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June 5, 2007

Hon. Jaclyn A. Brillling
Secretary
New York State Department
of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

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 please find the Staff Initial Comment in the above-captioned proceeding. A copy has been served on all active parties via e-mail and regular mail.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Leonard Van Ryn', is written over a light blue horizontal line.

Leonard Van Ryn
Staff Counsel

Enclosure
cc: All Active Parties

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.

STAFF INITIAL COMMENT

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Dated: Albany, New York
June 5, 2007

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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.

STAFF INITIAL COMMENT

PRELIMINARY STATEMENT

In the Longer-Term Issues Order,¹ the Commission discerned a need for a rational and comprehensive approach to planning for the future of New York's electric supply infrastructure and suggested that long-term contractual arrangements might facilitate the development of that infrastructure. The Commission concluded that expedited consideration of an integrated planning process for incorporating public policy considerations into electric infrastructure decisions was needed. The Commission cautioned, however, that the integrated planning process must be flexible and capable of responding adequately to rapidly-changing circumstances.

The Commission also decided to launch an inquiry into the role long-term contracts might play in the acquisition of

¹ Case 06-M-1017, supra, 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).

infrastructure and other resources. Besides assisting in the financing of new infrastructure, these contracts might be designed to facilitate the realization of public policy goals.²

The Commission asked interested parties to respond to a number of questions set forth in the Longer-Term Issues Order on a resource planning process and the development of long-term contracts. It set a deadline of June 5, 2007 for filing Initial Comments on the issues and questions raised in the Order, and a deadline of June 25, 2007 for submitting Reply Comments.

Staff of the Department of Public Service (Staff) believes that a resource planning process that is flexible and adapts to changing circumstances can be developed, and implemented through long-term contracting and other means. Staff envisions a multi-step process. First, specific strategic goals would be developed in a Dynamic Electric Planning Process (DEPP), directed by Staff in collaboration with affected stakeholders. The DEPP would accommodate various public policy goals established by the Commission or propounded by the stakeholders, and would be submitted to the Commission for its review and approval.

² The Longer-Term Issues Order, pp. 24-25, also provides that longer-term contracts may be entered into for the purpose of mitigating price volatility, as one component of a utility's strategy for hedging against that volatility.

Following approval of the DEPP, utilities would implement specific recommendations through targeted procurement mechanisms. The proposed mechanisms would be submitted to the Commission for its approval, and, once approval is obtained, the utility would proceed to procure the electric infrastructure enhancement or resource in conformance with the mechanism. Where a long-term contract is the most effective means of acquiring a needed resource, a mechanism can be directed towards the creation of such a contract.

The questions raised in the Longer-Term Issues Order would be answered within the context of this multi-step process. Any public policy goals that the Commission identifies, at the conclusion of this proceeding or otherwise, would be incorporated into the DEPP goals, and the requisite resources needed to meet the DEPP would be obtained through the procurement mechanisms. Long-term contracts would be entered into as necessary to effectuate procurement. To facilitate the implementation of those contracts, utilities would be permitted to recover their costs, after a review conducted to determine if the contract was properly entered into in conformance with the procurement mechanism. This multi-step process can be coordinated with the operation of New York Independent System Operator (NYISO) markets and with NYISO planning efforts as they are currently constituted, except that it may be necessary to

pursue some modifications to the NYISO's capacity markets in New York City. As a result, the proposed process is a flexible framework through which the infrastructure essential to the reliability of the electric grid may be enhanced and the various public policy goals deemed appropriate may be achieved.

DISCUSSION

The Longer-Term Issues Order requests responses to 11 questions. To facilitate and organize its response, Staff subdivides the questions as follows: Resource Planning Issues (Question 1); Long-Term Contract Issues (Questions 2, 3 and 5); Resource Procurement Issues (Questions 4, 6 and 7); Long-Term Contract Review and Cost Recovery Procedures (Questions 8 and 9); NYISO Markets and Planning Issues (Question 10); and, Innovative Solutions (Question 11).

Resource Planning (Question 1)

New York needs a resource planning process to ensure that electric infrastructure needs are met on a cost-effective basis consistent with adequate protections for the environment and achievement of public policy goals. A resource planning process would serve as the vehicle for selecting resource enhancement alternatives that are economically viable, cost-effective to ratepayers and consistent with the efficient operation of the electric grid. The process would ensure that public policy goals such as protecting the environment, reducing

carbon emissions to combat global warming, and promoting energy efficiency are met. The diversity of fuel sources for generation can be assured and new generation technologies can be accommodated and developed.

There is currently a planning gap. New York no longer performs the State Energy Plan process that in the past identified benchmarks, and proposals for meeting those benchmarks. The NYISO issues annually a Comprehensive Reliability Plan (CRP) that addresses the reliability of the bulk electric system over a 10-year period, and makes available to market participants information on economic opportunities for building electric infrastructure. The NYISO process, however, does not evaluate the cost-effectiveness of projects nor does it address public policy issues, other than to react to state and federal mandates and trends.

Therefore, a Dynamic Energy Planning Process (DEPP) should be instituted to close the planning gap. The DEPP would be coordinated with the CRP process.

The DEPP process would consist of two tracks. Track I would be conducted once every three years and would be structured to evaluate long-term policy directions and strategies over a 15 to 20 year term. The strategies would be supported with implementation plans that address the procurement of the resources needed to effectuate those strategies. A range

of options would be evaluated, and a variety of alternatives would be identified, to afford the flexibility to meet changing circumstances.

Track II would be conducted annually. The focus of that effort would be directed towards a planning horizon of five years, and would address the selection of the resources needed to meet the goals established in the plan. Progress reports monitoring progress towards acquiring previously-identified resources would constitute one feature of these plans.

Implementation of the DEPP approach would begin with an expedited, interim plan for all electric utilities. This plan would be developed by Staff in collaboration with all electric utilities and interested parties within four months of the issuance of an Order in this proceeding, and would ensure that higher priority procurement efforts are commenced promptly. The interim plan would compile all existing Commission policies affecting electric infrastructure and the acquisition of resources and would reflect the NYISO's most recent CRP findings. The implementation of each Commission and CRP initiative at each utility to date would be evaluated. Recommendations on any resource procurement efforts necessary on a short-term basis would be made included in the interim plan submitted by Staff at the conclusion of the four-month period.

Once the interim plan is in place, commencement of Track I may begin. This effort would commence with a state-wide planning approach. Long term goals would be evaluated in Track I and the implementation of measures intended to meet those goals would be addressed. Again, the statewide analysis would be conducted in a collaborative effort involving utilities and other interested parties, and a draft plan would be submitted by Staff to the Commission for its review and approval.

Once that approval is obtained, the Track II annual processes may commence and build upon the decisions made in Track I. Each utility would be expected to produce a Track II plan for its operations that fits within the statewide framework. The utility-specific five-year plans would be presented annually to the Commission for its review and approval.

The DEPP planning efforts can be readily coordinated with the CRP, since that effort is intended primarily to ensure the reliability of the electric system and does not address public policy goals.³ In the CRP, the NYISO identifies any needs that must be met within five and ten year forecast periods, and establishes a process for ensuring that the need is met. The wealth of data the NYISO assembles for the CRP and the

³ Where a transmission enhancement is recommended, cost recovery is decided by FERC; cost recovery for other types of resources are generally decided by the Commission.

recommendations it makes could be easily transferred to the DEPP process, which would be a broader approach focused on more than the minimum infrastructure needed to safely preserve adequate service.

While utilities would make the annual DEPP Track II filings, Staff, through the DEPP Track I process, would assure that the state-wide analysis appropriately provides guidance to the individual utilities. Staff would also conduct ongoing efforts, including serving as a centralized information resource, for assisting utilities in developing their plans. Staff would also monitor implementation of the various planning efforts, including assuring that the various individual utility Track II plans are coordinated, and make such reports to the Commission as are necessary to facilitate the planning process.

Long-Term Contracting (Questions 2, 3 & 5)

Long-term contracts can serve an important function in effectuating DEPP goals. As discussed in the Longer-Term Issues Order, the current market structure has not attracted, and does not seem likely to attract, a sufficient number of new entrants intending to build new merchant generation or transmission infrastructure. New York City is particularly in need of new resources,⁴ but despite the fact that the market prices of

⁴ The NYISO's 2007 Reliability Needs Assessment predicts a need date of 2011 for new resources in the downstate area.

electricity are among the highest in the nation, new merchant resources have generally not been forthcoming. Indeed, since restructuring of the electric industry, those resource infrastructure additions that have been built in New York City, except for a 250 MW merchant unit, have been supported by long term contracts or public purpose entities like the New York Power Authority (NYPA). Therefore, entry into long-term contracts should be facilitated so that infrastructure needs are met and public policies are advanced.

Moreover, long-term contracts are a flexible tool that can accommodate a number of goals. When appropriate, multi-party contracts, involving several utilities and perhaps even several providers, might advance public policy goals.

Identified resources obtained through contracts can include projects intended 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. The re-powering of existing generation and the construction of new generation, including renewable forms of generation, can all be accomplished through long-term contracts. As a result, long-term contracts could play a prominent role in securing the resources identified in the DEPP planning efforts.

Long-term contracts can be consistent with the NYISO's CRP process as well as the DEPP. Under the NYISO process, the

concern is that the infrastructure is built in a timely fashion in order to meet NYISO-identified reliability needs.

Infrastructure procured through use of long-term contracts can timely satisfy that need. Moreover, that infrastructure can be procured in the most cost-effective manner.

NYPA and the Long Island Power Authority (LIPA) are among the entities that have and continue to participate in long-term contracts. While these two entities are not subject to the Public Service Law (PSL), they should be encouraged to participate in the DEPP process and long-term contracting efforts should be coordinated with them. Similarly, non-utility load serving entities (LSE) should be encouraged to participate in long-term contractual arrangements.

There are, however, obstacles to a broader deployment of long-term contracts. The Longer-Term Issues Order addresses many of the barriers obstructing entry into long-term contracts. Uncertainties that discourage parties from entering into long-term contracts arise out of the potential for new State and Federal legislation, changes in policies directed by regulatory agencies, and the introduction of new practices at the NYISO. These changes can substantially affect electric infrastructure costs and the price of electricity. Moreover, although price fluctuations in response to capacity additions and retirements are an expected feature of electricity markets, the potential

for significant price changes exists upon net additions in a smaller market like New York City. Project developers might hesitate to move forward if they believe the entry into service of competing projects will depress the price they are paid. The outcome can be that no project is built when no one is willing to take the lead in moving forward.

Other risks affect parties attempting to structure long-term contracts. The absence of an electric generation siting process, similar to the former PSL Article X, increases the uncertainty associated with selecting a site for a generation facility and then building that facility. Carbon reduction policies intended to address global warming are under development, with their exact cost effect at present uncertain. Some technologies intended to reduce carbon emissions, including carbon dioxide capture and sequestration, are immature and pose risks. As a result of these and other factors, buyers and sellers have been unable to reach a consensus on pricing in the forward electric market, slowing the development of a robust forward electric market.

Another obstacle to long-term contracting is the financial risks utilities face when entering into those contracts. In the absence of regulatory certainty for recovery of costs associated with long term contracts, financial rating agencies consider long-term contractual obligations as the

equivalent of debt. This treatment of contractual obligations may increase the financial risk utilities face, and they may be otherwise reluctant to enter into long term contracts for public policy purposes without assurances of cost recovery. Means for addressing these financial risks may be necessary.

As a result, barriers to entry into long-term contracts must be addressed and risks managed before those contracts can serve as the vehicles for building electric infrastructure that is cost-effective and procuring the resources that satisfy public policy goals. The structuring of a long-term contract process designed to surmount those barriers is discussed below, in the context of resource procurement.

Resource Procurement (Questions 4, 6 & 7)

Once the DEPP plans and long-term contract policies are in place, the question becomes translating the DEPP goals and objectives into the resource procurements that effectuate those plans. Staff proposes that utilities should be required to present concrete resource procurement proposals to the Commission in their annual DEPP filings. These proposals would be directed towards the acquisition of the particular infrastructure or resource that is needed to meet a need identified in the DEPP.

These resource procurement proposals would often consist of requests for proposals (RFP) soliciting the

submission of project proposals by developers of infrastructure and resources. Under an RFP, an auction would be conducted where the respondents to the RFP would compete against each other for the selection of the particular project or resource that satisfies the conditions established in the RFP. The winner of the auction would then enter into a long-term contract with the utility providing for the development of the infrastructure or resource and the price that the developer will receive for furnishing it. Procurement processes other than RFPs could also be considered, where an RFP approach would not satisfactorily address the practicalities of acquiring a particular type of resource.

The Commission would approve each resource procurement proposal. Regulatory oversight would be accomplished through that process. Each procurement proposal could be coordinated with others as the Commission reviews the panoply of projects proposed. Where appropriate, several utilities can combine together to procure a resource. NYPA, LIPA and other LSE involvement is also potentially feasible. This oversight will ensure that DEPP goals are met. Moreover, utilities will acquire assurance that their procurement proposals are satisfactory.

This sort of process builds upon the efforts that were successfully used to implement utility divestiture of generation

facilities. Following policy direction from the Commission, each electric utility filed plans for divesting their generation. These plans were premised upon detailed RFPs, which were then approved by the Commission. Utilities implemented the approved RFPs, and entered into contracts with the winners of the auctions conducted under the auspices of the RFPs. Those contracts were then generally approved by the Commission.⁵

The process of RFP approval, followed by an auction and the approval of the contracts entered into with the winner of the auction, has developed into a reasonably effective mechanism.⁶ The lessons learned in conducting the divestiture RFPs, and in approving the contracts for the sale of the generation facilities, can be readily adapted to an RFP process for the procurement of electric infrastructure and resources through long-term contracts.

Once a DEPP is in place, and the mechanisms for procuring resources in conformance with the DEPP are approved, resource procurement may commence with the objective of ensuring

⁵ See, e.g., Case 96-E-0909, Central Hudson Gas & Electric Corporation, Order Approving the Transfer of the Danskammer and Roseton Generating Stations and Making Other Findings; Case 94-E-0098, Niagara Mohawk Power Corporation, Order Approving Transfer of Hydroelectric Generation Facilities and Making Other Findings (issued May 27, 1999).

⁶ See Case 03-E-1231, Rochester Gas and Electric Corporation, Order Approving Transfer, Subject to a Modification (issued May 20, 2004).

that system reliability is preserved and public policy goals are met. Since the DEPP will be coordinated on a state-wide basis, and resource procurement will be tied to DEPP objectives, regulatory oversight of the DEPP and each procurement mechanism will ensure that procurement is conducted in conformance with public policy.⁷ Existing initiatives will be recognized, including achieving energy efficiency and demand reduction goals through the policies that will be developed in Case 07-M-0548,⁸ and achieving additional fuel diversity for generation resources in conformance with the policies for the greater deployment of renewable generation developed in the RPS proceeding.⁹

The replacement of older, more polluting forms of generation with newer, cleaner forms of generation, and encouraging development of cost effective projects, can then be achieved in the context of achieving least-cost planning commensurate with the mix of resources desired. To the extent market power issues arise, they can be addressed in the resource procurement process, which can be tailored to avoid the creation of market power or to mitigate market power impacts. These

⁷ Modifications to the DEPP can be accomplished, if need be, in the process of approving a procurement mechanism.

⁸ Case 07-M-0548, Energy Efficiency Portfolio Standard, Order Instituting Proceeding (issued May 16, 2007).

⁹ See Case 03-E-0188, Retail Renewable Portfolio Standard, Order Regarding Retail Renewable Portfolio Standard (issued September 24, 2004).

goals can include eliminating or reducing the effect of specific load-pocket constraints.

The procurement mechanism can also be used to constrain the types of resources that will be developed. For example, California prohibits its utilities from purchasing generation from plants that emit carbon dioxide in excess of prescribed limits, in order to combat global warming. Similar restrictions could be implemented in New York through the DEPP and the procurement mechanisms effectuating its goals.

A procurement mechanism should be an open process, with competitors allowed to submit their proposals for a full and fair evaluation. Where utilities managing procurement mechanisms might be biased in favor of their affiliates, or otherwise might confront incentives to select a project that is not the most beneficial to ratepayers and the public at large, use of outside consultants could be required. For example, in the utility generation divestiture process, investment bankers and other types of consultants were retained to conduct the auctions. This ensured that an unbiased evaluation of each offer would be made, and that the overall best offer would be selected. In other procurement situations, however, utilities should be allowed to manage the procurement mechanism if that approach best controls costs to ratepayers and results in the selection of the best projects.

Through the mechanisms developed under this procurement process, public policy goals will be recognized, and the specific projects necessary to achieve those goals will be implemented. Regulatory oversight will be adequately achieved through review and approval of the mechanisms.

Contract Review and Cost Recovery (Questions 8 & 9)

In the past, the Commission has declined to approve long-term contracts entered into by utilities for the procurement of resources,¹⁰ because contract costs should be reviewed at the time recovery of those costs was sought, not at the time the contracts were entered into. It was also decided that the responsibility to select among power supply options was a role utility managements were expected to assume, and that a prudence review was better conducted when all the facts and circumstances surrounding a purchase were better known, that time was when the costs were recovered, not when the contracts were entered into. This approach to contract cost recovery has been consistently followed, most recently in the Cost Recovery Ruling and Order Denying Rehearing.¹¹

¹⁰ Case 90-E-0775, Consolidated Edison Company of New York, Inc., Order Accepting Contracts for Filing and Denying Petition (issued December 10, 1990).

¹¹ Case 02-E-1656, Consolidated Edison Company of New York, Inc., Declaratory Ruling on Cost Recovery (issued January 24, 2003) and Order Denying Rehearing (issued August 29, 2003).

Changing circumstances justify reconsideration of that policy. Failure to provide for rate recovery has become a substantial barrier to entry into long-term contracts by regulated utilities. Indeed, few such contracts have been entered into in the past decade by those utilities, and as discussed in the Longer-Term Issues Order, it is now necessary to rely upon those contracts to bring forth the resources needed to meet reliability and public policy needs. Moreover, providing cost recovery assurances will act to minimize the potential for rating agency imputations of a contract's costs as debt to a utility, relieving financial pressures on utilities that might discourage them from entering into such contracts.

The Cost Recovery Ruling itself, even though it continued the previous policy, underscores the importance of long-term contracts. The contracting process at issue there resulted in the construction of the Astoria Gen facility,¹² which timely entered service to meet reliability needs in New York City. Without a long-term contract, it is unlikely that facility would have been built.

The objections raised in the Cost Recovery Ruling to approval of cost recovery at the time the contract is entered into can be overcome. The primary criticism of that approach

¹² See Case 04-E-0058, Astoria Energy LLC, Declaratory Ruling on Lightened Regulation and Transfers (issued March 26, 2004).

raised in the Ruling was that it would be difficult to ascertain all the facts and circumstances surrounding a contract at that time. The procurement process described above, however, mitigates that difficulty. With the procurement process approved by the Commission, the utility's approach to procurement can be carefully reviewed and adjusted to protect the public interest. Once the contract is entered into, it can then be reviewed to determine if the utility complied with the approved procurement process. If it did comply, then the facts and circumstances surrounding entering into the contract should be sufficiently known to allow for a determination of prudence and the establishment of a cost recovery mechanism.

Moreover, the use of an approved procurement mechanism approach will also limit the number of contracts that must be reviewed and approved. Only those contracts that comport with the DEPP determinations, and are then procured through the approved mechanisms, will be reviewed for cost recovery. Those contracts will be limited in number, and so constraining the potential universe of reviewable agreements should enable the Commission to focus sufficient attention on each individual contract to assure a full and adequate review of its impacts.

As a result, the prior policy of declining to review long-term contracts for their prudence at the time they are entered into should be reversed, for those contracts that

satisfy the procurement process described above. Such a review will facilitate the development of resources that are needed to satisfy reliability and public policy.

The Cost Recovery Order is instructive on another point. The expectation, voiced in the Order Denying Rehearing, that implementation of the "demand curve" approach to structuring the NYISO's capacity market would call forth additional merchant generation supplies, has not yet been realized. Moreover, that Order specifically noted that, "a proceeding can be instituted in the future if a need for a specific administrative review" of long-term contract issues were needed. Given the circumstances described in the Longer-Term Issues Order, that review has been instituted, and its outcome should be changes in policy that facilitate utility entry into long-term contracts.

Where utilities recover from ratepayers the costs of the resources procured, one principle should control. That is, those customers that benefit from the procurement of a resource should pay for it. Determining the identity of the beneficiaries, however, will depend upon the specifics of the resource itself, its location, the circumstances surrounding its procurement, and other factors. As a result, the recovery and allocation of a resource's cost should be determined on a resource-specific basis.

The cost allocation and cost recovery can be decided at the time a contract is approved. At that time, it should be possible to determine whom the resource procured will benefit. Cost allocation and recovery can then be targeted towards those beneficiaries, through the development of traditional cost-recovery devices.

In some cases, complexities could arise. For example, if a utility enters into a long-term contract to purchase wind generation with the objective of enhancing fuel diversity, it could be determined that all customers in the state benefit. In this instance, cost recovery might be accomplished across NYISO zones and individual utility boundaries, as in the RPS Proceeding. On the other hand, if a contract is entered into to mitigate market power abuse by suppliers in a specific load pocket within the service territory of one utility, it might be appropriate to assign those costs only to customers residing in the load pocket. The necessary flexibility to achieve proper cost recovery in the fact of complex circumstances can be accomplished through case-specific review of each circumstance.

NYISO Market Rules (Question 10)

The NYISO operates energy and capacity markets, with the price in the spot capacity market determined using the "demand curve." Long-term bilateral contracts between buyers and sellers can co-exist with the energy market, and, under

current market rules, do not conflict with the operation of the capacity market. That is because LSEs are permitted to purchase capacity bilaterally from sellers, and then, in effect, bid that purchased capacity into the market at a price of zero.¹³ That practice, however, potentially could reduce the spot capacity market clearing price. This could affect some existing generators by potentially reducing their capacity revenues.

Many generators believe that some LSEs, like regulated utilities, NYPA and LIPA, can purchase capacity on a bilateral basis, and are able to recover any of the purchase costs that are above those set in the NYISO capacity spot market from captive customers. Those LSEs, the generators complain, can then offer capacity into the spot market at a cost lower than the contract cost, which could drive down the price the generators are paid for capacity. The generators recommend that LSEs be required to offer such capacity at the contract cost or at some fraction of "Cost of New Entry" (e.g., the cost of adding a new generation resource to the market), thus effectively creating a floor for market clearing prices in the capacity spot market. FERC is investigating this issue.¹⁴

¹³ In the New York City capacity market, certain sellers are prohibited from selling capacity on a bilateral basis, due to market power concerns.

¹⁴ FERC Docket No. EL07-39-000, New York Independent System Operator, Inc.

If such a floor price proposal is adopted, however, all buyers in the New York City spot capacity markets would be required to, in effect, purchase capacity at or above that floor price. Such a system could act as a disincentive to entry into bilateral long-term contracts for capacity, because market participants could be forced to pay for capacity twice -- once through the mandatory NYISO capacity market mechanism and again through their bilateral long-term contract.¹⁵

To the extent that FERC has jurisdiction to consider a mechanism that leads to such a floor price,¹⁶ it should not be adopted. FERC should be urged to defer from intruding upon State prerogatives to advance reliability and public policies through the use of long-term contracts. It is the States that are in the best position to determine the public policies that should be followed within their boundaries. A floor price mechanism could deter states from pursuing those actions deemed best suited for local reliability and for promoting environmental values, such as reducing greenhouse gas emissions.

¹⁵ If the floor price is above the market clearing price, the bilateral contract at the latter price would fail to clear the market, preventing buyers from using the contract capacity to meet its capacity obligations under NYISO tariffs.

¹⁶ FERC-approved capacity markets may be jurisdictionally deficient, especially where they intrude upon legitimate state interests; to the extent those markets are directed towards long-term resource adequacy, that function is reserved to the states under the Federal Power Act. 16 U.S.C.A. §824o(i)(2).

A floor price mechanism that benefits only certain generators while disregarding public policy concerns would not be just and reasonable.

Forward capacity market proposals to enhance capacity markets are also problematic. The mechanisms that have been proposed or adopted in other ISO control areas are complex. It is not yet clear that they will prompt the new investment needed to resolve reliability concerns, and they are not necessarily readily accommodated to meeting public policy considerations.

A long-term contracting process is better suited than ISO capacity pricing arrangements to both ensuring reliability and advancing public policy goals. Through the long term contracting process discussed above, those resources that are needed can be targeted and obtained at reasonable prices. Enhanced forward capacity markets do not necessarily permit selection among various supply alternatives, and may result in excessive reliance on one form of generation, such as gas-fired facilities.

Long-term contracts could also resolve the current inequities in the New York City capacity market. It is clear that the suppliers in that arrangement can exercise market power -- the existing ceiling on bids into that market has, in effect, become the market price. As a result, New York City ratepayers are not receiving the full benefit of competitive markets. On

the other hand, as discussed above, some generators believe that utility procurement of capacity through bilateral contracts, followed by the treatment of those resources as zero bids in the capacity market, would lower their revenue streams, preventing them from recovering their fixed costs. Long-term contracts can satisfactorily address the existing generators' concerns.

Cost-based long term contracts could be entered into with existing generators so that they can meet their fixed costs. Admittedly, disputes over the legitimacy of those costs would have to be resolved in order to price the contracts, and it would have to be decided if a generator should not receive a contract because its facility lacks long-term value to the City and its residents. Cost-based ratemaking regimes, however, can be developed to resolve those matters.

A second-best solution to the problem of existing New York City capacity arrangements could be cost-based rates instead of market rates. Since the capacity pricing arrangement in the City is not operating competitively, returning to cost-based ratemaking could be justified. Cost-based capacity rates could be set in coordination with the generation prices the facilities receive in the NYISO energy markets.

Existing capacity market pricing arrangements in upstate New York (the NYISO Statewide or Rest of State market),

however, appear to be working well. Staff does do not recommend modifications to the operation of those markets.

Innovative Solutions (Question 11)

Developers who desire to build generation facilities in New York City often find it difficult to find suitable sites. This constraint might reduce the number of developers willing to participate in an auction conducted pursuant to an RFP, thereby rendering that process less competitive and perhaps increasing the costs ratepayers must fund as a result of an RFP.

One potential remedy that could be explored to this shortage of sites is for the regulated utility, Consolidated Edison Company of New York, Inc., to obtain needed environmental permits for a site it selects prior to issuing an RFP. Participants in the RFP would then include the cost of acquiring the site in their bids, with the winner obtaining the site as well as the right to enter into a contract for the sale of generation from a facility built at the site.

This approach could attract more bidders to an RFP soliciting new generation proposals, and more vigorous competition could lead to lower prices for ratepayers. Although the benefits and barriers attending this approach require additional analysis, the potential for benefits impels its further consideration.

CONCLUSION

For the foregoing reasons, the Staff proposals on resource planning and long-term contracting should be adopted.

Respectfully submitted,

Leonard Van Ryn
Staff Counsel

Dated: June 5, 2007
Albany, New York