

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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.

Case 06-M-1017

COMMENTS OF THE
NEW YORK STATE CONSUMER PROTECTION BOARD

Dated: June 5, 2007
Albany, New York

MINDY BOCKSTEIN
CHAIRPERSON AND EXECUTIVE DIRECTOR
NYS CONSUMER PROTECTION BOARD
5 EMPIRE STATE PLAZA
SUITE 2101
ALBANY, NY 12223-1556
www.nysconsumer.gov

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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.

Case 06-M-1017

COMMENTS OF THE
NEW YORK STATE CONSUMER PROTECTION BOARD

In its April 19, 2007 Order in this proceeding,¹ the New York Public Service Commission (“PSC” or “Commission”) invited parties to submit their comments on the appropriateness of a “statewide integrated resource planning process to help guide the overall development of electricity infrastructure” and the use of long-term contracts help support the provision of new capacity.² The New York State Consumer Protection Board (“CPB”) commends the Commission for seeking input as it considers these important issues. The current electricity planning process does not properly consider environmental and other public policy objectives. In addition, needed additional electricity infrastructure has not been forthcoming. We urge the PSC to address these issues by adopting the recommendations identified herein.

¹ Case 06-M-1017, Order Requiring Development of Utility-Specific Guidelines For Electric Commodity Supply Portfolios And Instituting A Phase II To Address Longer-Term Issues, April 19, 2007 (“April 2007 Order”).

² Id., p. 29.

Commission action is required to protect consumers and ensure that electricity markets are operating in the public interest. The current model has led to extremely limited amounts of new generation from competitive providers, at least in part due to the absence of long-term contracts, and gives inadequate consideration of environmental and other public policy objectives. This has burdened customers, particularly downstate, with some of the highest electricity costs in the country with no end in sight, and resulted in lost opportunities to improve the environment. The Commission must act to reduce the vulnerability of New York's electricity consumers to shortages, high energy costs and volatile prices and to ensure that proper consideration is given to environmental impacts and other public policy objectives.

In Part I, the CPB further supports the need for such action. We explain that there has been little new investment in electricity infrastructure, despite high prices and policies designed to encourage new generation. In addition, we show that the existing electricity resource planning process does not properly consider issues such as environmental impacts and fuel diversity.

In Part II, we address the need for integrated planning to properly address the State's electricity resource needs and to achieve public policy goals. We explain why the PSC should adopt and coordinate a comprehensive statewide integrated planning process that considers public policy objectives, and respond to several specific questions posed in the Commission's April 2007 Order.

In Part III, the CPB explains why additional use of long-term contracts would be in the public interest. Contracts of longer than five years in duration

should be considered, as part of a supply portfolio, to minimize environmental impacts, obtain a diversity of supply, and correct market deficiencies. Finally, we also respond to several specific questions regarding long-term contracts contained in the April 2007 Order.

I. Commission Action is Required to Address Significant Concerns With the Wholesale Electricity Market.

The State no longer conducts integrated electricity resource planning as it did for decades to help guide the development of electricity infrastructure. In addition, the PSC currently discourages utilities from entering into long-term contracts for electricity supply,³ instead, relying on the competitive market to establish wholesale electricity prices, provide incentives for new supply and determine the fuel and technology used for generation.

One of the main justifications for restructuring the electricity industry was that it would transfer from consumers to power-plant developers risks, including construction costs and plant outages, which had been a considerable burden to customers of electric utilities, particularly in the 1990s. Although consumers no longer directly bear those risks, they now pay consistently high prices resulting from inadequate supply, while old, inefficient and relatively “dirty” plants continue to operate, to the detriment of the environment.

³ E.g., Case 00-M-0504, Proceeding on Motion of the Commission Regarding Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets and Fostering Development of Retail Competitive Opportunities, Statement of Policy on Further Steps Toward Competition in Retail Energy Markets, August 25, 2004, p. 34.

Electricity prices in New York State, and particularly in New York City and Long Island, continue to be among the highest in the country. Notwithstanding this fact, additions to electric supply by competitive suppliers in the State have been few, especially downstate, and there is little promise for new supply in the future. Nor is there much evidence of new electricity transmission capability. It appears that developers have been unwilling or unable to invest in needed infrastructure, despite consistently high market prices. The absence of new supply is particularly problematic given the New York Independent System Operator's ("NYISO") latest forecast that additional capacity is needed for system reliability purposes as soon as 2011.⁴ It is also of concern since policies implemented in early 2003 to provide suppliers a stable stream of revenues that would encourage new entry, through a "demand curve" for the capacity market, have not achieved expected results, despite costing consumers hundreds of millions of dollars.

Existing owners of generation seem to have little or no interest in constructing new more environmentally-friendly generation, since the market would reduce the price they receive for their existing electricity supply. Their inherent opposition to new sources of supply is exacerbated by demonstrated flaws in the wholesale electricity market in some areas of the State, particularly New York City. The current wholesale electricity market structure in that region permits generators to maintain market prices far above competitive levels. For example, the NYISO's Independent Market Advisor concluded that the "Installed

⁴ NYISO's Second Reliability Needs Assessment, April 2007.

Capacity Spot Market Auctions during the 2006 Summer Capability Period have been characterized by economic withholding of Capacity to exercise market power to the maximum extent allowed.”⁵ This has caused electricity prices to be artificially high throughout New York State, causing customers to pay more than \$100 million in inflated electricity prices in 2006 alone.⁶ These market design flaws continue in 2007, to the detriment of consumers.

As we discuss in Part II, the current planning process is market based and does not properly take into consideration the environmental and fuel diversity benefits of generation from renewable resources and efficiency improvements. This has led to an unwise dependence on electricity derived from natural gas.

Overall, changes are required to better serve consumers and the public interest. As explained further below, we urge the Commission to move forward by pursuing a comprehensive statewide process for planning the resources needed to provide electricity in the State while meeting public policy objectives. We also recommend that the PSC increase use of long-term contracts for electricity supply as part of a balanced portfolio. If implemented as intended, these measures will help secure additional sources of electricity supply, thereby reducing electricity prices, mitigating price volatility, reducing emissions of pollutants and CO₂ and increasing the diversity of supply, to the benefit of consumers and the State’s economy.

⁵ Federal Energy Regulatory Commission (“FERC”) Docket No. ER07-360-000, New York Independent System Operator, Inc., NYSIO Filing, December 22, 2006, Attachment II, Affidavit of David B. Patton, Ph.D., at 13-15.

⁶ FERC Docket No. ER07-360-000, Answer of Multiple Intervenors, The New York State Consumer Protection Board and Consumer Power Advocates In Opposition To The Motion By The Independent Power Producers of New York, Inc., May 15, 2007.

II. A Comprehensive and Dynamic Integrated Resource Planning Process Should Be Adopted.

The CPB recommends that the PSC adopt a form of integrated resource planning (“IRP”) that properly identifies and addresses the State’s long-term electricity resource needs and achieves public policy goals such as the “Clean Energy Strategy for New York” announced by Governor Spitzer on April 19, 2007. This process would ensure proper consideration of public policy issues such as the reasonableness of energy prices, the minimization of environmental impacts and the diversification of energy supply. The IRP effort should be directed by the Commission, with active participation from the utilities and other interested parties, and should be coordinated with the NYISO’s planning process. It should also be a dynamic process and updated frequently, to ensure that it produces accurate and timely results.

The comprehensive IRP we recommend would differ from the planning process used prior to restructuring of the electric utility industry and the creation of the NYISO. Before the introduction of competition, planning was conducted mainly by the State’s regulated utilities. Because utilities’ plans were considered in an open public process and were subject to approval by the PSC, there was an opportunity for public policy objectives to be incorporated. With the expiration of the New York State Energy Planning Law in 2002, however, individual utilities now conduct their own planning focused on their own service territories. Moreover, these planning activities are limited to distribution and transmission functions in their regions since the utilities have generally divested their generation assets. Statewide electric planning is conducted by the NYSIO

through its Comprehensive Reliability Planning Process (“CRPP”). That initiative, undertaken with the help of stakeholders, identifies additional resources required for system reliability, but does not prescribe how the requirements are to be satisfied. Instead, it relies on the market. Only in the event that a market response is not forthcoming, does the NYISO prescribe a solution, known as a “regulated backstop.” While this approach to planning has many advantages, it is not ideally suited to the promotion of public policy objectives.

The NYISO Planning Process – Overview and Limitations

The first step in the CRPP is a Reliability Needs Assessment (“RNA”) of the resource adequacy and transmission reliability of New York State’s bulk power system. Through this process, the NYISO identifies additional electric system resources needed to satisfy reliability criteria over a 5-year and 10-year horizon.⁷ Public policy goals or other factors are expressly excluded from the analysis.⁸ After approval of the RNA, the NYISO solicits solutions to the identified needs from the marketplace.

As part of the RNA, the NYISO identifies Transmission Owners (“TO”), referred to as “responsible TOs,” that are required to prepare regulated backstop solutions for the identified needs. These provide a last resort if there are no market solutions, and also serve to establish the timeframe within which market-based solutions must emerge.

⁷ The reliability criteria are established by the North American Electric Reliability Corporation, Northeast Power Coordinating Council and New York State Reliability Council.

⁸ Planning based on economic needs is limited to providing estimates of historic congestion and other information regarding the market place.

Finally, the NYISO evaluates all proposed solutions, including market-based, regulated backstop and alternative regulated solutions,⁹ and prepares the Comprehensive Reliability Plan (“CRP”). The first RNA and CRP were completed in 2006. The second RNA was released in April 2007 and the second CRP is due to be completed this summer.

Since the NYISO planning process is market based, it leads to solutions to identified system reliability needs that the marketplace finds suitable. Public policy considerations do not enter the picture. For instance, the State has had a long-standing energy policy objective of encouraging renewable energy resources. However, left to the market, as in the NYISO planning process described above, renewable resources will rarely be the solution, since they are generally more expensive than fossil fuels. Not surprisingly, most of the additional generation developed since restructuring has used natural gas as the primary fuel. For the State to successfully pursue public policy objectives, such as increased use of renewable resources, reduced environmental impacts, greater use of cleaner energy and enhanced fuel diversity, some form of IRP is necessary. This is particularly important in view of the Commission’s recent decision to commence a proceeding on an Energy Efficiency Portfolio Standard¹⁰ based on its finding that a 15% reduction in New York’s electricity usage by 2015

⁹ Developers and TOs that are not identified as responsible TOs can submit regulated solutions as an alternative to the regulated backstop solutions submitted by responsible TOs.

¹⁰ Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard, Order Instituting Proceeding, May 16, 2007.

is in the public interest. This objective cannot be achieved if left to the NYISO's planning process.

Relationship of the Proposed IRP to the NYISO's Planning Process

The CPB recommends that the new IRP be coordinated with the NYISO's planning process, thereby preserving the strengths of each. The NYISO's planning process identifies enhancements to the electric system necessary for reliability and considers solutions based primarily on economic efficiency and cost minimization criteria. A new IRP can build on the NYISO's needs assessment by identifying electric system needs for public policy purposes and can consider solutions that address all available resources and objectives including long- and short-term public policy goals, such as achieving environmental targets. The two processes are complementary, and should be fully coordinated.

The State's Renewable Portfolio Standard ("RPS") is a good example of how the two separate processes can work together. The State established the goal that at least 25 percent of the electric energy used in New York State would be derived from renewable resources by 2013.¹¹ It was apparent that this objective would not be realized if left to market forces since renewable energy is generally more expensive than fossil fuels. However, renewable resources provide ancillary benefits, such as, fuel diversity, energy security and reduced environmental impacts that are not quantified in the market. To ensure that the

¹¹ Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard.

renewable energy targets were achieved, the Commission augmented the NYISO's planning process by creating a mechanism to procure and fund renewable resources, with NYSEERDA as the administrator. A similar process could be used for resources required to address other public policy objectives identified in the IRP.

The Role of Utilities and Other Parties in the IRP

We recommend that regulated utilities continue their current role of focusing on planning distribution and transmission needs within their service territories. Similarly, utilities should continue to provide the regulated backstop in the event that a market-based solution to identified needs is not forthcoming.

We further recommend that the PSC be given the responsibility for directing the preparation of an annual statewide IRP, and for ensuring that targets established in the plan are achieved. The process should be designed to incorporate the results of the NYISO's CRPP, and should provide parties an opportunity to comment on the major objectives of the IRP, as well as the best way to achieve those objectives. Resources should be procured in a manner similar to that currently used for the RPS.

III. Electricity Utilities Should Be Required to Enter Into Long-Term Contracts, Carefully Designed and Evaluated to Protect Consumers.

Over the past several years, many generation plants and transmission projects have been proposed and, in some cases, licensed, but have not been

implemented, in part because developers cannot obtain satisfactory financing. Electric infrastructure construction projects are very capital intensive and require long lead times, exposing their investors to substantial market risk from changing input costs and output values. The inability of developers to lock in profitable spreads through long-term contracts for facility output or capacity is the most frequently cited reason for an anemic electricity infrastructure investment environment. To help address this problem, the PSC should facilitate the use by regulated utilities of contracts for electricity supply with terms of five years or more. Such contracts will provide the security necessary for developers to finance major new projects at reasonable cost.

Long-term contracts may also be needed to achieve certain public policy goals. The existing market-based approach to facility development has led to an almost complete reliance on gas fired generation. Reducing dependence on natural gas and encouraging fuel diversity will require investments having a longer cost recovery period and this, in turn, will necessitate long-term contracts for the new facilities.

Historical Context

Before restructuring, utilities were responsible for all major construction of generation. They had an obligation to build, and in return were assured recovery of their investments, absent imprudence. That assurance, financed by ratepayers, resulted in very large cost overruns from power plants and contracts with Independent Power Producers (“IPPs”) at disadvantageous prices, is

continuing to impose a burden on consumers today. Restructuring shifted the risk of constructing and operating electricity infrastructure to developers, however, as explained above, it appears that without long-term contracting supported by ratepayers, little new investment will be forthcoming.

The lack of investment in electricity infrastructure has been apparent for some time. Only a few years after restructuring, the NYISO recognized that the absence of stable revenues was a primary reason for inadequate investment and, it approved the “demand curve” to provide a stable source of revenues to generators, with the expectation that more investment would follow. That measure has not led to significant new electric generation.

In another effort to provide greater certainty to developers, the NYISO is now considering forward capacity markets in which investors could guarantee a certain revenue stream for a three-to-five year period. The NYISO’s counterparts in the mid-Atlantic and New England states have recently adopted such markets. However, due to the limited experience with forward markets, it is not yet clear whether they will facilitate new entry of generators. In addition, the three-to-five year period of forward markets is likely insufficient to significantly reduce the risk of revenue uncertainty.

Applicability of Long-Term Contracts¹²

The new policies we recommend regarding long-term contracts should apply to utilities as well as the New York Power Authority (“NYPA”) and the Long

¹² April 2007 Order, Question 3.

Island Power Authority (“LIPA”).¹³ As discussed above, such contracts may be essential to secure much needed new electric generation since investors are finding it difficult to finance these projects. The need for new generation is especially acute in New York City and Long Island. LIPA is the only entity on Long Island that will be able to provide the assurance of stable revenues to developers of electricity. Similarly, NYPA has a large customer base and is also able to provide the assurance of revenue stability to facilitate construction of new generation.

Other Load Serving Entities (“LSE”) such as ESCOs, should not be required to enter into long-term contracts. These LSEs are not regulated and should make their own business decisions regarding their commodity purchasing practices. If they enter long-term contracts, it should be a business decision and not a requirement. In addition, these LSEs may not be able to provide the assurance of revenue stability to new generators that utilities and the State’s power authorities can, since they generally lack large, stable customer bases.

Barriers to Development of New Electricity Resources¹⁴

The April 23, 2007 Order sought input on the barriers to development of new electricity resources. The absence of a “one-stop shopping” power plant siting law is an obvious example of a critical barrier to the development of new generation resources. The expiration of Article X and the lack of a replacement

¹³ We note that LIPA and NYPA are not regulated by the PSC.

¹⁴ Id., Question 5.

has increased the costs and the regulatory uncertainty of developing new electric generation.

Restrictions on Long-Term Contracts¹⁵

The NYISO planning process and the IRP would be open to participation by all types of generation and other resources. However, some types of generation should not be encouraged for public policy reasons. Accordingly, long-term contracts should not be used for resources that are not consistent with the State's public policy goals.

Cost recovery¹⁶

Conceptually, the cost of long-term contracts for supply purchased by utilities should be recovered from customers who benefit from the contracts. Contracts for public policy purposes that minimize environmental impacts or secure additional infrastructure, should be recovered through utility delivery rates, since they will provide broad benefits to all customers.

Long-term contracts may help in achieving the crucial objective of facilitating investment in new electric generation. However, past experience has shown that there can be significant drawbacks if these contracts are not properly structured, due to inherent difficulties in forecasting long-term energy and/or capacity prices. The State has a poor record in this regard, and is still paying for

¹⁵ Id., Questions 6 - 7.

¹⁶ Id., Questions 8 – 9.

the stranded costs of some uneconomic IPP contracts that originated in the 1980s and 1990s. Accordingly, long-term contracts must be carefully designed and evaluated to help ensure that consumers are not burdened with long-term obligations at high cost.

Consistency of Long-Term Contracts With NYISO Rules¹⁷

It is critical that that long-term contracts are harmonized with existing NYISO rules for energy and capacity markets. However, it is difficult to fully anticipate at this stage, what changes to NYISO rules, if any, would be necessary. Proposed rule changes should be considered in the NYISO's stakeholder process.

¹⁷ Id., Question 10.

CONCLUSION

The Consumer Protection Board recommends that the Public Service Commission adopt the recommendations contained herein.

Respectfully submitted,

/s/

Mindy Bockstein, Chairperson and Executive Director
Douglas W. Elfner, Director of Utility Intervention
Tariq N. Niazi, Chief Economist

Submitted: Albany, New York
June 5, 2007