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June 22, 2007

Hon. Jaclyn Brillling  
Secretary  
NYS Public Service Commission  
Three Empire State Plaza  
Albany, New York 12223

**Re: 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 – Phase II**

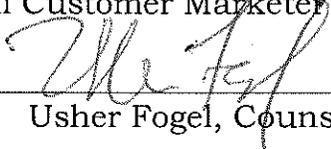
Dear Secretary Brillling:

Enclosed for filing with the Commission please find the original and ten (10) copies of the *Reply Comments of Retail Energy Supply Association and the Small Customer Marketer Coalition* in the above-captioned matter.

Thank you for your assistance in this matter.

Respectfully submitted,

Retail Energy Supply Association and  
Small Customer Marketer Coalition

By:   
Usher Fogel, Counsel

Cc: Active Parties (by electronic mail)

**STATE OF NEW YORK  
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 – PHASE II.**

**REPLY COMMENTS OF THE RETAIL ENERGY SUPPLY ASSOCIATION AND  
SMALL CUSTOMER MARKETER COALITION**

**I. INTRODUCTION**

These reply comments are submitted on behalf of the Retail Energy Supply Association ("RESA")<sup>1</sup> and Small Customer Marketer Coalition ("SCMC") in accordance with the schedule adopted in the *Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II to Address Longer Term Issues*, issued in the above-captioned proceeding on April 19, 2007.<sup>2</sup>

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<sup>1</sup> RESA member companies include Consolidated Edison Solutions, Inc., Direct Energy Services, LLC, Hess Corporation, Liberty Power Corp., Reliant Energy Retail Services, LLC, Sempra Energy Solutions, Strategic Energy LLC, SUEZ Energy Resources NA, Inc., and U.S. Energy Savings Corp. The opinions expressed in this document represent the position of RESA as an organization but may not represent the views of all members of RESA.

<sup>2</sup>Case 06-M-1017 – Proceeding On Motion Of The Commission As To The Policies, Practices, and Procedures For Utility Commodity 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* (issued April 19, 2007) ("Order").

## **II. PRELIMINARY STATEMENT**

In the initial phase, SCMC and RESA set forth their position that integrated resource planning (“IRP”) and increased use of utility long-term contracts to set the default price will negatively impact the competitive market.<sup>3</sup> Thereafter, other parties also submitted initial comments presenting their responses to the questions posed by the Commission in the Order. In these reply comments, RESA and SCMC will respond to the primary critical fallacies inherent in the positions advocated by a number of commenting parties supporting IRP and utility long term contracts which, if the Commission adopts as proposed, would fail to serve the public interest and potentially undermine the maintenance of viable and productive competitive markets.

In connection with the issue of utility long-term contracts, proponents of this option:

1. fail to acknowledge the significant risks to consumers and the market of reliance upon utility long-term contract pricing included in the default service price;
2. unreasonably presume that the perceived deficiency in available generating capacity is caused by the absence of utility long-term contracts;

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<sup>3</sup> See Case 06-M-1017 - Initial Comments of the Retail Energy Supply Association and Small Customer Marketer Coalition dated June 4, 2007 (“RESA/SCMC Comments”).

3. do not consider that default pricing that includes utility long term contracts can harm consumers and deny them the benefits of competitive markets; and
4. overlook the mechanisms already in place that can help spur the introduction of additional generating facilities without utility long term contracts.

With respect to the introduction of an integrated planning process, proponents of this view:

1. fail to adequately acknowledge the significant risks of replacing market forces with a command and control planning structure;
2. fail to emphasize the important role of providing consumers with clear and accurate market signals; and
3. overlook the need to develop a more targeted approach which focuses on ascertaining a clear deficiency in the market and then developing a market-based response.

### **III. REPLY COMMENTS**

#### ***A. Mandatory Use of Utility Long-Term Contracts in Determining the Default Price is Unnecessary, Will Harm the Competitive Market, and Will Not Ensure the Addition of New Capacity***

The Parties supporting increased use of utility long-term contracts unfortunately overlook the significant risks and costs that are associated with

this approach to securing electric supply. As underscored in our initial comments, utility long-term contracts that are included in the default service price result in prices that, over time, do not reflect the then-current market conditions, undermine and impair the competitive energy market, and create the significant risk that customers will be burdened with stranded costs.<sup>4</sup> The proponents, while asserting that utility long-term contracts are needed in order to spur and support the construction of additional generation,<sup>5</sup> fail to acknowledge that movement away from market-based arrangements will result in prices that are not market reflective and lead to an undermining of the vibrant competitive retail markets that have developed in the State pursuant to the Commission's policy favoring the growth of competitive markets.<sup>6</sup>

The longer the term over which prices are set the greater the probability that the contract price will diverge from market prices. Fundamentally, when utility long-term contract prices exceed market costs, consumers will overpay for their usage and, conversely, if market prices exceed the contract price, consumers will be provided with the erroneous price signal that their power is less expensive than it actually is, engendering overuse of valuable electric supplies. In this environment of diluted market signals, customers remain ignorant as to the benefits and/or costs associated with the use or conservation of electricity. This will lead to erroneous acquisition policies and potentially undermine the ability to implement cost-effective demand reduction

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<sup>4</sup> SMC/RESA Comments, p. 13.

<sup>5</sup> See, *e.g.*, Comments of NRG Companies, p. 2 and Consumer Protection Board, p. 2

<sup>6</sup> Comments of National Grid, pp. 26-29.

and energy efficiency measures, which are high priorities of the current administration.<sup>7</sup>

In addition to overlooking the failure to provide adequate pricing signals, advocates of utility long-term contracting fail to come to grips with the significant possibility, based upon historical experience, that such contracts will burden consumers with unnecessary stranded costs in the future. Prior flirtations with government-directed utility long-term contracts not only produced inaccurate market signals but also resulted in utilities acquiring contracts which imposed a significant stranded cost burden upon rate payers. Thus, for example, Niagara Mohawk Power Corporation absorbed \$2 billion in losses over a five-year period to address the stranded costs associated with its above-market contracts.<sup>8</sup> These earlier debacles led one of the commenting utilities to conclude that the Commission should “avoid the pitfalls created by past experiments with mandated long-term contracts...”<sup>9</sup>

The proponents also overlook that including utility long-term contracts in default service pricing potentially harms customers and denies them the benefits of competitive retail markets. In the first instance, from a costing perspective, utility long-term contracts may be a “lose-lose” proposition for customers as there is no persuasive evidence indicating that such contracts

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<sup>7</sup> Case 07-M-0548 – Proceeding on the Motion of Commission Regarding an Energy Sufficiency Standard, Order Instituted Proceeding (issued May 16, 2007).

<sup>8</sup> Case 94-E-0098 – Niagara Mohawk Power Corporation, Opinion and Order Adopting Terms of Settlement Agreement Subject to Modification and Clarification, Opinion No. 98-8 (issued March 20, 1998); Comments of Con Edison, pp. 8-9; See, also, Case 06-M-0002, Orange & Rockland Utilities, Inc., 2006 WL 2852356 9 (issued October 6, 2006) where the utility was authorized to defer approximately \$1.2 million for termination of an above-market long-term contract.

<sup>9</sup> Comments of NYSEG/RG&E, p.2.

will provide customers with lower rates. Indeed, based on the historical evidence noted above, utility long-term contracts may saddle customers with higher, above-market, utility rates.

In the second instance, such contracts inhibit ESCO activity. ESCOs are in the business of bringing customers the products and services they want-- that is the foundation of our businesses success, and without customers we do not exist. Unlike utilities, ESCOs do not have a captive customer base and, thus, are driven to listening to customer needs and responding to those desires on a timely basis. In short, an ESCO recognizes that, if it does not meet a customer's need, some other retailer will. Unfortunately, a default pricing structure encumbered with utility sponsored long-term contracts and IRPs, both of which dilute correct market signals and are a move away from a market-oriented approach, will impede the ability of retailers to respond to customer needs and preferences and offer the variety of services and products that are the hallmark of a robust competitive retail market.

In their comments, supporters of long-term contracts assume such contracts are necessary to overcome the alleged barriers to entry which preclude the development of new electricity resources.<sup>10</sup> However, there is little hard evidence presented supporting this proposition. Essentially, it is assumed, without more, that utility based long-term contracts are necessary or desirable for the development of new resources. However, supporters of long-term contracts fail altogether to consider whether the perceived absence in the

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<sup>10</sup> See, *e.g.*, Comments of Consumer Protection Board, p. 2, Staff, p. 8 and New York City, p. 5.

construction of new generation might be due to other factors, which could include the NIMBY (“not in my backyard”) syndrome which, in the absence of an Article X statute, significantly inhibits the construction of new generation throughout the State, especially in the downstate area. Moreover, such supporters neglect to look at whether the operational characteristics of certain types of resources that have been developed could be reflective of customer or market preferences and the market signals associated with the fundamental operations of the competitive supply market place. As previously noted, experience has shown that the investment community can support the introduction of new generation even in the absence of utility sponsored long-term contracts. In Texas over 30,000 MW of generation has been added in the last 10 years, all without ratepayer backed long-term contracts. <sup>11</sup>

In this regard, the NY Power Trends 2007 and NYISO have noted the following issues, among others that have inhibited the construction of new generating capacity in New York:

- Absence of a streamlined siting and permitting process for major power plants.<sup>12</sup>
- Need for additional market-based mechanisms designed to support the financing of energy infrastructure projects.
- Challenge to find solutions to environmental initiatives that maintain reliability.

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<sup>11</sup> <http://www.puc.state.tx.us/electric/maps/gentable.pdf>

<sup>12</sup> In the current 2007 Session the Legislature did not pass an Article X siting statute.

- New law that denies the power of condemnation to certain developers of new transmission facilities which serves as a deterrent to transmission developers.

This listing underscores that merely instituting an IRP or utility long term contracting may not result in the desired outcome, and without first providing solutions to the above mentioned problems may exacerbate an already troubled situation.

Although emphasis is placed on the use of utility long-term contracts to supply new generation, there is insufficient consideration given to existing structures already in place which have the potential to address any perceived resource deficiency. Currently, the NYISO has instituted a Comprehensive Reliability Planning Process that identifies resources needed to meet reliability standards and incorporates a process that ensures that needed resources will be developed either via a market-based solution or, if none is unavailable, by the regulated utility. In addition, the State has developed a forward capacity market which also presents another mechanism to aid in the development of new generating resources.<sup>13</sup>

In summary, utility long-term contracts should not be viewed as a panacea that will solve any perceived deficiency in the existing electric resource market. Instead, it is critically important for the Commission to recognize that utility long-term contracts entail significant risks to consumers and utilities

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<sup>13</sup> Comments of Con Edison, pp. 8-9.

and that there are already mechanisms in place that can help spur the development of needed generation in a manner that does not provide consumers with inaccurate market signals and expose them to a potential new generation of stranded cost.<sup>14</sup>

***B. Integrated Resource Planning Procedures are Unnecessary and Will Harm the Competitive Market***

Staff proposes the introduction of a Dynamic Energy Planning Process ("DEPP") as a vehicle to examine long-term electric resource needs of the state.<sup>15</sup> The DEPP, while described by Staff as a flexible process,<sup>16</sup> is eerily similar to an integrated long term resource planning effort and has hallmarks of planning processes that were employed to the disadvantage of the consumer in prior years. In this regard, under the DEPP, the Commission, in addition to identifying policy goals would identify the specific means by which those goals would be achieved over a 15-20 year period, including the use of utility long-term contracts and other vehicles that are not necessarily representative of the free interplay of market forces. In advocating this approach, Staff neither

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<sup>14</sup> It is most revealing that the major electric utilities that had to deal with the regulatory detritus arising from the Commission's previous reliance on long-term contracts, including Con Edison, National Grid, Orange & Rockland, NYSEG and RG&E, now advise the Commission to **avoid mandating** the utilities to enter into long term contract arrangements. See Comments of NYSEB/RGE, p.2, Con Edison/O&R, p. 8 and National Grid, p. 32.

<sup>15</sup> Comments of Staff, pp. 8-9.

<sup>16</sup> *Id.*, p. 4.

acknowledges nor attempts to address significant concerns associated with a centralized energy planning structure.<sup>17</sup>

Such a process highly distorts the required clarity of market signals, may undermine the efficient operation of the competitive markets and ultimately can harm consumers in a marked financial manner. Moreover, Staff does not mention that, from a historical perspective, it is well recognized that centralized energy planning structures simply do not work; past efforts by the State that displaced market forces through use of a command and control energy planning process have resulted in unfavorable outcomes for consumers and utilities; and attempting to forecast into the future with any degree of reliability and using such forecasts as the basis for capacity acquisition, at ratepayer rather shareholder risk, is inheritably unreasonable and unreliable.<sup>18</sup> If we ignore history, we increase the probability that the mistakes of the past will be visited on consumers in the future. The enthusiasm expressed by Staff and other parties for a DEPP type of structure should not be used as an excuse to either ignore or simply slough off the serious problems that arose from the use of integrated planning processes in prior decades.

In its listing of various policies and concerns that are to be addressed in the DEPP, Staff fails to adequately emphasize the importance of ensuring the maintenance of functioning competitive markets and the provision of accurate and timely market signals to consumers. Ultimately, a resource planning or

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<sup>17</sup> To the extent Staff favors a portfolio approach, this can and should be achieved without utility long-term contracts; a suitable portfolio includes several types of time-based rate schedules that may be offered including TOU pricing, critical peak pricing, real-time pricing, and demand reduction incentives.

<sup>18</sup> RESA/SCMC Comments, pp. 4-7; National Grid Comments, p. 29.

study process that fails to maximize the maintenance of a workable competitive market which assures consumers are adequately apprised of the market costs associated with their energy decisions, creates the serious potential for the State to engage in uneconomic supply acquisitions which will redound to the financial detriment of consumers for decades to come. Any study or planning process implemented by the Commission must, consistent with Commission policy, focus on preserving competitive choice and providing accurate market signals to consumers.

It is also disconcerting that, as part of the DEPP process, Staff does not emphasize the importance of clearly and reliably ascertaining the cost impacts associated with policies and strategies arising from the planning process. The issue of rising costs is a matter of rising urgency in the State. Almost every electric utility in New York will require material rate increases in the future to support installation of the requisite electricity distribution infrastructure. Most notable in this regard, is Con Edison's recently submitted request for an increase in distribution rates of \$1.2 billion. This cost burden will be further augmented by the significant cost associated with implementing the Commission's new energy efficiency initiative.<sup>19</sup> It is preliminary estimated that this initiative alone may require cost outlays with a present value of about \$5 billion.<sup>20</sup> The achievement of the Commission's stated goals for the use of renewable energy will further increase costs on an annual basis through the

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<sup>19</sup> Case 07-M-0548 – Proceeding on the Motion of Commission Regarding an Energy Sufficiency Standard, *Order Instituted Proceeding* (issued May 16, 2007).

<sup>20</sup> *Id.*, Preliminary Staff Analysis dated June 1, 2007, p.4.

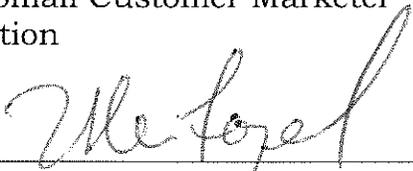
year 2011.<sup>21</sup> Obviously, in such a high rising cost environment, it is imperative that any subsequent strategy or resource decisions accurately take into account the potential cost impact upon ratepayers.

**IV. CONCLUSION:**

RESA and SCMC appreciate the opportunity to present their views on the important issues raised in the Order, and it is respectfully requested that the Commission adopt policies consistent with the views and recommendation expressed in our comments filed in this proceeding.

Respectfully submitted,

Retail Energy Supply Association  
and Small Customer Marketer  
Coalition

By: 

Usher Fogel, Counsel

Dated: Cedarhurst, New York  
June 22, 2007

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<sup>21</sup> Case 03-E-0188 – Retail Renewable Portfolio Standard, *Order Regarding Retail Renewable Portfolio Standard* (issued September 24, 2003).