

**STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION**

<b>Policies, Practices and Procedures for</b>	)	
<b>Utility Commodity Supply Service to</b>	)	<b>Case 06-M-1017</b>
<b>Residential and Small Commercial and</b>	)	
<b>Industrial Customers – Phase II</b>	)	

**INITIAL COMMENTS OF THE  
NATIONAL ENERGY MARKETERS ASSOCIATION**

The National Energy Marketers Association (NEM)<sup>1</sup> hereby submits its Initial Comments in the above-referenced proceeding pursuant to the Commission’s April 19, 2007, Order Requiring Development of Utility Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II to Address Longer-Term Issues. Specifically, this Commission instituted Phase II of this proceeding, “to examine the use of long-term contracts and whether an integrated planning process should be established in New York.” NEM urges the Commission to permit competitive market forces, rather than regulatory intervention, to identify and meet the need for new capacity resources.

NEM recognizes the import of long-term supply-related investments. However, after twenty-five years of success with increasingly market-based energy policies, regulators, legislators and consumers throughout the nation have learned that cost plus regulations that rely on vertically integrated energy monopolies to provide otherwise competitively

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<sup>1</sup> NEM is a national, non-profit trade association representing wholesale and retail marketers of natural gas, electricity, as well as energy and financial related products, services, information and advanced technologies throughout the United States, Canada and the European Union. NEM's membership includes independent power producers, advanced metering, demand and load management firms, billing, back office, customer service and related information technology providers. NEM members are global leaders in the development of enterprise solution software for energy, advanced metering, information services, finance, risk management and the trading of commodities and financial instruments. NEM members also include inventors, patent holders, systems integrators, and developers of advanced power line surveillance and grid reliability technology with advanced uses in Power Line Communications (PLC) technologies as well as new and innovative electrical encoding, applications or decoding known as Smart Electricity.<sup>TM</sup>

available energy supplies, services and technologies increases both the costs and risks associated with such investments.

The New York Public Service Commission has gained national recognition for its carefully crafted, prudently implemented transition to a market-based, consumer-focused competitive energy market. In response to ten years of consistently pro-growth, market-based pricing, the number of competitive suppliers serving New York has doubled, and more than 1.3 million New Yorkers have elected to shop for their energy supplies.

Until September 11, 2001, a war in Iraq and two major hurricane disasters, the cost of energy stayed remarkably stable with crude oil prices averaging \$20/barrel. Yet despite five years of steeply increasing cartel oil prices, New York has experienced energy cost reductions.<sup>2</sup> Studies recently released<sup>3</sup> estimate that tens of billions of dollars have been saved nationally by a transition to competitive, market-based energy policies.

NEM recognizes that the New York energy market is in transition. Many historically regulated utility investments have become increasingly competitive. Importantly, the New York Public Service Commission reports that the average number of competitive

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<sup>2</sup> The typical residential retail customer experienced a drop in total real electric price of an average of 16% between 1996 and 2004, and most commercial and industrial customers benefited from similar energy bill decreases. New York State Department of Public Service, Staff Report on the State of Competitive Energy Markets: Progress to Date and Future Opportunities, March 2, 2006, page 2. See also Joskow, Markets for Power in the United States: An Interim Assessment, The Energy Journal 2006, page 27, Figure 6 (showing approximate 14% decrease in real residential prices from 1996-2004).

<sup>3</sup> A recent CERA study found that, “[t]he majority of U.S. consumers have paid less for electricity since the onset of power system deregulation in 1997, achieving total savings of about \$34 billion compared with the costs if traditional regulation had continued.” Cambridge Energy Resource Associates, Press Release, “Power Deregulation Saved \$34 Billion, Benefited Majority of U.S. Consumers Over Past 7 Years: CERA Study,” October 19, 2005 (discussing findings of study titled, “Beyond the Crossroads: The Future Direction of Power Industry Restructuring”).

suppliers per utility service territory has now grown to six. This is a major accomplishment.

While this may not automatically solve the need for long-term capacity investments it does, however, present the Commission with sufficient evidence that reliance on market-based investments should ultimately make regulatory mandates of long-term capacity investments a less attractive policy option. Moreover, given the discipline that market-based policies bring to the energy market, obligating captive ratepayers to the higher costs and risks associated with cost-plus utility investments may undermine the enormous progress that has been made in market-based, energy supply and energy demand-related investments.

Market-based, demand-side incentives combined with a relatively stable regulatory framework for new competitive capacity investments should help New York meet its energy needs now and in the future. Competitive capacity investments in the State will be facilitated through the regulatory stability provided in this Commission's reaffirmation of its vision that utilities exit competitive functions.

#### **I. Regulatory Intervention Increases the Costs and Risks Associated with New Capacity Additions**

NEM is very concerned that a return to utility integrated resource planning and long term contracting represents a huge step backward toward the vertically integrated energy monopoly model. The restructuring of the natural gas and electricity industries was initiated in large part because the historical cost-of-service approach to energy supply and demand facilitated a steady increase in the costs for energy to the ultimate consumer, even in times of declining wellhead prices. Likewise, it was recognized that regulated

rates are a poor proxy for the efficiencies, innovations and potential price savings yielded by competitive markets. Competitive market participants are expert at controlling supply-related risks, and they do so without the requisite guaranteed return of and return on utility investments, the risks of which are borne by captive ratepayers.

NEM submits that the reallocation of utility capital, credit and resources from competitive commodity-related investments into distribution and transmission investments will increase the long-term reliability of the New York energy market. Moreover, NEM submits that one hundred and fifty years of contract law can be relied upon to meet or beat the reliability of regulatory capacity mandates. Regulatory mandates inevitably lead to higher costs than competitive market-based supply and demand-side investments. If utilities are forced into making long-term generation investments rather than or in addition to needed infrastructure investments, they should do so via an arms-length competitive affiliate, and subject to Commission-administered compliance with utility codes of conduct.

Simply stated, mandating long-term contracting for the purpose of encouraging capacity additions can artificially inspire new capacity additions, however, it should not be a policy reversal tantamount to retaining utilities in an otherwise competitive merchant function role. This Commission has inspired significant new investment by consistently supporting its well-formulated best practices outlined in its Retail Policy Statement and its vision that utilities exit competitive functions.<sup>4</sup> Additionally, the Retail Policy Statement cautioned that, “if it is determined that a utility has entered into a long term contract to retain market share or to otherwise impede the development of a competitive

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<sup>4</sup> Retail Policy Statement at 18.

market, the costs of those contracts may not be recoverable from ratepayers.”<sup>5</sup> NEM submits that utility long-term contracting for purposes of retaining market share versus utility long-term contracting for encouraging capacity additions is a very fine distinction that may not have a difference.

## **II. Utility Long Term Contracting Is Not the Solution to the Complex Issues that Inhibit the Building of New Capacity Resources**

The underlying premise of this inquiry is founded on the assumption that utility long-term contracting is a prerequisite to getting new capacity resources financed and built. This begs the question of whether there is a far more complex set of issues that are determinative of whether new generation gets built and whether addressing these other issues would create the framework necessary for competitive entities to bring new capacity resources into the State without requiring utilities to enter into long term contracts. NEM submits that the answer to this question is yes. There are a host of issues that influence whether generation capacity gets built. These include, amongst others: a) inadequate pricing signals; b) siting difficulties; c) regulatory uncertainty; d) lack of settled national policy on environmental standards; e) sanctity of contracts; f) lack of long-term firm transmission rights; and g) expectations of the financial community.<sup>6</sup>

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<sup>5</sup> Retail Policy Statement at 34.

<sup>6</sup> This list is by no means intended to be exhaustive. For example, Professor Paul Joskow of MIT identified regulatory, system operation and market imperfections that have led to inadequate incentives for new investment in generation consistent with prevailing engineering reliability criteria such as:

- (a) price caps on energy supplied to the market and related market power mitigation mechanisms that do not allow prices to rise high enough during conditions when generating capacity is fully utilized to provide energy and operating reserves to meet reliability constraints. Under these conditions supply and demand should be balanced by responses on the demand side to high prices that reflect the value of lost load, producing significant competitive scarcity rents for generators;
- (b) price caps on capacity payments in the market designs that incorporate capacity obligations and capacity prices;
- (c) actions by system operators that have the effect of keeping prices from rising fast enough and high enough to reflect the value of lost load during operating reserve emergencies when

### **a. Inadequate Pricing Signals**

With respect to inadequate pricing signals, this problem persists at the both the wholesale level and retail level. Measures that mitigate prices at the wholesale level fail to provide adequate compensation to generation, and can make new investments cost prohibitive.<sup>7</sup> Professor Hogan of Harvard University states, “[d]espite recent headlines to the contrary, the basic fact is that wholesale electricity prices have been too low to support either

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small changes in system operating procedures can lead to very large changes in prices and scarcity rents needed to cover fixed costs; (d) reliability actions taken by system operators that rely on Out of Market (OOM) calls on generators that pay some generators premium prices but depress the market prices paid to other suppliers; (e) the absence of adequate spot market demand response to allow prices to play a larger role in balancing supply and demand under tight supply conditions; (f) payments by system operators to keep inefficient generators in service due to transmission and related constraints rather than allowing them to be retired or be mothballed, (g) regulated generators operating within a competitive market that have poor incentives to make efficient retirement decisions, depressing market prices for energy and (h) engineering reliability rules that have not been harmonized with market mechanisms and may implicitly impose costs of meeting reliability standards that are significantly greater than what consumers would be willing to pay in a well functioning competitive market.

Paul Joskow, “Markets for Power in the United States: An Interim Assessment,” *Energy Journal* 2006, page 17.

<sup>7</sup> Professor Joskow explains that,

“numerous analyses of the performance of organized energy-only wholesale markets indicate that they do not appear to produce enough net revenues to support investment in new generating capacity in the right places and consistent with the administrative reliability criteria that are still applicable in each region. Moreover, while capacity obligations and associated capacity prices that are components of the market designs in the Northeast produce additional net revenue for generators over and above what they get from selling energy and ancillary services, the existing capacity pricing mechanisms do not appear to yield revenues that fill the “net revenue” gap. That is wholesale prices have been too low even when supplies are tight.”

Joskow also stated that, “Every organized market in the U.S. exhibits a similar gap between net revenues produced by energy markets and the fixed costs of investing in new capacity measured over several years time.” Paul Joskow, “Markets for Power in the United States: An Interim Assessment,” *Energy Journal* 2006, pages 15-16.

infrastructure investment or adequate demand side participation in the crucial spot markets.”<sup>8</sup>

At the retail level, there is a general lack of adequate market-based pricing signals, which are necessary to incent a meaningful demand response from customers. Relatedly, the participation of demand response in wholesale markets remains limited. The uncertainty of the role of demand response participation in markets, potentially displacing the need for other capacity resources, is therefore another complicating factor.

### **b. Siting Difficulties**

Siting difficulties also influence whether new capacity resources get built. These siting difficulties include expiration of the Article X power plant siting law in 2003, “NIMBY” resistance movements, as well as a lack of suitable locations in the densely populated urban centers that have high energy demands. To the extent possible, settling these siting difficulties would facilitate investment in capacity resources.

### **c. Regulatory Uncertainty**

Regulatory uncertainty is another impediment to new capacity building. This regulatory uncertainty emanates from many sources. For instance, there is a high degree of regulatory uncertainty associated with the Commission opening dockets that give the appearance it may be significantly changing retail market policies. There is a high degree

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<sup>8</sup> See FERC Docket AD07-7, Comments of William W. Hogan, Acting in Time: Regulating Wholesale Electricity Markets, May 8, 2007, page 5. Professor Hogan went on to explain that,

In particular, prices in organized markets tend to be too low during conditions of generation capacity scarcity, exactly the time when the unexploited demand side resource would be most valuable. But without the signal and the reward through prices, there is insufficient market incentive for demand side action or for adequate infrastructure investment. There are many reasons for this inadequate scarcity pricing that relate to both mistakes in market design and practices of system operators.

of risk for all market participants when the end state vision of the market is unclear, when the utility obligation to deliver remains unnecessarily tied to an obligation to supply, and when utility best practices implemented to facilitate customer migration appear threatened. The uncertainty of the role of the regulated utility, and relatedly, the perceived willingness of the Commission to intervene in the market, can disincent capacity investments because parties fear this regulatory uncertainty changes, limits or constrains the perceived market opportunity that otherwise may exist today. NEM submits that the Commission can overcome regulatory uncertainty to a significant degree in this proceeding by reaffirming its commitment to competitive retail energy markets and the utilities orderly transition out of the merchant function.

**d. Lack of Settled National Policy on Environmental Standards**

The lack of settled national policy on carbon and other environmental standards is also a significant impediment to building new generation capacity resources. There is growing recognition that federal legislation will likely be passed that imposes such standards and at an unknown compliance cost. Firm national guidance and rules in this regard would remove a significant impediment to investment in new capacity resources.

**e. Sanctity of Contracts**

The sanctity of contracts is tantamount to permitting willing buyers and sellers to transact purchases and sales of energy in the marketplace. Recent decisions by the Ninth Circuit<sup>9</sup> have raised some uncertainties associated with FERC's Mobile-Sierra doctrine as applied to wholesale power contracts under FERC's market-based rate regime as well as the

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<sup>9</sup> Pub. Util. Dist. No 1 v. FERC, 471 F.3d 1053 (9<sup>th</sup> Cir. 2006); Pub. Util. Commission of the State of Cal. V. FERC, 474 F.3d 587 (9<sup>th</sup> Cir. 2006).



“public interest” standard that should be used when “Mobile-Sierra” applies. Under Mobile-Sierra review, there is a presumption that privately negotiated contracted rates are just and reasonable, and FERC will not modify said contractual agreements unless it finds the public interest so requires. The impact of the Ninth Circuit decisions bears directly on parties’ willingness to enter into long-term contracts.

**f. Lack of Long-Term Firm Transmission Rights**

The lack of long-term firm transmission rights has also been a barrier to investment in new capacity resources. When firm transmission rights are only available for short terms it creates uncertainty for market participants that want to enter into long-term supply procurements because they will not know if they will have sufficient FTRs to meet their needs, and therefore be able to hedge congestion costs. Last year, FERC issued Orders 681 and 681-A requiring ISOs/RTOs in organized markets to make long-term firm transmission rights available to all transmission customers. The stated purpose of Order 681 was, “to provide increased certainty regarding the congestion cost risks of long-term transmission service in organized electricity markets that will help load serving entities and other market participants make new investments and other long-term power supply arrangements.”<sup>10</sup> The NYISO has submitted its compliance filing to comport with FERC’s Orders.<sup>11</sup> The availability of long-term transmission rights should improve the environment for new capacity resource investments in the State.<sup>12</sup>

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<sup>10</sup> FERC Order 681, para. 16.

<sup>11</sup> FERC Docket ER07-521.

<sup>12</sup> In its 2007 Reliability Needs Assessment, the NYISO states that, “The development of long-term firm transmission rights will help enable long-term power supply arrangements and the development of resource additions.” NYISO 2007 Reliability Needs Assessment, March 16, 2007, page 1, n. 1.

### **g. Expectations of the Financial Community**

Additionally, the expectations of the financial community factor into the investment of capacity resources. NEM is aware of the opinion held by some that a utility rate base is needed to support investment in a new generation plant. NEM submits that this opinion is antiquated and outmoded.<sup>13</sup> NEM suggests that an analogy can be drawn to real estate development projects as evidence that the financial community will support projects of uncertain “subscriberhip.” The financial community does not require fully committed occupancy in order to fund a real estate development project. Like other capital-intensive infrastructure investments, real estate investment occurs in cycles in response to market signals. The same should be said for investments in generating capacity.

In sum, NEM has listed the factors above to illustrate that the process of developing new capacity resources is dependent on a number of variables. Some of these can be resolved by this Commission. Others may require legislation from the U.S. Congress or the New York legislature. Still others require FERC action. NEM urges this Commission to focus

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<sup>13</sup> Professor Joskow explains that,

the combination of state initiatives and market opportunities has led to a considerable amount of restructuring of the ownership of existing generating plants. In 1996 there was about 750,000 Mw of utility-owned electric generating capacity in the U.S. of which investor-owned utilities (IOUs) accounted for about 580,000 Mw. After 1996, about 100,000 Mw of generating capacity was divested by IOUs and another 100,000 Mw transferred to unregulated utility affiliates to compete in the wholesale market. **Moreover, between 1999 and 2004 about 200,000 Mw of new generating capacity was completed, about 80% of which was accounted for by unregulated generating companies (independent power companies and unregulated affiliates of utilities). More new generating capacity entered the market between 2001 and 2003 than in any three year period in U.S. history. Indeed, there was so much entry (and so little exit) that by 2003 there was excess generating capacity in most regions of the country. By 2004 over 40% of the power produced by investor-owned companies in the U.S. (i.e. excluding federal, state, municipal and cooperative generation) came from unregulated power plants, up from about 15% in 1996.** After a decline in market liquidity following Enron’s collapse, during 2004, trading in financial electricity products increased by a factor of ten. (Emphasis added.)

Paul Joskow, “Markets for Power in the United States: An Interim Assessment,” Energy Journal 2006, page 7.

its efforts on finding meaningful long-term solutions to these problems, and chief among the solutions is providing regulatory stability by reaffirming the Commission's commitment to its vision that utilities exit competitive functions. Utility long-term contracting for capacity resources is simply not the answer. Moreover, any such requirement would inject more complexity and uncertainty into a process that should be guided by the market-based decisions of market participants.

### **III. The Commission Need Not Duplicate the Processes at FERC, NYISO and NERC for Ensuring the Availability of Adequate and Reliable Supplies**

Many stakeholders have long been focused on the issue of assuring the adequacy and reliability of our electric infrastructure, including FERC, NYISO and NERC. This Commission need not duplicate these processes by requiring utilities to enter into long-term capacity contracts and engage in integrated resource planning. For instance, NYISO has a Comprehensive Reliability Planning Process<sup>14</sup> pursuant to which it conducts a Reliability Needs Assessment (RNA). The RNA identifies resource needs over a ten year period. Subsequent to the issuance of the 2007 RNA,<sup>15</sup> the NYISO issued a solicitation for market-based solutions (as well as alternative regulated solutions if suitable market-based solutions are not identified) to the State's resource needs.

Additionally, other organized markets are implementing capacity constructs to facilitate the addition of new resources. For instance, ISONE has implemented a Forward Capacity Market and PJM has implemented a Reliability Pricing Model. This could potentially provide valuable lessons for New York stakeholders. FERC also recently

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<sup>14</sup> See Attachment Y to NYISO's Open Access Transmission Tariff.

<sup>15</sup> Available at:

[http://www.nyiso.com/public/webdocs/services/planning/reliability\\_assessments/2004\\_planning\\_trans\\_report/2007\\_RNA.pdf](http://www.nyiso.com/public/webdocs/services/planning/reliability_assessments/2004_planning_trans_report/2007_RNA.pdf)

opened a proceeding to “consider the justness and reasonableness of the New York ISO’s in-city ICAP market, and whether and how market rules need to be revised to provide a level of compensation that will attract and retain needed infrastructure and thus promote long-term reliability while neither over-compensating nor under-compensating generators.”<sup>16</sup>

NEM submits that the on-going efforts of these entities to ensure the adequacy and reliability of capacity resources need not be duplicated by this Commission requiring integrated resource planning for New York’s electric utilities.

#### **IV. Utility Long-Term Contracting is Inconsistent with State and Federal Policies in Favor of Demand Response**

Utility long term contracting is inconsistent with sending market-based pricing signals necessary to support consumer demand response. The federal government in the Energy Policy Act of 2005 and this Commission have both recognized the importance of market-based pricing and demand response for empowering consumers. The federal Energy Policy Act of 2005 (EPAAct) sets forth a national policy in support of demand response. It provides that,

It is the policy of the United States that time-based pricing and other forms of demand response, whereby electricity customers are provided with electricity price signals and the ability to benefit by responding to them, shall be encouraged, the deployment of such technology and devices that enable electricity customers to participate in such pricing and demand response systems shall be facilitated, and unnecessary barriers to demand response participation in energy, capacity and ancillary service markets shall be eliminated.<sup>17</sup>

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<sup>16</sup> ER07-360 and EL07-39, Order Rejecting Proposed Tariff Revision and Instituting Hearing and Settlement Judge Procedures, issued March 6, 2007, para. 17.

<sup>17</sup> Energy Policy Act of 2005, Section 1252(f).

In support of this national policy, EPAAct requires electric utilities to offer “time-based rate schedules” and supporting “time-based meters.”<sup>18</sup> Relatedly, this Commission found that,

As price signals for the highest peak hours are transmitted to customers, those large customers can be expected to respond, as the experience of National Grid and Central Hudson demonstrates. Since large customers use amounts of electricity disproportionate to their number, that response could have a significant impact on peak period prices.

More accurate price signals are also known to promote economic efficiency in general. Moreover, as demand-side load reduction and load control measures are implemented in response to these price signals, the potential for the exercise of wholesale market power is mitigated. Gaining and taking advantage of market power is more difficult, particularly during peak periods, when efforts to increase the price of supply meet resistance in the form of reductions to demand. As a result, moving from a policy of voluntary RTP to a policy of mandatory hourly pricing for large customers is fully justified at this time.<sup>19</sup>

As the above statements amply demonstrate, consumers should not be expected to reduce demand in response to long-term, non-time-differentiated, averaged rates that provide no incentive or reward for such behavior. If the Commission were to require utilities to enter into long-term contracts for generating capacity, it would be doing so at the “cost” of blunting/restricting the exact price responsive demand behavior that could offset the perceived need for generation investments. DOE succinctly stated that, “[r]etail electricity prices that are linked to contemporaneous supply costs or prices are one of the principal mechanisms for accomplishing demand response.”<sup>20</sup> Conversely, “[f]lat, average-cost retail rates that do not reflect the actual costs to supply power lead to

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<sup>18</sup> Energy Policy Act of 2005, Section 1252(a).

<sup>19</sup> *Id.* at 14-15.

<sup>20</sup> U.S. Department of Energy, Benefits of Demand Response and Recommendations, February 2006, at 52.

inefficient capital investment in new generation, transmission and distribution infrastructure and higher electric bills for customers.”<sup>21</sup>

NEM submits that the U.S. Department of Energy’s recent report on demand response is an important resource for highlighting the benefits of demand response and how to achieve them. DOE explains that,

The most important benefit of demand response is improved resource-efficiency of electricity production due to closer alignment between customers’ electricity prices and the value they place on electricity. This increased efficiency creates a variety of benefits, which fall into four groups:

- *Participant financial benefits* are the bill savings and incentive payments earned by customers that adjust their electricity demand in response to time-varying electricity rates or incentive-based programs.
- *Market-wide financial benefits* are the lower wholesale market prices that result because demand response averts the need to use the most costly-to-run power plants during periods of otherwise high demand, driving production costs and prices down for all wholesale electricity purchasers. Over the longer term, sustained demand response lowers aggregate system capacity requirements, allowing load-serving entities (utilities and other retail suppliers) to purchase or build less new capacity. Eventually these savings may be passed onto most retail customers as bill savings.
- *Reliability benefits* are the operational security and adequacy savings that result because demand response lowers the likelihood and consequences of forced outages that impose financial costs and inconvenience on customers.
- *Market performance benefits* refer to demand response’s value in mitigating suppliers’ ability to exercise market power by raising power prices significantly above production costs.<sup>22</sup>

And, of course, this is completely consistent with the Spitzer Administration’s “15 by 15” plan – to decrease the demand for power by fifteen percent from forecasted levels by the year 2015 through increased energy efficiency.<sup>23</sup>

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<sup>21</sup> U.S. Department of Energy, Benefits of Demand Response and Recommendations, February 2006, at v.

<sup>22</sup> U.S. Department of Energy, Benefits of Demand Response and Recommendations, February 2006, at vi.

**V. Utility Long Term Contracting for Capacity Resources Would Add Additional Layers of Unnecessary Costs and Complexities to the Retail Marketplace**

At the inception of deregulation, a contentious issue was utility recovery of stranded costs for base rate plants that were built for the benefit of all ratepayers. Stranded generation costs that were reasonably incurred and prudently mitigated should arguably have been spread to all customers on that basis. However, utility long term contracting to support the addition of new capacity resources at the current stage of market development would interpose a new layer of unnecessary costs and complexities to the retail marketplace. For instance, current migrated customers would not benefit from new utility plants and should not be required to pay for them. Relatedly, charging remaining utility customers with these costs could, if not phased out with the merchant function, result in a stranded cost “death spiral” as customers continue to migrate with fewer and fewer customers remaining on utility default service. In short, the last customer migrating to an ESCO would technically under applicable legal principles be responsible for the entire cost of the recently built capacity or generating facility. This layer of regulatory cost and risk is completely avoidable through the reliance on market-based solutions for the State’s capacity needs.

**VI. If Utility Long Term Contracting is Permitted, The Commission Should Impose a Set of Guidelines to Limit the Harm to Retail Market Development**

If, contrary to NEM’s recommendations, the Commission decides that a long-term utility contracting mandate is the means it decides to use to encourage new capacity

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<sup>23</sup> Speech of Governor Eliot Spitzer, “15 by 15” A Clean Energy Strategy for New York, April 19, 2007.

investments, NEM submits that the Commission should consider the following suggested safeguards to the public interest:

1. There should be a rebuttable presumption that the market can and should be relied upon first to meet the need for new capacity resources;
2. If a utility elects to remain a sole source, non-competitive, default supplier during its bona-fide transition to a full exit from competitive functions, and the Commission finds sufficient evidence to support a finding that the market has not, or more importantly, cannot satisfy this otherwise competitive function, the utility(ies) should be required to use a competitive solicitation for commodity so as to provide both transparency to the process that avoid potential anti-competitive, market-share and/or market-power issues;
3. The competitive solicitation process should be conducted in strict, good faith compliance with affiliate rules and standards of conduct. Violations of affiliate rules cannot become another cost of a utility doing business, effectively a reward for barring entry to competitors;
4. All resources – generation, transmission and demand response – should be permitted to participate in the solicitation and receive market-based compensation without utility long-term contracting used to artificially distort prices, maintain or grow market share or otherwise undercut competition.
5. The full costs plus all financial, regulatory and migration risks associated with all long-term contracting as well as hedges should be borne by utility



- shareholders and reflected in the commodity price for full service customers (who should have the right to opt out without penalty);
6. Choice customers should not incur an exit fee/choice penalty or other charge for shopping for non-utility generation, regardless whether it is paid for via long-term contracts or otherwise. Utilities' shareholders must take the operational, financial and migration risks associated with competing in an otherwise competitive commodity market. Given the Commission's finding that there are six competitors in each utility service territory, these markets may already be "workably competitive." Commission caution is urged given the distortions to both prices and investment risks that can result from market interventions;
  7. The extent of utility participation in the competitive supply function should be phased out as consumers migrate into the competitive supply market so that long-term contracts at today's historically high prices do not become stranded costs of tomorrow or non-bypassable charges that merely increase total energy costs for everyone without an end time specified;
  8. NEM urges the Commission to avoid the unintended consequences, high economic costs and significant investment risks associated with regulatory market intervention, particularly in a well functioning market that has proven itself to be "workably competitive" and quite successful for more than a million New Yorkers; and

9. NEM urges the Commission to reiterate its commitment<sup>24</sup> that utilities will exit competitive functions during a well defined period with quantifiable or at least observable service/reliability and/or other landmarks that will allay fears, lack of adequate public education and importantly, the higher costs and risks that result from regulatory mandates as well as regulatory uncertainty.

## **VII. Conclusion**

For the foregoing reasons, NEM urges the Commission to permit competitive market forces, rather than regulatory intervention, to identify and meet the need for new capacity investments. Such investments can be encouraged without the costs and risks of new regulations or utility mandates merely by insuring regulatory stability that will result from a Commission reaffirmation of its vision that utilities will be required to exit competitive functions over a reasonable time certain.

Sincerely,

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Dated: June 4, 2007.

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<sup>24</sup> Retail Policy Statement at 18.