NEW YORK STATE PUBLIC SERVICE COMMISSION

CASE 06-M-1017 - Proceeding on Motion of the Commission as to Policies, Practices and Procedures For Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers.	:

INITIAL COMMENTS OF CONSOLIDATED EDISON COMPANY OF NEW YORK, INC. AND ORANGE AND ROCKLAND UTILITIES, INC. CONCERNING LONG-TERM CONTRACTS

Consolidated Edison Company of New York, Inc. ("Con Edison") and Orange and Rockland Utilities, Inc. ("O&R") (collectively, the "Companies") hereby submit these initial comments in response to the Commission's April 19, 2007 Order ("Order") in the above-captioned proceeding.

PRELIMINARY STATEMENT

The Order instituted a Phase II of this proceeding to address issues concerning long term contracts and integrated resource planning ("IRP"). The Commission initially instituted this proceeding to determine whether it should develop guidelines for utility hedging practices. But, after certain parties raised issues concerning whether the Commission should also establish policies concerning long-term contracts and IRP, the Commission commenced this Phase II and requested comments on eleven specific questions concerning those issues.

To begin with, the Commission did not precisely describe what process it would follow after the receipt of comments. The Companies propose that, if the Commission desires to proceed with this inquiry and consider making a substantial change in State policy, it should order a thorough investigation to first determine whether there are specific State public policy goals that are not currently being achieved and whether there is a need for changes in the policy concerning long-term contracts in order to achieve those goals. And, as will be explained in further detail herein, the Commission should in particular explore all of the alternatives to utility long-term contracts.[1]

In commencing this Phase II, the Commission first made it clear that it:

> has consistently found that the development of competitive markets, where feasible, will assist in assuring the provision of safe and adequate utility services at just and reasonable costs. We have consistently endorsed competition where it is more effective than regulation, but also realize that markets alone may not automatically satisfy a broad range of public policy needs and goals.

Order at 29-30. The Companies note that the Commission and the State

have a wide variety of measures that can be employed to satisfy public policy needs and goals that are consistent with the workings of competitive markets. Examples abound in the State's renewable portfolio standard ("RPS"), the programs administered pursuant to the system benefits charge ("SBC"), and the Regional Greenhouse Gas Initiative ("RGGI"). In addition, the Commission recently determined to undertake an initiative to increase energy efficiency in this State.[2] New York State, the Commission and the New York Independent System Operator ("NYISO") face significant energy challenges as the industry seeks to address the need for secure and reliable supply, global warming, and maintaining a vibrant economy. The Company encourages the Commission to continue to explore solutions to these challenges consistent with the workings of competitive markets.

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[1] The Companies note that in Case 94-E-0952, the Competitive Opportunities proceeding that led to the restructuring of New York State's competitive markets, the Commission ordered collaboratives and other investigations that lasted almost two years before the Commission ordered any change in policies. In that proceeding, the parties were first "urged to work collaboratively to identify a few comprehensive principles to guide the transition" to a more competitive market structure. Opinion No. 96-12 at 2 (May 20, 1996).

[2] Case 07-M-0548 - Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard, <u>Order Instituting Proceeding</u> (May 16, 2007).

The Companies do not see a need to effectuate a change in existing policy concerning long-term contracts that would substantially alter the existing competitive markets model. While it may be theoretically possible to require utility long-term contracts without having an impact on the competitive wholesale markets, that result will be difficult to achieve in practice, and has inherent risks and potential costs to customers.

Under the existing policy, the Commission already allows utility long-term contracts in support of public policy goals,[3] and the NYISO has a process in place, the comprehensive reliability planning process, to determine and resolve reliability needs. There is currently no evidence that there are specific articulated public policy goals that are not being achieved that would require a more expansive policy on utility long-term contracts.

Accordingly, prior to adopting a substantial change in policy that has the potential to create a significant impact on the wholesale competitive market, the Commission should first ensure that New York State's wholesale competitive markets are being utilized to the greatest extent possible to achieve the State's public policy goals, *i.e.*, the Commission should first determine whether any articulated public policy goals that are not being met that could be addressed by ongoing initiatives at the NYISO, such as the current efforts to consider a forward capacity market, recognizing that such measures may take time to demonstrate their ability to satisfy any articulated public policy goal. Such a review of public policy goals is compatible with the simultaneous implementation of the NYISO's comprehensive reliability planning process, now in its second year of

[3] Case 00-M-0504, Statement of Policy on Further Steps Toward Competition in Retail Energy Markets (August 25, 2004) ("Retail Markets Policy Statement"). The Commission stated therein (at 34) that there "could be instances where a long term commodity contract might be judiciously used in support of public policy goals (system reliability, environmental considerations, fuel diversity, or market power mitigation."

implementation, which is designed to ensure that reliability needs are met through backstop solutions when the market does not adequately meet such needs.

Second, if it is determined that state intervention is necessary to achieve public policy goals, mandated utility contracts should not be automatically considered the preferred option for implementing state policy goals. Such contracts could have significant adverse effects on the competitive market and could undermine the important economic signals that the competitive market is designed to provide to consumers and investors. Further, the potential shift in policy itself may chill the markets such that investment is halted awaiting resolution of these issues, which in and of itself would result in a need for long-term contracts.

RESPONSES TO QUESTIONS

1. Should there be a statewide integrated resource planning process to examine long term electricity resource needs? To what extent or in what manner would a statewide integrated resource planning process build on or parallel existing reliability planning processes? What time frame should be examined in such a process and what issues should be considered? What is the role of the utilities and other interested parties in the process? How should the process differ from any previous integrated resource planning processes? What processes should be adopted, if any, to ensure that resource portfolios at the utility and statewide level, satisfy overall planning objectives and public policy considerations? How should immediate concerns and long range considerations be addressed?

The Companies understand the need for statewide energy planning goals and objectives, such as improving efficiency and reducing the environmental impact of electricity. These overall policy goals can be established in a variety of different ways and can be used to inform and provide guidance for specific statewide policymaking proceedings or utility rate cases, as appropriate. For example, as discussed above, the Commission recently established a statewide energy efficiency goal and commenced a proceeding to begin implementation of a program to achieve that goal – it did not need a formal statewide energy planning process to establish that goal. Likewise, in the last Con Edison electric rate case, the Commission established a demand management goal based upon the projected load growth for the Con Edison service territory.[4]

The Commission should continue to actively consider energy policy issues and energy supply adequacy and implement new policies where it is appropriate, consistent with the workings of competitive markets. As the Commission notes in the Order (at 33), planning for public policy needs must "be flexible and capable of responding adequately to rapidly changing circumstances." The "process" to date, which has produced public policy goals and programs to implement them, has not been shown to be deficient. Indeed, a formal planning process, which would result in formal plans approved by the Commission, would decrease flexibility to the extent that they required amendment in order to permit certain actions. This is why the flexible process has worked to date and should be maintained.

In particular, the Companies do not see a need for a statewide integrated resource planning process to examine long term electricity resource needs. The NYISO and its stakeholders should continue to conduct reliability planning, as they do now pursuant to the current comprehensive reliability planning process ("CRPP"), which culminates in the issuance of a comprehensive reliability plan ("CRP"). Under the CRPP, the NYISO first determines if there is a reliability need that has to be satisfied. It then determines if there is a proposed viable market-based solution that will be in operation in time to satisfy a reliability need. If not, the NYISO will state in the CRP that implementation of

[4] Joint Proposal (at 61-62) adopted by the Commission in Case 04-E-0572, Order Adopting Three-Year Rate Plan (March 24, 2005) ("Joint Proposal").

a regulated solution may be necessary, and will continue to monitor developing market projects, calling on the backstop project only when it is apparent that no other project will meet that identified need. If the NYISO determines that implementation of a regulated solution is necessary, the responsible utility shall then make a submission to the appropriate regulatory agency.

This process is reflected in the current Con Edison Electric Rate Plan,[5] which provides as follows:

> the procedure to be employed related to the implementation of the appropriate backstop solution(s) will involve a filing by the Company with the Commission that describes the backstop solution(s) chosen by the Company, including the rationale for its choice(s), the Company's proposal for implementing its solution(s), and any plan to solicit and consider offers or bids associated with the proposed solution(s). Interested parties will then be provided an opportunity to comment on the Company's filing.

Thus, the CRPP already includes a role for the Commission -- it will decide whether the utility should proceed with its proposed reliability solution, or whether it may prefer an alternative solution, and have the opportunity to apply State energy policies to the extent necessary.

The Companies recognize the role that informed policy input can play in ensuring that the competitive market achieves overall policy goals and objectives in the most cost-effective manner, and the CRPP allows for that input. In addition, the Federal Energy Regulatory Commission ("FERC") recently provided for increased stakeholder input in planning.[6] There would be no incremental benefit if there were a duplicative statewide reliability or economic planning process, or mandated individual utility processes.

[5] Con Edison Joint Proposal at 76.

[6] The NYISO is required under FERC Order 890 to expand its current planning process to perform economic planning studies, including a forecast of congestion costs, and the utilities are required to provide for stakeholder input regarding their individual plans.

Rather, such duplication would cause confusion among market participants, and chill investment.

Moreover, there does not appear to be any benefit to a regular utility specific IRP process at this time (utilities, of course, engage in such planning and assess bulk transmission system needs as part of their participation in NYISO CRPP, in addition to their distribution planning). The State and the Commission have recognized that important public policy issues such as the environmental impacts of electricity are, at a minimum, statewide issues that should be resolved on a statewide basis. For example, in order to increase the amount of renewable power consumed, the Commission adopted a *statewide* goal of 25% of the power coming from renewable sources by 2015.[7] Similarly, the Commission recently adopted a *statewide* energy efficiency goal that looks to reduce the State's overall consumption of electricity by 15% by 2015. Finally, it was understood from the outset that RGGI should be a regional initiative, not limited to a statewide goal, although with respect to climate change and greenhouse gases, a national program would be preferred.[8]

Accordingly, it makes sense to resolve major public policy issues on a statewide basis, and not on a utility-by-utility basis. Because these are statewide (or even regional or national) issues, utility specific IRPs would be inappropriate.[9] Issues have been and can continue to be raised in utility rate cases, which can result in the Commission making

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[7] Case 03-E-0188 – Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, Order Regarding Retail Renewable Portfolio Standard (Sept. 24, 2004).

[8] It has long been recognized that New York comprises a complex single integrated electricity market. This is why the FERC found in Order 888 that New York is a "tight pool," *i.e.*, a single integrated electric system. FERC Order No. 888, Final Rule, 75 FERC 61,080 (April 24, 1996).

[9] Utility specific IRPs would be necessary if the utilities were required to enter into long-term contracts as a matter of ordinary business. But, as explained herein, it would be at best premature to adopt such a policy.

utility specific determinations, such as the Con Edison demand management goal. This *ad hoc* process has worked well to date and should continue.

Finally, while the NYISO's CRPP is still relatively new, and it is still not precisely clear how backstop projects will proceed when needed, it would be premature to declare the process unworkable; rather, the process should be supported through the development of appropriate procedures. Specifically, there are certain procedural details associated with the CRPP that are not yet fully developed, such as how the Commission will resolve competing claims when there is more than one backstop solution that could resolve a reliability need, (such procedural issues are best resolved through the NYISO's market participant process). But the existence of such procedural issues does not change the fact that the CRPP is the right process -- *i.e.*, no stakeholder has identified a flaw that justifies its abandonment in favor of a different process.

2. Should major regulated electric utilities be required or encouraged to enter into long-term contracts, with existing generators, proposed generators, and other entities, that 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? Should such contracts be entered into for the purposes of improving fuel diversity, mitigating market power, or furthering environmental policies?

There should be no mandated long-term contracts for investor owned utilities. Requiring utility long-term contracts would substantially eliminate one of the principal objectives in adopting a competitive market policy – that the risk of infrastructure investments should be borne by the investors of project developers and not by utility customers. There can be no question that one of the major factors that led to industry restructuring was the extreme dissatisfaction with the long-term contracts that were mandated in the 1980's and 1990's. Those mandated long-term contracts with prescribed prices based on long-term estimates of avoided costs and, in New York, a statutory minimum payment, resulted in huge overpayments and stranded costs that had to be recovered from utility customers. As the Commission explained when it started electric industry restructuring, "We expect to see market-based solutions to public policy issues rather than regulatory mandates. Competitive providers (generators and energy service companies) would bear more of the risk of investment decisions, and customers less, than under regulation." Opinion No. 96-12, *supra*, at 30-31. This is precisely why the current process, which relies in the first instance on competitive markets and the NYISO CRPP, provides that regulated solutions are implemented only if there is a reliability need that cannot be satisfied by the competitive market.

Moreover, new long-term utility contracts may be treated as utility debt and would therefore raise costs for both investors and ratepayers. In December 2003, the Financial Accounting Standards Board issued Interpretation No. 46 Revised (FIN 46R), Consolidation of Variable Interest Entities, which requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among the parties involved. Under FIN 46, a utility with a long-term contract may often be considered the primary beneficiary (the one who receives the majority of the rewards and/or absorbs the majority of the risks per the terms of the contract) and, therefore, that utility (in most cases) would have to consolidate that power plant, and its associated debt / liabilities, into its financial statements even though it does not have a voting interest in the power plant.

While the Companies do not agree, they are also concerned that the NYISO may require new long term contracts to be bid in at a price such that those contracts may not clear the NYISO's capacity auction. Currently, a utility's long-term capacity contracts may be bid into the NYISO demand curve auction at a price of zero. This ensures that such capacity clears the auction so that the utility and its customers obtain credit for the capacity they already purchased through the long-term contract. If the NYISO establishes a required bid price, which does not clear the NYISO's capacity auction, a utility may wind up paying twice for the same capacity; once for the capacity it purchased by contract and a second time for the capacity it had to buy in the auction through the demand curve market design. This is another risk associated with requiring a utility to enter into long-term capacity contracts.

Accordingly, other alternatives should be exhausted before utility contracts are required, *i.e.*, utility contracts should be considered as a "last resort" only after all other measures have failed. Significantly, as discussed above, there may be alternative measures, less harmful to ratepayers that can be employed to satisfy public policy needs that are not being met, if any. For example, the State already has an initiative in place to achieve renewable power goals (which will increase fuel diversity[10]), and is part of the Regional Greenhouse Gas Initiative ("RGGI") to reduce emissions that contribute to global warming and climate change. Finally, the State has just begun a proceeding to reach an energy efficiency goal of a 15% reduction in electricity consumption by 2015.

While the Commission expresses a concern that long-term contracts may be necessary to facilitate the construction of new generation,[11] there are other regulatory measures with less potential harm that should be considered before utility long-term

[10] Other fuel diversity goals, such as ensuring that natural-gas fired facilities have and use oil as an alternative fuel, can be handled through a State siting process, which needs to be enacted.

[11] The Companies assume that the Commission is referring here to new generation that would be "needed" for other than a reliability reason, because the NYISO already has a process in place to satisfy reliability needs.

contracts. For example, the NYISO has yet to implement a forward capacity market that would facilitate the financing of new electric infrastructure and/or demand side management resources. At a minimum, the Commission should wait until a forward capacity market has been in place for a number of years before determining whether other measures should be implemented. Otherwise, the Commission's actions could create precisely the kind of regulatory uncertainty that discourages financial institutions from financing major energy projects without such contracts, and become a self-fulfilling prophecy. As the Commission recognized in the Order (at 3), uncertainty over changing market rules can impede investment into new electric infrastructure:

> Regulatory uncertainty could have a substantial impact on investment decisions, and those uncertainties may arise in new state or federal legislation, new policies of regulatory agencies, or new practices at the NYISO. . . . Changing market rules, and the consequences such changes can sometimes bring, provide continuing risks and uncertainties for investors in new generating, demand side management (DSM), and transmission facilities.

Finally, the Commission should make clear in this proceeding that a utility built facility will be allowed as an alternative to entering into long-term contracts. A utility built facility can be a better option than a long-term contract because there would be increased operational flexibility as conditions change, *i.e.*, no need to amend a contract, and the increased stability and reliability that comes from the actual owner being a creditworthy entity[12] Moreover, for Con Edison, there may well be opportunities to repower facilities to provide for both steam and electric needs, as well regional environmental benefits. Accordingly, the opportunity for Con Edison to propose a modern, clean cogeneration facility should be maintained as an option.

[12] Notably, a long-term contract requires the utility to finance and pay for the construction of a 30-40 year plant, but use it for the 10-15 year term of the contract. A utility-built plant, on the other hand, allows ratepayers to retain the benefits of the plant until the end of its service life.

3. Should Load Serving Entities other than utilities, including the New York Power Authority and the Long Island Power Authority, be required or encouraged to enter into long-term contracts as described above? What role, if any, might entities other than Load Serving Entities play in such resource procurement?

Entities other than utilities, such as public power agencies, can enter into long-term contracts pursuant to public policy (but long term contracts can still have a negative impact on the competitive markets -- even when public authorities are involved). Such entities already exist and have entered into or announced long-term contracts entered in to on voluntary terms. For example, the Long Island Power Authority ("LIPA") entered into a long-term contract to finance the 660 MW Neptune transmission line from New Jersey to Long Island, and the New York Power Authority ("NYPA") has announced that it plans participate in a contract to facilitate the construction of a new 500 MW transmission line into New York City. Moreover, as with the RPS, the New York State Energy Research and Development Authority ("NYSERDA") is available as an entity that may enter into long-term contracts.

Finally, as the Commission notes (Order at 35), there is no reason at this time to abandon the "expectation that ESCOs who have acquired a significant level of customer load will enter into longer term contracts." The Commission further explains (*id.* at 35 n. 31) that approximately 40% of the State's electricity usage is being served by ESCOs, and that this "magnitude of usage should enable the ESCOs to engage in long term contracting." ESCOs, including NYPA, already serve about half the load in Con Edison's service area and are expected to continue to serve more customers in the future. The ESCOs may be able to utilize a market mechanism for forward markets through the NYISO as a basis to finance new infrastructure. Accordingly, the Commission should also investigate the reasons why ESCOs have been unwilling to enter into long term contracts and whether there are public policy or market structure changes that would facilitate their entering into such contracts.

4. Should resource procurement, as described in Question 1, be coordinated on a statewide basis? What regulatory oversight, if any, would be appropriate?

As the Companies state above, the public policy issues discussed in the Order should be managed and resolved on a Statewide basis. In addition, the Commission has been provided with a role in the CRPP, although the Companies believe that this role could be further clarified and refined.

5. What barriers, if any, exist that discourage long-term contracts for development of new electricity resources? What other barriers exist, if any, for the development of new electricity resources? Should incentives beyond what exist today be created to encourage entry into long-term contracts generally, or to foster the development of any particular type of resource? How could those incentives be structured consistent with the goal of acquiring the most cost-effective resources?

The two primary barriers are the lack of assurance of cost recovery, with no offsetting incentives for utilities –*i.e.*, the lack of a proper risk/reward balance. If the Commission desires that utilities enter into long-term contracts, then it should seek to provide utilities with greater assurance of cost recovery with pre-approval of contracts and incentives.

While the Commission currently declines to pre-approve the terms of contracts, it has done so in the past, especially with respect to federal- and state-mandated contracts. The Commission also has, in limited occasions, recognized that “extraordinary circumstances” can “warrant a limited departure from the general rule” that the

Commission will not issue contemporaneous prudence determinations. Case 27940, Statement of Policy Concerning Measures to Facilitate Conversion of Oil-Fired Power Plants to Coal, at 30 (Dec. 2, 1981). Requiring utilities to enter into long-term contracts in order to satisfy a public policy goal, *i.e.*, to ensure that merchant infrastructure is financed and built, should constitute an "extraordinary circumstance" that allows for a determination of prudence prior to contract execution.[13]

The Commission's current policy is to refuse to provide pre-approval of utility contracts, even when entered into for a public policy purpose. In its Declaratory Ruling on the recent Con Edison RFP (at 10),[14] the Commission stated that "one commission can neither bind future commissions nor relieve future commissions of their duty to balance ratepayer and shareholder interests when setting 'just and reasonable' rates." However, the Commission could, at the very least, conduct a review of the terms of the contract and determine that they are reasonable based on the facts known at the time of the review and is therefore prudent. This would provide utilities with some protection against a future disallowance based on imprudence. For example, the Commission could adopt a form of the *Mobile-Sierra* doctrine for such determinations, and make it clear that utilities have the ability to withdraw from a contract if a regulatory disallowance does occur.[15] Alternatively, if it were decided that utility long-term contracts were necessary, the Commission could seek legislation guaranteeing cost recovery for contracts entered into to further public policy goals.

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[13] In the Companies' view, the Con Edison RFP for 500 megawatts that resulted in a 10-year contract constituted such "extraordinary circumstances," *i.e.*, to meet New York City reliability needs.

[14] Case No. 02-E-1656. Declaratory Ruling on Cost Recovery (Jan. 24, 2003).

[15] The *Mobile -Sierra* doctrine is derived from the Supreme Court's companion cases, *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956). It generally provides that an agreement (or order) can be modified only if it is required by the public interest, as opposed to the general standard of a just and reasonable rate.

The Commission should also authorize utility recovery of management fees and incentives. The specific framework for incentives should be determined in utility-specific collaboratives or rate cases, if the Commission ultimately decides that it is necessary for utilities to enter into long-term contracts. Two options that should be considered are paying the utility a management fee based upon the dollar value of the contract and a percentage of the net benefits produced by the contract.

The Commission should also explicitly recognize that a long-term contract entered into by a utility for a public policy purpose constitutes state action that immunizes utilities from anti-trust liability. [16] Unquestionably, utilities will not and should not enter into a long-term contract if it creates a risk of anti-trust liability (such as monopsony power claims). The Commission has the power and authority to shield utilities from anti-trust liability, and it should explicitly do so if it desires that utilities enter into long-term contracts.

Finally, the Commission asks whether other barriers exist for the development of new electricity resources. With respect to generation, the lack of a State siting statute is a significant barrier that still needs to be addressed.

6. Should constraints be imposed that would, under certain circumstances, restrict the resource types eligible for long-term contracts, limit the length of contract terms or establish the content of other contract conditions? What steps should be taken to limit any anti-competitive impacts long-term contracts might create?

The Companies do not believe that any rigid guidelines should be adopted at this time. If the Commission ultimately determines that a specific public goal can only be accomplished through a utility long-term contract, then guidelines can be developed. In

[16] *E.g., California Retail Liquor Dealer's Assoc. v. Midcal Aluminum, Inc*., 445 U.S. 97 (1980).

any event, the Companies submit at this time that long-term contracts should be limited only to new resources intended to meet incremental public policy goals because incumbents should not need this type of extraordinary support, and customers should not take on risks unless it is necessary to meet a specific reliability need that cannot otherwise be met by the market.

7. Should restrictions or guidelines be imposed on the resource procurement practices employed in selecting the resources that would be acquired under the long-term contracts?

The Companies believe that this question is premature, but note that the general principle would be to ensure that resource procurement practices are administered in a competitively neutral manner and take statewide interests into account. This is why the Commission selected NYSERDA to be the administrator of the RPS that would enter into long-term contracts with renewable facility developers.

8. How should long-term contract costs be recovered from customers, and should different recovery mechanisms be developed based on the type of resource that is acquired under the contract, the length of the contract, or other factors?

Should utilities be required to enter into long-term contracts, the costs of such contracts should be recovered through a NYISO uplift charge. Most, if not all, of these contracts would have a beneficial impact on more than one service territory, which is why recovery through a NYISO uplift charge makes the most sense. This also demonstrates why the NYISO CRPP is the best process for determining whether new electric infrastructure needs to be constructed to meet reliability requirements with regulated support, due to a lack of market response.

In the alternative, if there is to be a utility wires charge, long-term utility contracts that serve a public policy purpose should be recovered through a wires charge applicable to all customers, full-service, retail access and municipal. The Commission should reaffirm here the determination in the Retail Markets Policy Statement (at 35) that the costs of these contracts, *i.e.*, the variation from prevailing commodity prices, "should be reflected in delivery rather than commodity rates." The Companies believe that this wires charge should be made applicable to all customers. For example, for Con Edison, NYPA customers should not be exempted from paying a charge for a contract that is designed to achieve a statewide policy goal.

9. What procedures should be followed in reviewing a long-term contract and in establishing its qualification for cost recovery? Under what circumstances, if any, should recovery of contract costs be pre-approved?

Discussed in response to Question 5.

10. Can long-term contracts (energy and/or capacity) be harmonized with existing NYISO rules for energy and capacity markets, and with potential NYISO forward capacity markets? If so, how can they best be harmonized? What changes to NYISO market rules, if any, would be necessary or appropriate for the purpose of accommodating long-term contracts? Should NYISO market rules recognize or ameliorate the impact, if any, of long-term contracting on the NYISO capacity prices paid existing generators, or, if amelioration is appropriate, should it be accomplished through non-NYISO mechanisms?

This question demonstrates why the Commission should require utility long-term contracts as a last resort only. It will be difficult to harmonize long-term contracts with the NYISO rules for energy and capacity markets. But, even more importantly, if there is a policy requiring long-term contracts, it will be difficult to develop a policy that will facilitate market financing of energy infrastructure because those long-term contracts would inevitably eliminate the market for the financing of new projects and have an adverse impact on the economics of existing projects.[17]

The Companies do not see any way to ameliorate this impact without further compromising the competitive markets. For example, if long-term contracts have impacts on existing generators, then they may require financial support in order to be able to continue operating and provide needed reliability (other ISOs have entered into “must run” reliability contracts with generators that are necessary to maintain reliability but do not earn enough revenue to remain in operation[18]). This raises the possibility, however, that there would be a limited number of generators that would be competing in the NYISO markets. Indeed, one could be left with a “market” where there are new generators that have long-term contracts to operate, existing generators with reliability contracts, and very few generators left that operate in a purely competitive manner.

11. Are there any other creative solutions that might be considered to address the issues identified herein?

The Commission should seek legislative authority to employ securitization to reduce the costs of long-term contracts. A policy that requires long-term contracts will ultimately result in higher prices, as occurred in the past with mandated contracts. Accordingly, the Commission should seek to employ measures that will help to reduce the ultimate price to customers. As the Companies have previously stated, legislative authorization should be sought to guarantee cost recovery for utilities that enter into long-term contracts, and authorization to securitize those costs should be sought at the same time.

[17] Indeed, as discussed above, the regulatory uncertainty of the Commission reconsidering such issues may in and of itself be sufficient to have an adverse impact.
[18] *See* FERC Docket No. ER05-903-000 (for New England ISO).

The Commission should also continue to foster discussion over policy goals as part of the regulatory process and seek to implement such goals where appropriate. The recent Con Edison electric rate case, which contains a demand management goal, is a good example.

CONCLUSION

Based upon the foregoing, the Companies request the Commission to refrain from mandating long-term utility contracts. Because long-term contracts are not required, utility specific IRPs are also not required. To the extent such contracts are needed as a last resort, there should be an appropriate balance between cost recovery assurance and incentives for the risks inherent in such contracts.

Dated: New York, New York
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Respectfully submitted,

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