RECEIVED
PUBLIC SERVICE
COMMISSION
EXEC-FILES-ALBANY
2007 JUN -5 PM 4:12

LEBOEUF, LAMB, GREENE & MACRAE LLP

NEW YORK
WASHINGTON, D.C.
ALBANY
BOSTON
CHICAGO
HARTFORD
HOUSTON
JACKSONVILLE
LOS ANGELES
SAN FRANCISCO

99 WASHINGTON AVENUE
SUITE 2020
ALBANY, NY 12210-2820
(518) 626-9000
FACSIMILE: (518) 626-9010

LONDON
A MULTINATIONAL PARTNERSHIP
PARIS
BRUSSELS
JOHANNESBURG
(PTY) LTD.
MOSCOW
RIYADH
AFFILIATED OFFICE
ALMATY
BEIJING

June 5, 2007

VIA HAND DELIVERY

Honorable Jaclyn A. Brilling
Secretary
New York State 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

Dear Secretary Brilling:

Pursuant to the New York State Public Service Commission's April 19, 2007 Order in the above-referenced case, enclosed please find an original and ten copies of 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.

Respectfully submitted,

Scott J. Mueller /NMK

Scott J. Mueller

Enclosures/97476
cc: Active Party List in Case 06-M-1017 (via First Class Mail and e-mail)

CERTIFICATE OF SERVICE

I hereby certify that I caused an original and ten (10) copies of 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 ("Initial Comments") to be served, by hand delivery, upon the Honorable Jaclyn A. Brilling, Secretary to the New York State Public Service Commission. In addition, copies of the Initial Comments were served upon the Active Party List for Case 06-M-1017 via First Class Mail and electronic mail.

Dated this 5th day of June, 2007.

Carol Davis

Carol Davis

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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	Case 06-M-1017 Phase II

INITIAL COMMENTS OF NEW YORK STATE ELECTRIC & GAS CORPORATION AND ROCHESTER GAS AND ELECTRIC CORPORATION ON THE USE OF LONG-TERM CONTRACTS AND OTHER MEANS TO FACILITATE THE ENTRY OF NEW RESOURCES

I. Introduction

Pursuant to the Order Requiring Development of Utility-Specific Guidelines for Electric Supply Portfolios and Instituting a Phase II to Address Longer-Term Issues (the "Order"), issued on April 19, 2007 by the State of New York Public Service Commission ("PSC" or the "Commission") in the above-captioned proceeding, New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation (respectively, "NYSEG" and "RG&E" and collectively, the "Companies") hereby submit their initial comments on the Phase II questions enumerated in the Order (at pages 36-37). Phase II of this proceeding will focus on the critical issue of how to protect ratepayers from shortages of supply where the restructured markets may not ensure an adequate and diverse supply of resources. The questions posed in Phase II include:

- Should there be a statewide integrated resource planning process to examine long term electricity resource needs?
- Should major regulated electric utilities be required or encouraged to enter into long-term contracts to facilitate the construction of new generation, the development of additional energy efficiency, the development of additional renewable generation resources, the re-powering of existing generation, or the relief of transmission congestion?

NYSEG and RG&E support a statewide energy planning process to establish overall policy objectives and to identify potential mechanisms for achieving those goals. Under the New York statutory framework, electric utilities have the obligation to provide supply service to any customer in their service territories at just and reasonable rates. Electric utilities should have the opportunity to meet their supply obligations based upon a portfolio of diverse resources which may include new or re-powered utility-owned generation. Providing the opportunity for utility-owned, rate-based generation, rather than discouraging this resource option,[1] is an appropriate policy for meeting the objectives of ensuring adequate energy supplies, promoting resource diversity and protecting customers from price volatility in the future.

The statewide energy planning process should be based upon the existing Comprehensive Reliability Planning Process ("CRPP") conducted by the New York Independent System Operator ("NYISO"). The Commission should not mandate long-term supply contracts by distribution utilities when the NYISO identifies resource deficiencies through the Reliability Needs Assessment ("RNA"). Ultimately, distribution utilities have the supply obligation as providers of last resort ("POLR") when the market does not provide adequate resources or when customers chose not to purchase from other suppliers. Requiring utilities to enter into long-term contracts to meet their uncertain load obligations under the current retail access paradigm may unnecessarily increase customer costs. The Commission should avoid the pitfalls created by past experiments with mandated long-term contracts and should provide distribution utilities with the opportunity to manage load migration, participate in the NYISO markets and to meet their customer's needs through a diverse portfolio of resource options, including utility-owned generation.

---

1 See Case 00-M-0504 - Development of Retail Competitive Opportunities, Statement of Policy on Further Steps Towards Competition in Retail Energy Markets (Aug. 25, 2004).

II. Background

A. Phase I and Phase II

In Phase I of this proceeding, the Commission solicited comments on the portfolio management practices employed by electric utilities to provide a hedged commodity supply for mass market (residential and small commercial and industrial) customers.[2] The issues considered in Phase I were limited to the portfolio management practices needed to constrain price volatility.[3] In ruling on the Phase I issues, the Commission endorsed the benefits of utility hedging for mass market customers, subject to the development of appropriate guidelines to ensure that the hedged rate is just and reasonable.[4] The Commission recognized that mass market customers expect and prefer that utilities provide a regulated commodity service with a stable rate that limits volatility.[5]

The Order on Phase I issues directs electric utilities to participate in collaborative discussions for the purpose of developing: 1) standards for measuring price volatility; 2) goals for limiting price volatility; and 3) mechanisms for reporting utility portfolio price information in an aggregate form.[6] NYSEG is pursuing these collaborative discussions in Case 07-E-0479, regarding the Company's supply service filing, and NYSEG looks forward to reaching consensus on the Phase I issues.

The issues addressed in Phase I did not include practices intended to ensure resource adequacy or other public policy issues. Recognizing that protecting ratepayers from shortages of supply was of paramount importance, the Commission initiated Phase II of this proceeding to

---

2 Order at 2.
3 Id. at 5.
4 Id. at 12-13.
5 Id.
6 Id. at 38.

address the appropriate policies for resource planning and consider issues such as long-term contracting.[7]

B. Prior Energy Policies and Prices

The Order was issued in parallel with Governor Spitzer's announcement of a comprehensive plan for reducing energy costs and re-evaluating the state's energy policies that have failed to reduce some of the highest electricity costs in the nation. In order to fully understand the challenges facing New York, and to evaluate the available policy options, it is instructive to briefly review some background on energy policies and prices. New York State's electricity prices have exceeded the national average for many years. In 1990, its rates were more than 40% above the US average (EIA[8]). This price disparity was caused in small part by the higher cost of doing business in New York, but in large measure resulted from regulatory and legislative policies including mandatory long-term contracts that increased costs for consumers.

In the 1980s, New York went beyond the federal PURPA mandates[9] and passed its own legislation requiring utilities to purchase power under long-term contracts from qualifying facilities (QFs) at a set price of six cents per kWh.[10] In addition, the use of administratively determined long-run avoided cost to set purchase rates for PURPA facilities contributed to increased costs for customers. The Six-Cent Law and associated policies created an obligation for utilities to purchase over 5,000 MW of excess, new generation in the state at a price that turned out to be well above market levels. These contracts were difficult to break, caused rates to rise, and led to the near bankruptcy of one electric utility.

---

7 Id. at 5.

8 http://www.eia.doe.gov/cneaf/electricity/page/sales_revenue.xls, "state totals" tab.

9 Public Utilities Regulatory Policies Act of 1978, 16 U.S.C. 2601, et seq. ("PURPA").

10 N.Y. Pub. Serv. Law § 66-c (partially repealed) (the "Six-Cent Law").

By the mid-1990s, rates in New York rose to 60% above the national average (EIA[11]), and the Commission sought new ways to lower customer rates. The Commission pursued policies to encourage greater competition in the wholesale and retail supply of electricity through retail access pilot programs, the divestiture of utility generation, and the unbundling of generation from delivery rates.[12] Expansion of programs to promote and "jump start" the retail markets increased the migration of New York customers to competitive suppliers, but did not reduce prices for customers. In January of 2007, the State's electric prices were 63% above the national average, and 45% higher than January, 1999 levels.[13]

While the price increases over the last 8 years are due in large measure to increasing natural gas prices, some in the state (and across the nation) point to the "failure of competition" and seek a return to regulation in some form or other. They point out that electric prices are set today by the high cost of gas and the least efficient generator on the margin compared to the pre-competition era when prices were set on the basis of cost of service regulation which reflected a diverse fuel mix and average cost pricing resulting in low rates related to fuel costs.

Others cite a lack of new generation in the state as contributing to the high price environment. Since 1999, net new generation in New York has totaled 2,500 MW, while peak load has increased by 3,600 MW. As a result, reserve margins have fallen from 22% in 1999 to 17% in 2006. The level of new investment by merchant generators in New York is lower than the amounts added in New England, Texas or the Southeast on a percentage basis.

---

11 http://www.eia.doe.gov/cneaf/electricity/page/sales_revenue.xls, "state totals" tab for 1995.

12 Wholesale competition in New York began in earnest in 1999 when the NYISO began operations that provided New York with day-ahead and real-time markets in energy and ancillary services, monthly auctions for installed capacity, trading in transmission congestion contracts, and locational pricing.

13 http://www.eia.doe.gov/cneaf/electricity/page/sales_revenue.xls

C. New Initiatives

In response to recent electricity price escalation, the perceived lack of success of wholesale and retail competition, and the lack of leadership in environmental stewardship, the State, and the Commission in particular, have launched a number of new initiatives, including the following:

- *Review of Retail Access Policies (07-M-0458)* – A proceeding to determine whether the various programs implemented to spur retail competition are still effective and necessary
- *Proceeding on Policies, Practices and Procedures For Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers (06-M-1017)* – Orders utilities to collaboratively design and implement guidelines under which they will provide a hedged portfolio of power to defaulting mass market customers to limit volatility
- *Phase II to Address Longer-Term Issues (06-M-1017)* – Seeks comment on the advisability of requiring utilities to enter into long-term supply contracts and/or to implement integrated resource planning
- *Order Requiring Proposals For Revenue Decoupling Mechanisms (03-E-0640)* – Requires utilities to propose in their next rate cases mechanisms to separate revenue recovery from load growth to eliminate perceived disincentives of utilities to encourage conservation

Taken together, these new initiatives suggest that policy makers are questioning the cost and current structure of retail access programs in New York and are extremely concerned about small customer rate volatility. As explained herein, the NYISO CRPP process should be used to promote state-wide policy goals for ensuring adequate and appropriate resources. The Companies do not support, however, returning to an integrated resource planning and long-term contracting regime that was previously unsuccessful in stabilizing prices and reducing costs for customers.

III. Initial Comments

The Order invites interested parties to address eleven multi-part questions focusing on statewide integrated resource planning (See Questions 1, 4 and 11) and the use of long-term contracts by electric utilities (see Questions 2, 3 and 5 thru 10). NYSEG and RG&E provide the following initial comments on the issues identified in the Order.

A. NYSEG and RG&E Support a Statewide Energy Planning Process Which Is Based Upon the NYISO CRPP and Recognizes the Benefits of Utility-Owned Generation

New York should have a state-wide energy planning process that establishes broad policy goals regarding issues such as resource adequacy, fuel diversity, environmental objectives, energy efficiency and renewable resources. The state-wide resource planning should be based upon the NYISO CRPP and RNA mechanisms. Where there is an identified need for additional resources, electric utilities, which have the statutory obligation to provide distribution and commodity service, should have the opportunity to meet their load obligations through a portfolio of resources, including utility-owned generation.

Under the CRPP, the NYISO assesses generation adequacy and transmission reliability in New York. As part of that process, the NYISO conducts an RNA which identifies the bulk electricity grid needs over the ten-year planning horizon. Despite the highest wholesale electric prices in the country, little new generation is being sited in New York and the most recent NYISO RNA identifies a need for new resources starting in 2011.[14]

A statewide planning process could identify general policy goals beyond those currently addressed through the NYISO's existing CRPP. Where the RNA identifies the need for new resources, electric utilities should be allowed to meet their POLR obligations consistent with the

---

[14] NYISO News Release, The NYISO Issues Second RNA (Mar. 19, 2007).

state's broad policy objectives. While the Companies do not support re-institution of utility-specific IRPs, the state should adopt appropriate policies to encourage electric utilities to acquire a diverse portfolio of generation capacity, including utility-owned resources that reflect a mix of base-load, intermediate and peaking facilities.

In order to ensure that sufficient generation is available to meet future reliability and energy needs, market structures and regulatory structures need to provide for the recovery of investment in new generation capacity, and electric utilities such as NYSEG and RG&E should not be precluded from owning generation. While many merchant generators continue to struggle to recover their financial health, electric utilities generally have the financial strength to secure the necessary long-term financing, provided they have the support of the state and federal regulatory bodies. NYSEG and RG&E are prepared to invest in new rate-based generation assets under appropriate regulatory conditions and have the financial strength required to do so.

The resource planning horizon should be long-term, focusing on expected demand and supply over at least a rolling ten-year time frame. Under the existing regime in New York, the capacity markets have not sent the necessary price signals to encourage a mix of generation capacity (i.e., base load, intermediate and peaking facilities). A forward looking market model, such as that developed for ISO-NE, is an improvement over existing capacity markets because its focus is long-term. New York should encourage the NYISO to seek FERC approval to institute a forward market for capacity, like capacity markets in the ISO-NE and PJM.[15]

While New York should establish broad policy objectives for resource planning, the state should not return to utility-specific IRPs nor institute a statewide resource procurement process. Electric utilities should be responsible for procurement of adequate resources, consistent with

[15] New York may want to consider a longer term forward market than the three-year capacity model employed by the ISO-NE and PJM.

general policy objectives, to meet their supply as providers of last resort. To the extent the competitive market is not meeting the statewide resource needs as identified in the RNA, utilities are obligated to supply all customers who request supply service. The state policy should encourage utilities to meet that need through a portfolio of resources, including utility-owned generation.

B. New York Should Not Require Electric Utilities to Enter into Long-Term Contracts for Electric Supply

Based upon prior experience with mandated long-term supply contracting in New York, the Companies believe it would be poor public policy to require electric utilities to enter into long-term contracts to procure generation resources. While electric utilities may consider the use of long-term obligation as part of a diverse resource portfolio, and to meet state policy objectives such as fuel diversity or environmental goals, long-term contracts should not be imposed. Mandating long-term contracts to facilitate the construction of new generation could ultimately result in higher costs to customers as experience with the Six-Cent Law has shown.

Notwithstanding the Companies' opposition to mandatory long-term contracts, where electric utilities opt to enter into long-term commitments to meet their supply obligations and/or the state's energy policy objectives, the utilities should be provided with cost recovery, including appropriate returns and incentives, through a NYISO or retail wires charge. Utility-owned, rate-based generation should be considered as an alternative to long-term resource options.

Development of new resources by electric utilities is impacted by Commission policies which on the one hand require utilities to provide supply service, but on the other hand discourage utilities from continuing in the generation business to meet those obligations. Such inconsistent policies also create risk for electric utilities in regards to cost recovery. Electric utilities should have the opportunity to develop resource portfolios consistent with their supply obligations, and should be provided with appropriate incentives to develop such a portfolio, including the opportunity to fully recover the cost of such obligations and an opportunity to earn a fair return on the utility's investment. Electric utilities' long-term contract costs should be recovered through the commodity or a non-bypassable wires charge. To the extent the costs are incurred to support a state policy objective, such as hedging to prevent price volatility, the costs should be recovered through a wires charge applicable to all customers.

Electric utilities should have the flexibility and discretion to manage their supply portfolios consistent with statewide policy objectives. Under the existing regime, electric utilities such as NYSEG and RG&E have continued to own and operate generation resources, which ownership has not impeded market development. In contrast, however, mandating that electric utilities enter into long-term supply contracts could have a chilling effect on the market and may prevent investment in new generation in the state.

IV. Conclusion

The Companies appreciate this opportunity to provide their initial comments on the issues identified in the Order and look forward to further participation in the Phase II proceedings.

Respectfully submitted,

Scott J. Mueller /NMK

Scott J. Mueller
LeBoeuf, Lamb, Greene & MacRae LLP
260 Franklin Street
Boston, MA 02110
(617) 748-6843
Scott.Mueller@llgm.com

Noelle M. Kinsch
LeBoeuf, Lamb, Greene & MacRae LLP
99 Washington Ave
Suite 2020
Albany, NY 12210
(518) 826-9000
Noelle.Kinsch@llgm.com

Attorneys for New York Electric & Gas Corporation and
Rochester Gas and Electric Corporation

B115174