

VIA AIRBORNE EXPRESS

March 27, 2003

Hon. Janet Hand Deixler
Secretary
State of New York
Public Service Commission
Three Empire State Plaza, 19th Floor
Albany, New York 12223-1350

Re: Case 03-E-0188 – Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard.

“Order Instituting Proceeding” (issued and effective 2/19/03)

"Ruling Concerning Procedure and Schedule" (EES) (issued 2/20/03)

"Ruling Revising Schedule" (EES) (issued 3/6/03)

COMMENTS OF NIAGARA MOHAWK POWER CORPORATION

Dear Secretary Deixler:

Niagara Mohawk Power Corporation (“Niagara Mohawk” or “Company”) submits this original letter and five (5) copies hereof as and for its Comments in response to the above-referenced Order and Rulings.

Copies of this filing are being provided via e-mail to Judge Stein and to the Active Parties in this proceeding.

Kindly acknowledge receipt and filing of this submittal by date-stamping the enclosed copy of this letter and returning it in the postage-paid envelope provided for your convenience.

GENERAL COMMENTS

1. Any Renewable Portfolio Standard Should Be Implemented on an Overall State-Wide Basis, and Not on an Individual Retail Supplier Basis

Any Renewable Portfolio Standard ("RPS") should be based on state-wide electricity supplies and not on individual retail supplier portfolios. In this regard, the New York Independent System Operator ("ISO") is charged with the management of wholesale electricity markets. As such, it should be the administrator of any RPS.

One important benefit of an ISO-administered RPS program is that costs can be spread state-wide, thereby minimizing disproportionately-spread individual retail supplier costs and expenses. In addition, with an ISO-administered program, costs could be minimized. If, for example, each individual Load Serving Entity ("LSE") is required to meet an RPS, there will likely be incremental costs and complexities in tracking the effects of customer switching among LSEs. Managing the RPS on a state-wide basis will be more efficient.

Another important benefit, as discussed in (2) below, is that an ISO-administered RPS program would not interfere with the orderly development of a workably competitive wholesale market, which is an important goal of the Commission. Retail supplier-specific RPSs, in contrast, specifically RPSs that require long-term procurement contracts, could interfere with market development, as discussed in (2) below.

Finally, the ISO already has market monitoring mechanisms in place that could be adapted to assure that wrongful conduct would be detected and deterred. There would be less risk that generators or renewable resources would improperly leverage market power if there is only one market and one entity managing and monitoring that market. In contrast, with multiple, smaller LSEs, the risk of improper generator conduct may increase and may go undetected by the ISO. Individual retail suppliers would have far less effective defenses against what could be subtle market manipulation practices.

One or more Public Authorities, whether the Power Authority of the State of New York ("NYPA"), the New York State Energy Research and Development Authority ("NYSERDA"), or the Long Island Power Authority ("LIPA"), could help facilitate an ISO-administered RPS program, either through the direct procurement of renewable energy resources (including aggregated purchases for the benefit of State agencies) or through investments in, or construction or financing of, renewable resource generating facilities. The State Energy Plan seems to contemplate this type of arrangement.

2. Any RPS Should Not Assume the T&D Utility's Retention of Commodity Procurement Functions

The long-term goal embraced by the Administrative Law Judges in their Recommended Decision ("RD") in the Competitive Markets Proceeding (Case 00-M-0504) is that T&D Utilities should exit the commodity supply business and that all Energy Services Companies ("ESCOs") should have obligations to serve. In furtherance of this goal, the RD cautioned that long-term utility commodity procurement contracts

could impede the development of a stable workably competitive wholesale electric market, or result in a significant exposure to utility stranded costs (RD pp. 75-83).

Specifically, the RD observed:

[I]n viewing the options available from the perspective of fostering the development of retail markets, matters become more complex. It is generally assumed that one can avoid or limit the impact of market volatility through hedging, which, in the long run, will result in a higher but more predictable cost for the commodity. In the short run, hedges can either reduce total costs compared to the market or increase them; it is a gamble with the cost of the hedge (the bet) proportional to the risk it covers. There is no way to know in the short-run whether a hedged product will be more expensive than buying from the spot market.

In addition, if the utility's price is largely hedged through long-term contracts, it may be very difficult for ESCOs, who have a tiny fraction of the utility's purchasing power, to offer as attractive a product. If market prices fall below the utility-hedged price, migration to ESCOs should be brisk; but as soon as the price relationship reverses, customers will flock back to the utilities. A stable market will have a difficult time forming under these circumstances, and additional problems are created by the possibility of stranding the costs of the utilities' hedges if customers leave in large numbers.

* * * * *

Therefore, we recommend that the hedging portfolio requirements of the Statement of Policy Regarding Gas Purchasing Practices be continued for gas . . . and be adopted for electricity. We hasten to add, however, that there should be some temporal limit to the physical and financial hedging contracts purchased by the utilities. If these contracts extend beyond the time when a workably competitive wholesale electric market comes into being, customers may be locked-in to utility contracts and market development could be stalled. And even if customers are not constrained under

utility contracts, hedging well into the future creates a significant exposure to utility stranded costs.

RD pp. 77, 79-80.

The Company shares the concerns expressed in the RD. In transitioning out of the commodity supply business, a T&D Utility should not be required to enter into long-term bilateral contracts with suppliers of renewable resources. Further, the RPS should call for the voluntary, not mandatory, marketing by T&D Utilities of renewable resources sold by other retail suppliers.

Finally, the Commission is presently soliciting comments in its separate proceeding (Case 03-M-0117) implementing recent revisions to the Home Energy Fair Practices Act ("HEFPA") as to whether ESCOs have an obligation to serve under New York law. Pending resolution of this issue, any RPS should not be predicated on the assumption that the T&D Utility, and only the T&D Utility, has a POLR obligation.

3. The RPS Costs Should Not Outweigh the Benefits

In its February 19, 2003 "Order Instituting Proceedings" (p.2), the Commission noted that these proceedings should examine appropriate methodologies for assessing costs and benefits. On this issue, Niagara Mohawk is deeply concerned at the conclusion reached by NYSERDA in its preliminary report of February 14, 2003 ("NYSERDA Report") that "renewable resources will initially be more expensive than conventional energy resources" (p. 3 of 7).

While the Company supports and endorses responsible management of the environment, the Company and the Commission also have a keen interest in reducing electricity costs. Indeed, the very objective of independent generation sources, retail competition, and the elimination of vertically integrated utilities has been the reduction of costs. Until all RPS-related costs are identified, the benefits of renewable resources cannot be truly weighed.

At this time the types of costs reviewed in the NYSERDA Report are unclear. In Niagara Mohawk's opinion, the relevant costs that merit examination in this proceeding include (1) increased commodity prices at the wholesale (ISO) and retail (NYS consumers and businesses) levels; (2) costs of required infrastructure improvements (such as electric interconnection facilities, transmission system upgrades, expanded gas transportation facilities); (3) forecasted levels of congestion; (4) financing costs of new generation; (5) costs of new renewable projects distinguished from the costs of existing renewable projects; (6) costs of any facilitating activities of State agencies such as NYPA, LIPA and NYSERDA; (7) fluctuations in gas prices (in the event gas-fired technologies are included as renewable resources); (8) potential T&D Utility lost revenues associated with net metering initiatives or increased levels of partial or full islanding; and (9) any other RPS-related costs. All RPS-related costs must be reviewed in totality and weighed against the important State objective of reduced electricity costs.

On this point, if, indeed, as NYSERDA concludes, an RPS will result in increased costs, a real risk exists of increased islanding (whether whole or partial) in response to

these increased costs. If the increased islanding is in the form of non-renewable distributed generation, the root RPS goal of achieving a cleaner environment could be undermined and the remaining, non-islanding customers would see even higher RPS-related costs because there would be fewer customers over which RPS-related costs could be spread.

Finally, the NYSERDA Report (p. 4 of 7) states that setting a capacity goal in terms of megawatts would be easier to meet, while an energy goal would result in a greater overall energy cost to consumers. Niagara Mohawk believes that any RPS adopted by the Commission must be consistent with the overriding Commission goal to reduce electricity costs. Thus, inasmuch as an energy goal will indeed result in increased costs, an energy-based RPS merits no further consideration.

SPECIFIC COMMENTS

Niagara Mohawk hereby submits the following comments in response to the threshold issues posed by the Commission in its Order.

1. The types of resources that should be considered as “renewable” for the purposes of a renewable portfolio standard.

In order to meet the 25% target, hydroelectric facilities should be included in the RPS, along with other resources referenced in the State Energy Plan. In the absence of hydroelectric power, achievement of the 25% target within the proposed time frame seems unrealistic.

On this point, the Order (p. 1) expresses the Commission's concern regarding the climatic effects of fossil-fired generation. Notwithstanding this concern, however, some of the potential types of renewable energy resources cited in the NYSERDA Report (p. 2 of 7) include those fueled by fossil sources such as gas. To the extent that the reference to "renewable" can be deemed to include all environmentally friendly energy resources, and not literally to resources that are self-replenishing, the Company believes that consideration should be given to the inclusion of nuclear-fueled facilities in any RPS. From an emissions perspective, nuclear-fueled generation plants are far cleaner than fossil-fueled facilities of any type. Clarification is thus necessary as to the meaning of the term "renewable energy resource" and whether and to what extent it is based upon impacts to the climate or environment.

If fuel cells or other small on-site, end-use generation resources are included in the definition of "renewable" resources, as suggested in the NYSERDA Report, then demand response load reductions and any installed capacity ("ICAP") associated with such small resources should count toward any RPS goal. An appropriate methodology for "counting" load reductions would need to be developed.

2. The appropriateness of including renewable resource energy procured from outside the State, such as hydropower from Canada or wind energy from New England.

Given the regional nature of energy markets, and, in particular, the interdependency of bulk power transmission facilities, renewable resource energy procured from outside the State should be included. At a minimum, renewable resource

electricity supplies imported from the New England states and New Jersey should continue to be countable as such, in accordance with Opinion 98-19, “Opinion and Order Adopting Environmental Disclosure Requirements and Establishing a Tracking Mechanism”, issued and effective December 15, 1998 in Case 94-E-0952.

As discussed above, however, imported power transactions should be through ISO-administered markets, or voluntary retail supplier marketing programs and procurement transactions, and not through mandated T&D Utility power purchase agreements.

3. The retail suppliers that should be required to sell energy from renewable resources.

As discussed above, Niagara Mohawk believes that the ISO should be allowed to manage energy markets in the State. Through ISO-administered programs, as supported by the facilitating activities of NYPA, LIPA, and NYSERDA, the voluntary programs and transactions (whether procurements or conversion transactions) undertaken by LSEs, and appropriate aggregation strategies pursued by large retail customers such as the State of New York and its municipal entities, the 25% target for renewable energy resources should be met.

The Company does not believe that any distinctions should be drawn among LSEs. For purposes of the continued evolution of competitive wholesale markets in this State, an LSE is an LSE. And for purposes of lowering zonal and individual consumer impacts associated with implementation of an RPS, costs should be spread among all LSEs. On this point, the Commission, as it noted in Opinion 98-19, has clear jurisdiction

over T&D Utilities, ESCOs and municipal and cooperative utilities who are not solely NYPA customers. Equal treatment of these entities is essential in order to maintain a system of fair competition. As for non-jurisdictional entities, such as NYPA, LIPA, and municipal and cooperative utilities whose rates, services and practices are governed by the provisions and principles established in a contract with NYPA, an ISO-administered RPS program would necessarily affect, to varying degrees, the electricity supply portfolios of these entities.

Contrary to the practices in other states, Niagara Mohawk does not believe that the POLR and only the POLR should be held to an RPS standard. The only way for costs to be minimized overall is for all LSEs, through their participation in ISO-administered markets, to bear their appropriate share of RPS costs. Higher-priced POLR pricing could result in disproportionate price impacts upon consumers and others who lack the ability to benefit from aggregated service offerings through non-POLRs.

4. The impact, if any, on the ability of energy services companies' (ESCOs) abilities to compete with utilities if they are required to procure renewable resources beyond what their customers request, given the relative sizes of the loads supplied by utilities and ESCOs currently, and how such impacts might be overcome.

As discussed above, the best ways to minimize impacts for all are through the creation of ISO-administered programs, through the facilitating activities of NYPA, LIPA, and NYSERDA, through State-fostered aggregation programs, or through some combination thereof. If cost-spreading occurs evenly among all LSEs as a result of ISO market operations, there will be no upset in the relative competitive dynamics between

ESCOs and T&D Utilities. Competitive imbalances will surely exist, as noted in the Competitive Markets Proceeding RD, if T&D Utilities are required to meet the renewable objective as an LSE through long-term power purchase agreements. Finally, the Commission has expressly noted in Opinion 98-19 (p. 19) that there must be equal treatment of ESCOs and T&D Utilities in this area.

5. The best methods for retail suppliers to procure renewable resources (e.g., construction and ownership versus purchases).

As discussed above, renewable energy resources, like all other energy resources, should be procured through ISO-administered markets, through NYPA, LIPA or NYSERDA-sponsored initiatives, through voluntary retail supplier programs (such as Niagara Mohawk's Green Power Program), and through voluntary retail supplier procurement and conversion transactions. Given the long-standing Commission initiatives to facilitate utility divestiture of generation resources, T&D Utility construction and ownership of new generation facilities must not be mandated.

6. Methodologies for the recovery of costs by regulated utilities.

In connection with any increased prices for the purchase of renewable resources, if the RPS is met by LSE purchases through the ISO, existing utility tariffs include provisions for ISO-related cost sharing among retail consumers. In the case of Niagara Mohawk, the relevant tariff provision is Rule 46 of the Company's Tariff, P.S.C. No. 207-Electricity. Any increased congestion contract costs would also be recovered through

Rule 46. It is unclear under Opinion 98-19 where conversion transaction costs would be captured.

As discussed above, however, there are many other costs that might be incurred by T&D Utilities. Any costs associated with infrastructure development would be passed along, on the wholesale side, to the cost-causing entity, in accordance with federal interconnection policies. But the T&D Utility would be required to bear infrastructure costs that cannot be passed along to the generator, which costs should be recovered through some mechanism. On the retail side, appropriate contributions in aid of construction would be required in the case standby service were requested and the T&D Utility had to extend new facilities to provide such service. Here again, there may be electric infrastructure costs that cannot be passed along to the subject customer. In the case of Niagara Mohawk, implementation costs and costs associated with any reduction in revenues, such as those resulting from recent net metering initiatives or partial islanding by retail loads obtaining standby service, would be accounted for in the appropriate deferral mechanism, as established in the Joint Proposal Merger Rate Plan approved in Case 01-M-0075.

Depending on the decision to include gas-fired distributed generation in the RPS, the gas delivery infrastructure may require strengthening or expansion, costs for which may only be partially recoverable from the specific projects. Gas distribution utilities should be able to recover the costs associated with strengthening or expanding their gas delivery systems due to implementation of the RPS.

To the extent T&D Utilities will be required to monitor post-busbar, subzonal activities, or engage in other types of activities, consideration should be given to the recovery of these costs from available System Benefit Charge funds, consistent with Opinion 98-19. Any unreimbursed costs should be recoverable and treated in accordance with individual utility rate plans.

7. Individual retail suppliers' targets, if appropriate.

As discussed, Niagara Mohawk does not believe individual retail supplier targets are appropriate. Rather, any RPS target should be measured at a State-wide level.

Whether the target is on an individual retail supplier basis or on a state-wide basis, clarification would be beneficial of the 25% goal. For example, would this target be an annualized amount? Or would it need to be met on a monthly basis? Or a daily basis? Obviously, the shorter the interval, the higher the resulting costs may be. In Niagara Mohawk's opinion, in order to take into account the seasonal or climatic variances associated with such renewable resources as wind power and hydroelectric power, the target should be an annualized amount. For purposes of environmental tracking and reporting, however, the Commission's quarterly requirement adopted in Opinion 98-19 is still practical.

Finally, the Commission should also consider providing an exception to or interpretation of achieving the 25% goal in the event significant events have the effect of temporarily or permanently remove qualifying renewable resources from the RPS.

8. The potential impact on reliability and system operations due to the addition of renewable resources, especially those resources that operate only intermittently (e.g., windmills and photovoltaics), and what, if anything, must be done to ensure that reliability is maintained.

Whether and to what extent the addition of renewable resources will affect reliability and system operations necessarily depends on the locations of such resources and on the nature of the renewable resources (e.g., wind power may be less reliable than hydroelectric power). Infrastructure changes necessary to mitigate reliability and system operation concerns will be required where necessary. Developers, where necessary, should be required to install protective equipment.

9. The appropriate means to monitor progress toward meeting the goal and to ensure results, including possible rewards and disincentives.

ISO and T&D Utility reporting mechanisms adopted in Opinion 98-19 could be adapted for the monitoring of progress toward meeting the goal. Any measurement of progress must take into account any existing contractual obligations that may limit attainment of the RPS.

In terms of rewards or disincentives, a State-wide RSP through ISO-administered programs would not require any rewards or disincentives. If the Commission were to adopt individual retailer targets, it would be unfair to burden T&D Utilities alone with enforcement mechanisms. In accordance with the equality of treatment principles adopted in Opinion 98-19, all jurisdictional LSEs (including ESCOs) should be treated the same.

In any event, existing T&D Utility rate plans should not be disturbed for the purpose of incorporating penalties. Because these plans reflect considerable “give and

take” among numerous parties on many complicated issues, they should not be reopened for the purpose of imposing enforcement mechanisms on T&D Utilities.

10. The appropriateness of a “renewable attributes trading” system, and the components of any such system that might be developed.

The need for a renewable attributes trading system would seem to depend on the extent to which renewable resources are scarce, whether because they do not exist or because they are tied up in long-term contracts held by few.

If hydroelectric and out-of-state resources are deemed to be “renewable”, and if the RPS were to be met through ISO-administered programs and through the activities of NYPA, LIPA, and NYSERDA, no renewable attributes trading system would appear to be necessary. Scarcity of renewable resources would be unlikely.

To the extent a system is deemed to be important, the existing conversion transactions, as discussed in Opinion 98-19, appear to be effectively working.

11. The impact, if any, on the Commission’s Environmental Disclosure Label Program, and any modifications that might be needed and appropriate for that program.

It is not clear that any modifications will be necessary to the Environmental Disclosure Label Program. Opinion 98-19 incorporated flexible standards, and also vested appropriate discretion in the Program Administrator.

12. The practicality of installing new renewable facilities in the high load areas of the State. If the targeted renewables are built upstate, the impact, if any, such construction might have on the addition of new resources in the load centers where they are most needed, and the appropriate means to ensure that additional generation and transmission resources will be built where they are most needed.

In a properly working ISO-administered market, LBMP pricing is intended to send appropriate signals to new generation sources regarding the siting of facilities. The prices of congestion contracts and other wholesale transactions also send signals regarding generation siting. In addition, Article VII and X proceedings provide venues for the siting of facilities. To the extent non-jurisdictional entities, such as municipal and cooperative utilities, NYPA and LIPA, possess eminent domain authority and receive funding for new generation sources, relief to load pocket areas could be provided.

On this point, because any individual LSE cannot assure or be assured that new generation sources can or will be sited where needed, individual LSE RPS goals may not be realistic. A State-wide RPS, as discussed at the outset, is more practical and achievable.

13. The impact, if any, the renewable portfolio standard would have on existing green marketing programs in the State, and what the State might do to support developers and green power marketers during the process of developing rules to implement the standard.

Niagara Mohawk believes that voluntary LSE marketing programs should be encouraged and count toward the RPS goal. Costs of such programs would ultimately be borne by LSE customers.

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14. Changes needed, if any, by the Public Service Commission and NYSEDA in the SBC-funded renewable energy program to coordinate with the new target.

As recognized in Opinion 98-19, SBC funding is appropriate for the reimbursement of various monitoring and reporting functions. Niagara Mohawk believes that SBC funding should be expanded to recover other costs that may be incurred in the implementation of an RPS. In addition, SBC funding should be considered as a source of financing for new renewable resource projects and for infrastructure improvements.

Respectfully submitted,

Lisa Gayle Bradley, Esq.

cc: ALJ Eleanor E. Stein (via e-mail)
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