proceeding and its offspring.

In the RPS proceeding, the Commission quickly ascertained that its plan to formulate a policy statement on retail Renewable Portfolio Standards and to establish implementation standards may have a significant effect on the environment.<sup>36</sup> When it made available the DEIS a year later, the Commission explained that its significance determination was based on the fact that the proposed action “involves changes in policy, practices and economic arrangements affecting the choice and development of new sources of electric generation.”<sup>37</sup> Here, the Commission is being asked to alter policies and adopt actions having similar, though demonstrably more far-reaching, impacts. Accordingly, the Commission should issue a notice of significance and direct Staff to begin preparation of a DEIS according to SEQRA. This has been the consistent practice of the Commission in major electric policy cases, from the integrated resource plans and competitive bidding cases in the 1980’s,<sup>38</sup> the Competitive Opportunities Case,<sup>39</sup> and, as noted, the RPS proceeding.

## **V. STAFF’S PROPOSAL THAT CON EDISON OBTAIN PERMITTING FOR A SITE PRIOR TO ISSUING AN RFP IS NOT VIABLE.**

Staff suggested that, to improve interest in responding to an RFP for building on a site in New York City, given the shortage of possible sites, Con Edison should obtain the necessary

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<sup>36</sup> Case 03-E-0188, *Retail Renewable Portfolio Standard*, Notice of Determination of Significance (issued March 18, 2003). The Commission had commenced the proceeding on February 19, 2003.

<sup>37</sup> Case 03-E-0188, *supra*, Notice of Completion of Draft Generic Environmental Impact Statement (issued April 8, 2004) at 1.

<sup>38</sup> *See, e.g.*, Case 88-E-241, *Orange and Rockland Utilities, Inc.*, Opinion and Order Establishing Guidelines for Bidding Proposals, 29 N.Y. P.S.C. 221, 248-50 (April 13, 1989).

<sup>39</sup> Opinion No. 96-12, Findings Statement at 83 *et seq.*

permits before issuing the RFP, and then transfer the site and permits to the winning bidder.<sup>40</sup> IPPNY finds this approach impractical and unreasonable. Con Edison would have to select a specific technology and unit type and make decisions concerning environmental equipment, perform detailed engineering work, environmental studies and outreach as part of the design and permitting process. Permitting agencies may attach a host of construction and operational requirements and environmental conditions, and may place restrictions on possible other entities acquiring and building on the site. All of the above considerations involve making both financial and operational trade-offs. The T&D utility should not be in position to bind the future owner to such permit conditions and restrictions. By the time the utility has completed this costly several-year process, it may conclude that it is in the best position to go forward – an outcome IPPNY disfavors, as noted above and in IPPNY’s Initial Comments.<sup>41</sup> Therefore, Staff’s suggestion should not be endorsed.

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<sup>40</sup> Staff Initial Comments, at 26.

<sup>41</sup> IPPNY Initial Comments, at 14.

## VI. CONCLUSION

Consistent with the foregoing and the principles discussed in IPPNY's Initial Comments, the Commission should ensure that any policies it adopts concerning long-term contracts and IRP do not interfere with the competitive market. The Commission should also require the T&D utilities to hold competitive solicitations for new resources to satisfy their obligations to procure a regulated backstop or alternative regulatory solution to meet reliability needs if no adequate market-based solutions are developed. T&D utilities should be authorized to proceed with construction of generation only if there are no adequate market-based solutions and a properly structured solicitation fails to produce an adequate solution.

Respectfully submitted,

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