

# THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

## Committee on Energy

### ELECTRIC REGULATION IN THE STATE OF NEW YORK

#### 1. Introduction

The role of electricity in contemporary society is increasingly important and supplying it reliably and economically is crucial to the economy. While the business of generating and delivering electricity has long been comprehensively regulated, in 1996 the New York Public Service Commission (“Commission”) embarked on a restructuring of New York’s electricity industry.<sup>1</sup> The Commission’s overall objective was to “identify regulatory and ratemaking practices that will assist in the transition to a more competitive electric industry designed to increase efficiency in the provision of electricity while maintaining safety, environmental, affordability, and service quality goals.”<sup>2</sup>

Since 1996, the Commission has overseen the divestiture by the State’s electric utilities of their generating facilities; the establishment of an independent system operator, which operates both the State’s competitive wholesale markets and its bulk power transmission system; and the creation of competitive retail markets, which permit end use customers to purchase electricity from energy service companies (“ESCOs”) which compete with incumbent utilities. The election of a new Governor, following a twelve-year administration by a Governor who supported the Commission’s restructuring initiative, provides an

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<sup>1</sup> Competitive Opportunities Regarding Electric Service, No. 94-E-0952, slip op. (N.Y. Pub. Serv. Comm’n Mar. 6, 1996). New York adopted an administrative approach to restructuring, as opposed to the legislative approach adopted by other states, such as New Jersey and Pennsylvania. The Commission’s initiative parallels actions by the Federal Energy Regulatory Commission (“FERC”) to open the nation’s transmission system to non-discriminatory usage. Specifically, on April 24, 1996, FERC issued Order No. 888 with the intent of remedying undue discrimination in the provision of interstate transmission services by public utilities and introducing more competitive electricity markets. Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 FR 21,540 (May 10, 1996), FERC Stats. & Regs. Para. 31,036, clarified, 76 FERC Para.61,009 and 76 FERC Para. 61,347 (1996).

<sup>2</sup> *Id.* at 4.

appropriate opportunity to examine the regulation of New York's electric utility industry.

Consideration of the state of electric regulation in New York is also timely because important developments in the supply of electricity have occurred over the past two decades and seem likely to occur over the next decade. The cost of energy fuels has risen, making the goal of supplying electricity efficiently even more important. Such cost increases seem likely to continue, particularly if the worldwide demand for energy continues to increase. International geopolitical concerns have led to a national call for increased energy independence. The "environmental footprint" of energy production and use is also very significant. There is a growing consensus that greenhouse gas emissions are affecting the global climate and have the potential to cause massive dislocations in worldwide societies and economies, and steps necessary to reduce global warming will further increase the cost of energy fuels. Finally, New York's energy prices are well above the national average and industrial energy prices average over 8.0 cents per kilowatt-hour, compared with 2.5 cents to 5.5 cents per kilowatt-hour in states which compete with New York for businesses.<sup>3</sup> (See discussion of current electric power industry conditions in Section 2 of this Report.)

This Report addresses two issues pertinent to the regulation of the electric industry in New York. First, what changes should be made to encourage long-term investments in new generating capacity? Several studies of the State's future need for generating capacity indicate that new power plants will have to be added to the electrical grid.<sup>4</sup> This need arises primarily from continued growth in the demand for electric power and the expected retirement of existing power plants. In addition to this need for new capacity to meet reliability needs, new generating plants have another benefit: they are more efficient than the older, existing plants with less adverse impact on the environment. Moreover, the limited addition of new plants to the State's electric capacity resources in recent years is affecting the overall supply of electricity and thus appears to be creating the potential for upward pressure on price levels in the wholesale competitive markets, particularly in zones or sub-regions of the State where demand has historically exceeded generation. (See discussion of the need for

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<sup>3</sup> Report to Governor George E. Pataki and the Legislature from the Temporary Commission on the Future of New York State Power Programs for Economic Development (Dec. 1, 2006), [http://www.empire.state.ny.us/Power\\_Commission.asp](http://www.empire.state.ny.us/Power_Commission.asp). Energy costs in New York have generally exceeded those in other states, reflecting the higher cost of doing business in New York.

<sup>4</sup> Of course, the growth of demand response and energy efficiency programs will limit the amount of new generating capacity that would otherwise be needed.

new generating capacity below in Section 3, including particular focus on three options.)

Second, should a State-administered energy planning function be re-established? Legislative authority for State-administered energy planning has been allowed to expire and the State Energy Office, which was charged with conducting energy planning, was eliminated. In general, the Commission and the New York Independent System Operator (“NYISO”) now look to the competitive market to guide when, where and what type of energy investments are made. The NYISO, for example, conducts comprehensive system planning, but only for the purpose of meeting reliability needs. Is this planning approach sufficient and appropriate? Is the State’s current approach to planning for new bulk transmission facilities, which is conducted by the NYISO and participants in the wholesale markets, leading to under-investment in transmission facilities?<sup>5</sup> (See discussion below in Section 4.)

With respect to the first of these issues, the need for new generating capacity, a number of independent power plant developers have secured siting permits for construction of new power plants, but some of these developers have opted not to proceed with construction and operation of the plants. A common explanation of the absence of construction of new power plants is the reluctance of plant sponsors and lenders to finance the new plants in the restructured wholesale market on a “merchant basis,” that is, without the economic support of long-term power supply agreements (“PSA”). This explanation is supported by the fact that virtually all additional generation facilities constructed recently have been backed by long-term PSAs, the use of public financing, or both.<sup>6</sup>

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<sup>5</sup> The competitive wholesale markets operated by the NYISO are regulated by the Federal government (i.e., the FERC), and thus fall beyond the direct regulatory authority of the State. It appears that the wholesale competitive market has, at a minimum, led to the wholesale cost of electric power being lower than it would have otherwise been. (See Note 15, below.) For these reasons, the Committee does not examine the regulation or restructuring of the wholesale electricity markets in this Report. The Committee does suggest a role for the State regarding energy planning, which would encompass significant interaction with the NYISO in coordinating energy planning.

<sup>6</sup> For example, the only truly merchant plant built in New York City since 1999 has been KeySpan-Ravenswood’s 250 megawatt (“MW”) project. Orion Power also invested approximately \$25 million in restarting a retired unit at the Astoria Generating Station. Otherwise, all major new plants have been either built by the New York Power Authority (“NYPA”) or under long-term contract to the Consolidated Edison Company of New York, Inc. (“Con Edison”) or the Long Island Power Authority. Outside New York City, however, plants have been constructed on a merchant basis.

At present, there is no organized long-term forward capacity market in New York. Moreover, traditional utilities have been discouraged by Commission policies from entering into long-term PSAs. A number of industry experts agree that some action must be taken to assure the development of additional generating capacity in the near term. Accordingly, the Committee is considering three options to foster the development of additional capacity: (1) Should the NYISO institute market structure changes designed to elicit new merchant generation development, including the creation of an effective, long-term forward capacity market? (2) Should the Commission encourage load serving entities (“LSEs”), which include utilities and ESCOs, to enter into long-term PSAs with project sponsors, thereby providing them with the needed financial assurance to allow construction of new power plants? (3) Should a new entity be created – or an existing entity restructured and authorized, e.g., NYPA – to fill the role of a creditworthy buyer under long-term PSAs?

These are difficult questions that must be answered, and each option draws objections from certain market participants. The Committee suggests in this Report: (1) that the State encourage the development of new generating capacity either by (a) working collaboratively with the NYISO to institute certain market structure changes to encourage merchant power plant development, including developing an appropriate long-term forward wholesale capacity market, or (b) determining whether the current structure of the market should be amended to facilitate entry into long-term PSAs by utilities or a special purpose entity sufficient to allow the construction of new generation and transmission projects, or by pursuing both of these strategies; and (2) that the State re-establish State-administered energy planning, which complements the planning now undertaken by the NYISO, the Commission, utilities and other market participants.

## **2. Current Framework for Electricity Regulation**

The restructuring of the utility industry created distinct wholesale and retail electric markets in place of the previous integration of those functions. The wholesale market – that is, transactions which do not include end use customers – encompasses generating facilities, both those divested by incumbent electric utilities and other plants owned by independent power producers; and bulk power transmission facilities, which continue to be owned by the electric utilities. The wholesale supply of electricity involves specific auction markets for electric

energy,<sup>7</sup> electric capacity<sup>8</sup> and the ancillary services required to operate the system safely.<sup>9</sup> The provision of transmission service is a part of the wholesale markets. The functions of the wholesale markets are regulated by the FERC, under the Federal Power Act. In New York, most wholesale market functions are administered by the NYISO, which is subject to FERC supervision.

Since 1996, the Commission has issued a number of opinions and secured a number of agreements and settlements with regulated utilities that have resulted in utilities' divestiture of their generating facilities, creation of holding companies and specific-purpose subsidiaries, and creation of competitive retail markets for electricity. The NYISO commenced operations in late 1999 after extensive discussions among entities involved in the electric power business, which were facilitated by the Commission. Among its other functions, the NYISO operates day-ahead and balancing markets for energy, ancillary services and capacity.

The NYISO also operates the New York bulk power transmission system and provides transmission service to bulk supply customers. While in concept the price of energy should be the same throughout the State at a given time, in fact transmission constraints impose limits on how much energy can be transmitted to certain regions. When the available capacity of particular transmission facilities is exhausted and the transfer of lower cost electric power to regions such as southeastern New York is limited, there is a "congestion cost" included in the affected energy transactions.<sup>10</sup> In general, electricity costs in New York City and on Long Island are considerably higher than in other parts of the State because of the higher cost of generation in these regions and transmission constraints which limit transfers of lower cost electricity from other regions.

The NYISO operates three forward auctions of installed capacity ("ICAP"): a strip auction, which includes each of the months in the upcoming

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<sup>7</sup> "Energy" describes the units of electric energy actually used by customers, and is expressed as kilowatt hours.

<sup>8</sup> "Capacity" refers to customers' demand for electricity power and generators' capability to supply electric power, and is expressed as kilowatts.

<sup>9</sup> "Ancillary services" include operating reserves, system regulation, scheduling, system control and dispatch, voltage control and black start capability (the ability to start a generator following a system shutdown).

<sup>10</sup> The congestion cost is not a penalty or fee, but results because the electricity purchaser must use higher cost generation on the "high cost side" of the transmission constraint to meet its full demand.

six-month capability period, a monthly auction and a spot monthly auction. In addition, LSEs<sup>11</sup> are permitted to satisfy their capacity requirements through bilateral arrangements. Starting in 2003, the NYISO introduced (and the FERC approved) a new way of valuing capacity, known as the demand curve. The demand curve is used to set prices for capacity in three capacity markets: New York City, Long Island and the remainder of the State. The demand curve for New York City is set so that if the amount of capacity available in the New York City equals 80 percent of the projected peak load, such capacity is valued at the cost of a peaking power plant.<sup>12</sup> In addition to the NYISO's requirements, the Commission has indicated that utilities should maintain a portfolio of capacity supply agreements of different periods, known as a "balanced contract portfolio," for the benefit of customers that are not likely to migrate to competitive suppliers, i.e., residential customers.<sup>13</sup>

Retail markets include electric service delivered to end use customers, including sale and delivery of energy and capacity. All customers obtain delivery service for their electricity from the incumbent utility – whether the customer buys electricity from an ESCO or from the utility itself. The utility includes certain non-bypassable charges in its delivery service rates. In some cases, these charges constitute contributions to important social goals, such as research and development or creating a fund that provides subsidies to low income customers. In other cases, however, the non-bypassable charge may reflect the imposition of a charge to amortize utility investments made in the past which the Commission has permitted to be passed on to customers.<sup>14</sup>

While measurement of the impact of competitive wholesale markets is difficult because of the number of independent variables, such as fuel costs, a number of studies indicate that the introduction of competitive wholesale markets has led to reduced costs to customers. A recent study of the impact of

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<sup>11</sup> LSEs include both regulated utilities and ESCOs.

<sup>12</sup> The arrangements for Long Island and the rest of the State are comparable, but the pricing is different. Capacity prices in the statewide market are lower because surplus capacity exists (i.e., capacity that exceeds demand). There is no locational component to the statewide market, meaning capacity obligations can be satisfied from resources anywhere on the system.

<sup>13</sup> Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets and Fostering Development of Retail Competitive Opportunities, 235 P.U.R.4th 225 (N.Y. Pub. Serv. Comm'n Aug. 25, 2004), at 53.

<sup>14</sup> Two examples of such charges for "stranded costs" result from above-market legacy costs of contracts with small power producers and utilities' investments in particular power generating facilities, such as nuclear plants.

the introduction of competitive wholesale markets by the NYISO and PJM Interconnection, L.L.C. (“PJM”) indicates that customers in the NYISO and PJM regions are experiencing substantial savings, compared to the costs that otherwise would have been incurred.<sup>15</sup> This conclusion is similar to the results found by the Staff of the New York Department of Public Service in a recent report.<sup>16</sup> Between 1996 and 2004, the real price of electricity to a typical residential customer, which did not switch to a competitive supplier, dropped an average of 15.9 percent.

The State’s utilities have been permitted – even encouraged – to engage in hedging in their purchase of the electricity needed to supply residential customers. Instead of buying all of the needed power supply for residential customers in the NYISO’s short-term markets (e.g., day ahead and balancing), utilities may build portfolios of energy supplies through contracting directly with energy suppliers for longer term supplies.<sup>17</sup> Such contracts permit the utility to protect itself – and its residential customers – from sudden short-term price swings in the energy and capacity markets. Price changes resulting from changes in fuel costs and other market-affecting causes are moderated over a longer period. By contrast, utilities are generally not permitted by the Commission to engage in such smoothing or hedging transactions for the electricity which they sell to larger customers. As a result, electricity prices for larger customers are likely to be more volatile than are prices for residential customers. These customers, however, can obtain energy hedges which have the effect of tempering such changes.

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<sup>15</sup> Scott M. Harvey, Bruce M. McConihe & Susan L. Pope, *Analysis of the Impact of Coordinated Electricity Markets on Consumer Electricity Charges* (Nov. 20, 2006), available at [http://www.ksg.harvard.edu/hepg/Papers/LECG\\_Analysis\\_112006pdf.pdf](http://www.ksg.harvard.edu/hepg/Papers/LECG_Analysis_112006pdf.pdf). For the PJM and NYISO regions’ average load of around 100,000 MW per hour, the study estimates a rate reduction of \$0.50/MWh. This projects to \$1.2 million per day and \$430 million in total savings over a year. Based on 2004 numbers, the study indicates yearly savings in New York alone of approximately \$190 million. Other studies’ models, identified in this study, show estimated rate reductions of \$1.5/MWh.

<sup>16</sup> N.Y.S. Dept. of Pub. Serv., *Staff Report on the State of Competitive Energy Markets: Progress to Date and Future Opportunities* (Mar. 2, 2006), available at <http://www.dps.state.ny.us/StaffReportCompetition.pdf> (“Staff Report”). The Department of Public Service (“DPS”) is the administrative and operating arm of the Commission.

<sup>17</sup> The Commission has commenced a proceeding to examine how utilities should secure capacity to serve such customers. See *Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers*, No. 06-M-1017, slip op. (N.Y. Pub. Serv. Comm’n Aug. 28, 2006).

### 3. Additional Generating Capacity Is Needed to Meet New York's Needs

#### A. New York's Future Generating Capacity Needs

Experts agree that additional generation capacity is required, particularly in southeastern New York. Thus, the NYISO and others have argued that New York's former power plant siting law, Article X of the Public Service Law,<sup>18</sup> should be re-enacted to facilitate permitting of new generating projects that will be needed in the near future. The NYISO considers that New York could be facing a supply deficiency relatively soon, and that there may well be a reliability need for additional capacity in New York City before the rest of the State. In particular, the NYISO's initial Reliability Needs Assessment ("RNA") in December 2005 indicated that the State's transmission and generation resources should be adequate through 2007. This initial estimate of need was revised in the first Comprehensive Reliability Plan issued in August 2006, in which the NYISO projected a reliability need by 2011,<sup>19</sup> while Con Edison, in its own December 2005 assessment, suggested 2012 as a system reliability need date.<sup>20</sup> Given the lengthy lead time associated with developing new capacity, such projected need dates are closer than they may appear. Moreover, the RNA identified potential reliability issues in southeastern New York, starting in 2008, due to increased power demand and the scheduled retirement of several generating units. Those shortfalls could reach 2,250 MW by 2015 if no action is taken.<sup>21</sup>

Similarly, in January 2004, New York City's Energy Policy Task Force released a report entitled "New York City Energy Policy: An Electricity Resource Roadmap."<sup>22</sup> That report indicated that New York City required approximately 665 MW of new capacity was required through 2008 to meet reliability standards.<sup>23</sup> While that projected shortfall was based in part on expected plant retirements, which do not now seem likely to occur, more recent submissions by

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<sup>18</sup> N.Y. PUB. SERV. L. §§ 160-72 (Consol. 1992) (*repealed* Jan. 1, 2003).

<sup>19</sup> NYISO, *The Comprehensive Reliability Plan for 2005: A Long-term Reliability Assessment of New York's Power System* 19 (Aug. 22, 2006), [http://www.nyiso.com/public/webdocs/services/planning/reliability\\_assessments/2004\\_planning\\_trans\\_report/crp\\_final08222006.pdf](http://www.nyiso.com/public/webdocs/services/planning/reliability_assessments/2004_planning_trans_report/crp_final08222006.pdf) ("CRP").

<sup>20</sup> Con Edison's System Reliability Assessment Study (issued Dec 30, 2005).

<sup>21</sup> CRP, Note 15.

<sup>22</sup> N.Y.C. Energy Policy Task Force, *New York City Energy Policy: An Electricity Resource Roadmap* (Jan. 2004), [http://www.nyc.gov/html/om/pdf/energy\\_task\\_force.pdf](http://www.nyc.gov/html/om/pdf/energy_task_force.pdf).

<sup>23</sup> *Id.* at 10.



New York City call for new generating capacity that will be needed in the foreseeable future.<sup>24</sup>

New York has adopted an installed capacity requirement for the State, and for specific regions within the State. Although this requirement has served to meet the defined reliability requirements, it has not led to construction of a significant amount of new merchant generation capacity. In 2003, the NYISO amended the operation of the installed capacity requirement to make the pricing more transparent to market participants. The key innovation, the demand curve, allows market participants to understand gradual changes in the value of capacity. To the extent that the demand curve was expected to spur construction of new power supply, however, it has not been successful.

Arranging for sufficient generation capacity is important both to maintain reliability and to ensure that the wholesale markets are workably competitive. Thus, additional generating capacity is needed not only to meet engineering-based reliability requirements, but also to meet the State's goal of maintaining competitive wholesale and retail markets. The City's Task Force indicated that an additional 1,000 MW of capacity would be required to meet the requirements of a workably competitive market, to avoid excessive volatility in the price of electricity in the newly deregulated power generation market and to assure market stability. Similarly, the NYISO has indicated that generating capacity, above what is required to meet reliability standards, is needed to create robust wholesale markets.<sup>25</sup>

Turning now to how capacity requirements are met, the restructuring of the electric industry has dramatically changed how LSEs obtain their power supply.<sup>26</sup> Prior to restructuring, a significant portion of such supply came from utilities' own generating resources, plus supplies committed to the utilities under

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<sup>24</sup> Policies, Practices and Procedures For Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers, Case 06-M-1017, Comments by New York City (Nov. 17, 2006), 15.

<sup>25</sup> See, e.g., NYISO, *Power Alert: New York's Energy Crossroads* 6, 9 & 14 (Mar. 2001), [http://www.nyiso.com/public/archive/webdocs/newsroom/power\\_alert\\_wp.pdf](http://www.nyiso.com/public/archive/webdocs/newsroom/power_alert_wp.pdf). This level is compared to the statewide reliability-based reserve standard of 118 percent of projected peak load. The reserve margin is used to determine capacity prices and locational capacity requirements (i.e., the percentage of capacity that must be located in New York City and on Long Island).

<sup>26</sup> See Staff Report, *supra* note 16 (identifying a pending proceeding before the Commission). The Committee does not intend to comment generally on the issues raised in Case 06-M-1017, *supra* note 17.

long-term bilateral contracts. The divestiture of utility-owned generation, however, ended utilities' ability to supply customers from their own sources. There are three other sources of generation capacity. First, LSEs may have legacy long-term bilateral power supply agreements with independent power producers which predate the current regulatory policies.<sup>27</sup> Second, LSEs may maintain capacity supply portfolios of medium-term and short-term power supply agreements. Third, LSEs make purchases in the NYISO-administered capacity markets of commitments not longer than six months.

One result of restructuring, therefore, has been to reduce the average length of power supply arrangements. No longer are most LSEs able to rely upon the output of a power plant it owns, which can be projected to operate for more than 30 years. Typical power supply agreements are not now as long as the contracts which were used to finance the wave of new construction that flourished as a result of the Public Utility Regulatory Policies Act of 1978.<sup>28</sup> The benefit to customers of this change of policy is that long-term commitments that turn out to be above market price are less likely to be made, and customers are spared the risk and responsibility of such commitments.

The Committee believes that the shortened term of power supply arrangements, however, has also adversely affected financing of new capacity projects. There are now a number of proposed power generating projects which have received siting approval to be built, but have not obtained the necessary funding.<sup>29</sup> Although generation projects have been approved in the siting process, the risks of financing a plant without the assured cash flow represented by long-term contracts have inhibited new projects from moving forward. Moreover, the expense of building new supply capacity in the high cost regions of the State, the potential for changes in the market rules and market conditions and environmental constraints associated with the downstate congestion pose additional difficulties for project sponsors seeking to finance new supply capacity projects.

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<sup>27</sup> See Staff Report, *supra* note 16. While the phrase "long-term" to describe power supply agreements is used variously in different contexts, the Committee uses the phrase to describe agreements with a term of ten or more years.

<sup>28</sup> Public Utility Regulatory Policies Act of 1978, 16 U.S.C. §§ 2601 *et seq.* (1978).

<sup>29</sup> See N.Y. Pub. Serv. Comm'n, N.Y.S. Bd. of Elec. Generation Siting & the Environment, Article X projects & applications website, <http://www.dps.state.ny.us/articlex.htm>. This situation reflects both the financial issues involved in a new plant, and the problems of licensing new power projects.

The Staff Report recognizes that energy markets have unique characteristics and that unlike typical competitive models it is not clear that in the energy arena “energy-only markets, without regulatory interference, will provide sufficient signals to ensure adequate system capacity, including needed reserves, to ensure reliability on a going-forward basis.”<sup>30</sup> In energy markets the question is complicated by “the long lead-times needed to develop, site and construct facilities, regulatory and political uncertainties inherent in the development process, and financial uncertainties due in part to the still-relatively-new energy markets as well as the capital intensive character of energy facilities.”<sup>31</sup> The Staff Report recognizes that “[g]iven the present relatively low levels of price-responsive load, an energy-only competitive wholesale market design relying solely on energy prices to finance new generation may lead to unacceptably high levels of involuntary curtailments, particularly within major load pockets such as New York City and Long Island.”<sup>32</sup>

As noted above, the NYISO has imposed capacity requirements and instituted use of a demand curve to mitigate against this risk, but the Staff Report recognizes that there has not yet been a definitive test of the effectiveness of these mitigation measures and that “[t]he true test will come when the need for new generation is on the near-term horizon and investors decide whether to enter the market in time to satisfy that need.”<sup>33</sup> It appears to the Committee that the true test has come in New York City and the energy and short-term capacity model currently in effect in New York State is simply not working to lead to development of the additional generation and transmission needed. The energy sector is of such significance to every aspect of the economy and to life itself that the State does not have the luxury of leisurely waiting for the market to correct itself.<sup>34</sup>

## B. Three Options for Adding New Long-Term Generating Capacity

Accordingly, the Committee believes that steps should be taken to facilitate the addition of new generating capacity. There are at least three options for the State which could lead to construction of increased generating capacity: (1) the NYISO’s development of market structure changes to encourage new

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<sup>30</sup> See Staff Report, *supra* note 16, at 23.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> Of course, investment in transmission capacity that permits increased transfer of power from upstate to downstate may be as significant an energy issue. See Section 4(C), below.

merchant development, including an adequate forward capacity market; (2) the Commission's encouragement of utilities to enter into long-term PSAs (i.e., ten years or more duration) in areas of the State where capacity has consistently fallen short of demand; and (3) the creation of a special purpose entity for the purpose of financing construction of new generating capacity. Each of these options is described in the balance of this Section and key advantages and disadvantages of each option are noted.

(1) The NYISO Could Develop an Adequate Forward Capacity Market

(a) Description

As noted above, the NYISO-administered existing capacity market is limited to six months. This absence of market or regulatory mechanisms to encourage construction of new power supply is highlighted by comparison to the market frameworks of the two adjacent regional transmission organizations, ISO New England and PJM. In November 2006, ISO New England adopted a new capacity auction market. In essence, ISO New England conducts an auction for existing and new generating capacity about three years prior to the delivery year. Demand response, conservation and intermittent resources are permitted to bid as well as traditional generating facilities. The auction is designed so that only capacity needed to meet the projected installed capacity requirement is purchased. The capacity market is intended to attract new resources to constrained regions. A new capacity resource can choose a commitment period up to five years.

The PJM system operator similarly conducts an auction for capacity three years ahead of the delivery year. Incremental auctions are held prior to the delivery year and a bilateral market exists as well for capacity. The basic auction is established so that load serving entities can procure the resource commitments needed to satisfy the region's unforced capacity obligation. The incremental auctions provide an opportunity to respond to changes in the region's capacity requirements, while the bilateral market allows for hedging and for covering any auction commitment shortages.

While the details of a new forward capacity market in New York will necessarily be addressed by market participants in NYISO discussions, it appears to the Committee that creation of such a market comparable to the capacity markets in the adjacent control areas, New England and PJM, would be

beneficial. Such a market should address what at least some observers see as key shortcomings in the current wholesale market in New York.

Developers are resistant to investing in larger new facilities, without long-term supply agreements, for fear of reducing the very capacity payments that they view as essential to finance their facilities. Furthermore, developers without long-term PSAs may fear contracts will be awarded to other developers (or assets may be self-built by large LSEs and thus produce the same unattractive result), and may not be reflected in the ICAP market, thus producing lower market prices while at the same time benefiting a competitor.

A means to address this issue is to require contracts to be reflected in the market. One such method is to require that the contract counterparty be obligated to enter the contracted-for volume at some discount to contract value. A “floor,” such as 70 percent of contract value, would be enforced unless the counterparty could demonstrate why this was inequitable. Thus, the counterparty would receive the benefit of the contracted-for volume at its contracted-for price but not distort the overall market results to the detriment of all market suppliers.

Under existing NYISO market rules for ICAP, bilateral ICAP contracts are essentially entered into the relevant ICAP auction at zero dollars. While a long-term contract for capacity from a new power plant is not worth zero dollars, that is the value imputed to it by its treatment in the ICAP market auction. Under the NYISO’s demand curve, this has the effect of reducing the clearing price for ICAP, because the resulting clearing price does not reflect the value of all the capacity contracts. On the other hand, certain parties argue that this does not injure suppliers because under the NYISO market structure the highest accepted bid needed to clear the market sets the price for all suppliers, regardless of how much lower many other bidders’ costs may be. Moreover, as has been noted recently by the NYISO’s Independent Market Advisor, Dr. David B. Patton, in the case of the capacity market, the short-term costs of supplying capacity, once a resource has been constructed and placed in service, approach zero.<sup>35</sup> This is because the so-called capacity market is essentially intended to address system reliability concerns, rather than function as a genuine market, as that term is generally understood. It identifies system resources that are prepared to generate power or reduce load when called upon by the NYISO dispatch schedule.

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<sup>35</sup> NYISO, *Affidavit of David B. Patton*, No. ER07-360-000 (FERC Dec. 22, 2006).

(b) Advantages and Disadvantages of the Option

Advantages

- The creation of a new forward capacity market in New York could be implemented by the NYISO, subject to approval by the FERC.
- The forward capacity market in New York would address an aspect of the New York wholesale market in which there is a sharp difference between the markets in New York and those in the adjacent control areas.
- The forward capacity market would be consistent with the encouragement of long-term PSAs.
- Creating a forward market that is consistent with the NYISO's planning horizon for its reliability plan would facilitate the ability of market-based resource additions to prevent reliability issues from arising.

Disadvantages

- Changing the market rules will necessarily benefit certain participants and injure others. Also, changing the market rules unsettles the expectations of all market participants.
- The expected costs of establishing a forward capacity market are as yet unknown, but are likely to be significant, and will be additive to the costs already imposed on ratepayers.
- Since the forward capacity markets in the areas adjacent to New York State have only been recently approved by FERC, there is limited experience regarding how they actually work and whether the net benefits will exceed the expected costs associated with those forward markets.
- While financing for capacity typically requires long-term contracts, (ten years or more) in order to be viable, existing forward capacity markets are of far shorter duration. It is unclear whether there will be any beneficial incremental effect from the initiation of such a short-term market.

(2) The Commission Could Encourage Utilities to Enter Into Long-Term Power Supply Agreements

(a) Description

Another way LSEs can meet their capacity requirements is through entry into long-term PSAs. Such agreements also provide long-term financing assurance for project sponsors, allowing construction of new capacity projects.

Utilities have traditionally been reluctant to enter into such agreements without clear regulatory approval that they will be able to recover these costs in rates. However, such approvals, often referred to as advance prudence approvals, are inconsistent with the Commission's regulatory practice precluding such approvals. In the face of this regulatory practice, an advance prudence review mechanism would have to be developed to provide adequate assurance to the LSEs.

An alternative to explicit, advance regulatory approval of a long-term PSA would be for the Commission to establish a regulatory "roadmap," which if followed by a regulated utility would provide a sufficient level of confidence that the Commission would approve the inclusion of the costs of the PSA in the utility's rates. In essence, the roadmap would involve due diligence measures to be taken by the regulated utility to establish the reasonableness of the costs under the proposed long-term agreement. One essential part of such a roadmap would be regulatory assurance that the Commission would view the facts as they appeared at the time the PSA was negotiated, not later when one or more market circumstances may have changed. Consideration can be given to whether the long-term PSA would have to be sized to cover the entire cost of a proposed project or be for only so much of a plant's output as is needed to retire the debt on the project and so assure the availability of financing. It may be reasonable to expect that independent power producers and their financiers, who are in business to take risks and gain appropriate rewards, would share in the financial risk. Finally, such a roadmap should incorporate a diligent review process including an analysis of whether utilities seeking to enter into PSAs have adequately considered alternatives such as demand side resources.<sup>36</sup>

In addition, any exploration of utilization of long-term PSAs should include an analysis of their impact on competitive retail market structures already in place in New York. As of December 2006, 76.4% of the large commercial and industrial customer load, 48.6% of the small commercial and industrial customer load and 11.2% of the residential customer load have migrated to ESCOs for their commodity supply service.<sup>37</sup> These numbers are

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<sup>36</sup> Some utilities question the Commission's ability to adhere to such a roadmap approach in the event of changing economic and/or political circumstances. The utilities also note that entering into long-term PSAs entails financial risk, the level of which likely will not be known fully at the time of contract execution. While the utilities are currently uncompensated for such risk, they consider it unlikely that rating agencies will turn a blind eye to such exposure.

<sup>37</sup> See N.Y. Pub. Serv. Comm'n, N.Y.S. Retail Access Migration Reports (Dec. 2006), [http://www.dps.state.ny.us/Electric\\_RA\\_Migration.htm](http://www.dps.state.ny.us/Electric_RA_Migration.htm).

consistent with migration trends outlined in the Commission’s Staff Report, confirming the existence of a robust and sustainable retail electric market for commercial and industrial customers.<sup>38</sup> Several ESCO stakeholders, however, have pointed out that market-reflective default service pricing is essential for maintaining the robustness and sustainability of the retail markets because without it customers cannot receive accurate price signals that enable them to choose the commodity supply product that is most compatible with their specific needs and ESCOs cannot tailor their product offerings to customer-specific needs without conveyance of market-reflective price signals.<sup>39</sup> To the extent long-term PSAs move default service pricing away from current structures – such as mandatory hourly-priced service for large commercial and industrial customers and partial NYISO day-ahead hourly pricing for small commercial and residential customers – ESCO stakeholders argue that this mechanism will undermine and destroy even the robust retail electric market now in place for large commercial and industrial customers.<sup>40</sup> Therefore, the impact of long-term PSAs on the competitive retail electric markets now in place in New York should be part of any State consideration of this mechanism.

In contrast with the pre-restructuring era, when investments in capital projects were generally collected through rates, the number of projects given explicit approval under the Committee’s suggested new policy is expected to be limited and subject to Commission control. While it may be too restrictive to determine that only projects which meet “public policy” goals be approved for the rate treatment suggested here, the most immediate need for such agreements is for regions which are facing limited capacity resources, such as New York City.<sup>41</sup>

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<sup>38</sup> See Staff Report, *supra* note 16, at 47-57.

<sup>39</sup> See, e.g., Initial Comments of the Small Customer Marketer Coalition & Retail Energy Supply Ass’n, Comments of Hess Corp., Initial Comments of Direct Energy Serv., No. 06-M-1017 (N.Y. Pub. Serv. Comm’n Nov. 17, 2006).

<sup>40</sup> *Id.*

<sup>41</sup> The State of California has been faced with a comparable problem of inadequate market signals to foster necessary additional generation capacity. California established a system to assure new generation by (1) identifying how much new capacity is required, (2) requiring utilities to submit plans for how they will provide such capacity, (3) having the California Public Utility Commission (“CPUC”) pre-approve requests for offers by utilities to meet the additional capacity requirements and (4) having the CPUC approve the PSAs, including cost recovery arrangements. The contracts entered into pursuant to this process are ten years in duration and provide the long-term PSA commitment required to lead to new generation. See CPUC Procurement & Resource Adequacy website, <http://www.cpuc.ca.gov/static/hottopics/1energy/r0404003.htm>.



## (b) Advantages and Disadvantages of the Option

### Advantages

- Provides a backstop approach to the need for new generating capacity in the event the market fails to provide the required capacity.<sup>42</sup>
- The addition of new capacity into the wholesale markets, particularly if most or all of the capacity additions are in one or two presently concentrated markets, will have a significant impact on the market. The Committee expects that the resulting new capacity should reduce capacity and energy costs for customers simply by increasing the supply of relatively low cost, efficient generating capacity. In addition, the concentration of supply-side (but not buy-side) market power that exists in New York City will be reduced, which may lead to further cost reductions.<sup>43</sup> The Commission's oversight of the new long-term PSAs will help to assure that efficiency gains from introduction of these new supply resources are passed on to customers.
- Since the ultimate source of credit is the utility's ability to collect PSA-related payments from its large number of end use customers, the long-term PSAs between project sponsors and utilities are the simplest and most direct means of using that credit for the benefit of the entity seeking to build the new capacity and, hence, for the benefit of the end use customers. This simplicity may be reflected in interest rates or advantageous contract terms, which could be shared by investors and customers.
- While the entry into long-term PSAs is essentially shifting the risk of loss to the utility and/or the end use customer, there are mitigating factors that lessen this risk. State-administered energy planning could provide value to the State, particularly to address the question of when a utility should

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<sup>42</sup> Some experts have argued that long-term PSAs are not additive to the proposed NYISO-administered forward capacity market but a mutually exclusive alternative. With the approaching deadline for starting new generating capacity projects for the downstate market, however, this contention might result in an unacceptable delay while the forward capacity market's potential was explored without any new capacity being added through long-term PSAs.

<sup>43</sup> See Independent Market Advisor to the New York ISO, *2005 State of the Market Report to the New York ISO* (Aug. 2006),

[http://www.nyiso.com/public/webdocs/documents/market\\_advisor\\_reports/2005\\_NYISO\\_SOM\\_Final.pdf](http://www.nyiso.com/public/webdocs/documents/market_advisor_reports/2005_NYISO_SOM_Final.pdf) (suggesting that a certain amount of capacity in New York City is not being accepted in the capacity market but is participating in the energy markets and that this may imply an inappropriate exercise of market power). The NYISO Board recently proposed certain capacity market mitigation measures, which are currently under review at FERC.

seek a long-term power supply agreement. The use of requests for proposals (“RFP”) to secure the most appropriate type of project from which to purchase electricity limits the potential for self-dealing by the LSE, by making it transparent.

### Disadvantages

- New York has had a poor record of predicting what appropriate investments in new generating capacity are. Over the past 25 years, substantial investments in small power producers, cogeneration plants and large nuclear power plants proved to be uneconomic in light of changed circumstances. The result is that end use customers are paying today for these classes of over-market value investments.
- The addition of new supply capacity will affect the market’s balance among suppliers. In particular, the new plants will benefit from the new State-approved PSAs, either explicitly or through the roadmap described above, thus affecting the balance among existing and new power suppliers. Existing generators may well have not had the advantage of a PSA approved by the State.
- Due to potential economic and/or political changes, there is no guarantee that the Commission will not limit the ability of utilities to collect PSA-related costs directly from customers on a timely basis, or alternatively will not make other ratemaking adjustments detrimental to the utilities. Any such action by the Commission will adversely affect the financial health of utilities, ultimately raising the cost of service, and affects the corresponding ability of utilities to make necessary investments in their delivery systems.
- The implementation of long-term PSAs will disable customers from receiving the market-reflective price signaling necessary for ESCOs to tailor their products to fit the customers’ specific needs. For ESCO stakeholders, this could seriously undermine retail electric markets that are already robust and sustainable, such as large commercial and industrial customer markets.
- The regulatory adoption of long-term PSAs to ensure the availability of electric capacity may interfere with the development of a viable competitive market.
- To the extent that non-economic market standards are used to determine whether to add capacity, there is an increased probability that uneconomic facilities will be acquired.

### (3) The State Could Create a Special Purpose Entity, or Authorize NYPA, to Finance New Generation Capacity

#### (a) Description

If it is determined that a capacity need identified by the NYISO or another planning entity is not being met by the market, a new Special Purpose Entity (“SPE”) created by law for this purpose, including perhaps NYPA, could issue a request for proposals for resources that would meet the identified need. If the entity were NYPA, it is assumed that this role would be separate from serving the needs of its current customers through separate RFPs. Whether this role was assigned to a new SPE or to NYPA, appropriate legislation would likely be required to authorize the activity and secure cost recovery.

The SPE would issue an RFP requesting bids for capacity or capacity and energy. The RFP could seek physical generation, demand side resources or transmission, depending on the need and NYISO requirements.<sup>44</sup> Upon an award, the SPE would enter into a PSA of sufficient duration to enable the developer to finance the project. The SPE would offer to resell the products purchased under the PSA through an auction, under which ESCOs, marketers, utilities, etc. could buy all or part of the RFP products. Any amounts not disposed of by this process would be sold by the SPE into the NYISO-administered markets (e.g., capacity auctions and/or the daily energy markets).

The SPE’s internal costs and payments to the developer would be reconciled to its revenues from sale of the output. The net under- or over-recovery would be passed on to end use customers in the regions of the State benefiting from the resource either through an “uplift” administered by the NYISO, in a manner similar to the existing NTAC charge, or by direct assessments to the incumbent distribution utilities by the Commission. In either

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<sup>44</sup> This option is presented in the context of an RFP for generation (or demand side) capacity, but the same model could be explored for the acquisition of transmission built to meet a generation capacity need. Such a line could be a dedicated generator lead or controllable line designed to deliver capacity from outside a zone that would qualify under NYISO rules as capacity within the zone, such as In-City Capacity. Because of the complexities of transmission pricing and cost recovery under the NYISO’s Open Access Transmission Tariff, it is possible that costs of transmission projects financed by contracts with an SPE might have to be recovered entirely through a mechanism like the NYPA Transmission Adjustment Clause (“NTAC”) that is assessed by the NYISO on end use customers. Such a charge could be assessed only on customers in regions that benefit from the project.

event, the SPE would need legally-binding assurance that it would be made whole and that its other customers would not be at risk of covering losses on the transaction. These requirements could be addressed in authorizing legislation.<sup>45</sup>

It should be noted that the NYISO's CRP is intended to lead to identification of a regulated reliability solution if the market does not respond. This solution could be new transmission, generation or demand side actions. The transmission owner in whose district the reliability violation occurs is responsible for developing a solution to the need. This process, however, is still developing and could be improved.

## (b) Advantages and Disadvantages of the Option

### Advantages

- Allows the market to be the primary source for new capacity, but provides a backstop mechanism to assure adequate and reliable service if the market fails to do so.
- Model could be used to build energy infrastructure consistent with State energy policy objectives that might not otherwise be built in a pure market environment (e.g., clean coal with CO<sub>2</sub> sequestration, renewables, etc.).
- If NYPA were the SPE, it has established credit and is a large NYISO market participant with experience managing large, complex RFPs and PSAs.

### Disadvantages

- Looks like old fashioned "Central Committee Planning."
- It will be difficult to assure the public that the best deal can be achieved through an RFP if cost recovery is assured to the entity evaluating the bids.
- Actions requiring legislative action may be delayed or significantly transformed.
- It will be difficult to assure that the SPE will recover its costs, based on utility experience with Commission's prudence reviews, need for FERC approval of NYISO role, and the reluctance of the Commission to bind future Commissions.

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<sup>45</sup> As in the Case of Option 2, the term of the PSAs secured by a contract with an SPE or NYPA need not necessarily last as long as the plants' expected life spans.

- If NYPA were the SPE, it would essentially be a “bank,” even though its strengths are asset development, ownership and operation. It would also be necessary to protect NYPA’s other customers and lenders from losses.
- Might undermine the competitive markets and discourage new market-based resource entry. It would be difficult for any generator recovering its costs in a competitive market to compete with a SPE which had guaranteed recovery of its costs, especially if the SPE has access to tax-exempt financing.

#### **4. New York Should Re-Institute State-Administered Energy Planning**

##### A. History of Energy Planning in New York State

Until the expiration of Article 6 of the Energy Law on January 1, 2003, the New York State Energy Planning Board agencies were required to review and if necessary update a state energy master plan at least once every two years.<sup>46</sup> The State Energy Plan included: a forecast of state energy requirements, together with the bases for such forecasts; a summary of the plans of the State’s major energy suppliers for meeting forecasted energy requirements; an identification and analysis of emerging trends related to energy supply, price and demand; and recommendations for specific energy policies including administrative and legislative actions. The state energy planning process benefited from the participation of knowledgeable staff from key State agencies as well as the opportunity for interested parties to submit written and oral comments. The result of the process was useful plans that created a framework for State agency action that forced the agencies to think and work collaboratively.

The 2002 State Energy Plan and Final Environmental Impact Statement were released by the State Energy Planning Board in June 2002. Since then, there have been no subsequent State Energy Plans because of the expiration of Article 6. Staffs of the Energy Planning Board agencies, however, issued memoranda documenting progress with the 2002 Energy Plan in December 2002, February 2004, February 2005 and March 2006. In March 2006, the New York State Energy Research and Development Authority ended its requests for information on a voluntary basis “as compliance with this voluntary request has waned

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<sup>46</sup> The Energy Planning Board agencies were the Commission, N.Y.S. Energy Research and Development Authority, N.Y.S. Department of Transportation, N.Y.S. Department of Economic Development, and N.Y.S. Department of Environmental Conservation.

considerably.”<sup>47</sup> New York State no longer has a comprehensive state energy planning process.

## B. Interaction of Administrative Energy Planning with NYISO System Planning

The NYISO addresses system reliability needs through its Comprehensive Reliability Planning Process, but it does not attempt to provide the type of comprehensive planning that existed in the past through the state energy planning process.<sup>48</sup> In particular, the NYISO does not attempt to analyze the variety of emerging trends related to energy supply, price and demand that had been previously been addressed by the Energy Planning Board.

In addition, the NYISO does not address non-reliability-related issues, such as fuel diversity, whether transmission capacity should be increased to meet economic needs, whether specific measures addressing load pockets and bottled generation should be taken and whether sufficient attention is being paid to demand response and energy efficiency programs. Fuel diversity, for example, is a crucial long-term issue for the State as most, if not all, of the new capacity resource proposals involves a generating plant which uses natural gas. Each of the other issues is comparably of critical importance to the provision of affordable energy while minimizing the environmental footprint of meeting the State’s energy needs.

These limitations on the NYISO’s planning process are particularly important as market forces have led to construction of limited new supply resources or transmission infrastructure in the regions of the State with the highest cost electricity. While it is conceivable that the competitive market may provide the most efficient answers to energy planning over the long-term, it remains unclear as to whether the competitive market will provide such answers in the short-term. Also of significance is that the NYISO does not address the environmental implications of its system reliability planning.

State-administered energy planning, particularly to the extent it replicates traditional integrated resource planning, can be considered to interfere with the operation of the market. The Committee is sensitive to the adverse impact that some form of energy planning could have on the operation of a robust market

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<sup>47</sup> Energy Coordinating Working Group, *State Energy Plan – 2005 Annual Report and Activities Update* (Mar. 2006), available at [http://www.nyserda.org/Energy\\_Information/energy\\_state\\_plan.asp](http://www.nyserda.org/Energy_Information/energy_state_plan.asp).

<sup>48</sup> See generally Comprehensive Reliability Plan for 2005, *supra* note 19.

and urges that in any state planning care be taken not to interfere with the competitive markets absent an overriding public policy purpose.

### C. NYISO's System Planning Balance of New Transmission and Generation

While new transmission projects can be may be viewed as substituting for new generation projects in particular regions, in a broader sense transmission provides the infrastructure on which the State's entire electric system works and enables competition in that it allows remote generation to compete with local generation. The NYISO's planning process permits the submission of transmission projects as market responses to the NYISO's reliability needs assessment, but no transmission projects were submitted by market participants in response to the NYISO's initial request for market-based project proposals.<sup>49</sup> The transmission projects identified in the current plan were submitted by transmission owners in response to their obligation to maintain a safe and reliable system. The financing of transmission projects, which connect different transmission regions of the State and are proposed by independent transmission sponsors, is particularly difficult to arrange as it may be difficult to determine who benefits from a new facility and to assign benefit shares to different sets of customers.

Moreover, it is not clear whether the current competitive wholesale market is leading to new construction of sufficient generation and transmission where customer costs are highest and demand requires additional supply because the NYISO planning process does not adequately identify and address economic needs. Only when economic needs are addressed and a process is developed to identify both market and cost-effective regulated solutions to those needs, will the State be able to evaluate whether customer costs are higher than they need or ought to be, whether there is new generation and/or transmission that could be built to the benefit of customers, and whether existing market incentives are sending the right signals to merchant producers in constrained areas, such as New York City. The limited amount of new merchant power plant construction in New York City is an indication that the right signals are not being sent.

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<sup>49</sup> *Id.*

#### D. State Energy Planning in the Context of Competitive Electric Utility Markets

Assuming that competitive electric utility markets will continue to exist in New York, state energy planning continues to be essential in order to enable the State to comprehensively analyze and respond to emerging affordability, environmental, reliability, economic planning and national security effects of supplying energy. There is no inherent conflict between state energy planning and the existence of competitive markets. In Pennsylvania, for example, state energy planning exists along with the PJM regional transmission operator, which administers competitive markets comparable to the NYISO's markets.<sup>50</sup> The competitive market rules in the State are designed to meet the State's objectives and those rules can be changed, as necessary, to respond to State policy as determined in a comprehensive planning process.

In other regions of the country, where a regional transmission operator covers a number of states, FERC is encouraging the creation of regional state committees ("RSCs"). The proposed RSC for New England, for example, will address key system planning issues, including, resource adequacy and system planning-expansion. The New England RSC:

will strive to achieve a comprehensive and integrated approach to achieving resource adequacy and system planning and expansion without relying unduly on any single resource or type of infrastructure. . . . [It] will recommend policies and comment on proposed market rule and tariff changes related to resource adequacy, demand response and energy efficiency. . . . [Finally, the RSC] will recommend policies designed to ensure that resources are available to provide for regional electric reliability and, where it is feasible and cost-effective, to eliminate persistent and costly congestion over transmission lines and to enable the inter-connection of generation resources. In addition, [the RSC] will study and evaluate approaches to the siting of interstate transmission lines on a regional basis.<sup>51</sup>

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<sup>50</sup> See Penn. Pub. Util. Comm'n, Bureau of Conservation, Econ. & Energy Planning website, [http://www.puc.state.pa.us/general/com\\_org/bur\\_cons\\_eco\\_ener\\_plan.aspx](http://www.puc.state.pa.us/general/com_org/bur_cons_eco_ener_plan.aspx). The Bureau develops energy, water, and telecommunications policy; disseminates information and analysis on utility operational aspects; and researches a broad range of utility policy issues, including potential impacts of utility restructuring activities, market power, energy strategies, mandatory water conservation plans with appropriate technologies, resource planning, competitive bidding and rate design.

<sup>51</sup> Proposed Term Sheet for New England RSC, submitted to NEPOOL Participants Committee on August 4, 2006: [http://www.iso-ne.com/committees/comm\\_wkgrps/prtcpnts\\_comm/prtcpnts/mtrls/2006/aug112006/supp\\_notice\\_aug112006.pdf](http://www.iso-ne.com/committees/comm_wkgrps/prtcpnts_comm/prtcpnts/mtrls/2006/aug112006/supp_notice_aug112006.pdf) (citations omitted).



Although the adoption of an RSC identical to New England's is inapposite in New York State because the NYISO operates in only one state, the goals of New England's RSC can be adopted for New York's energy planning effort.

## 5. Committee Conclusions

The Committee suggests that the State's most significant energy issue is the encouragement of construction of new generating capacity in regions of the State where it is needed.<sup>52</sup> New generating capacity provided by merchant generators is needed to address reliability issues and the market conditions in southeast New York over the next few years. While the re-enactment of Article X, the power plant siting law, is crucially important, the Committee does not consider that such legislative action by itself will be sufficient.

In addition to action on Article X, the Committee, first, suggests the NYISO can act promptly to implement a forward capacity market along the lines described above in Section 3(B) of this Report. Second, the Committee suggests that relying solely on an untested forward capacity market at this juncture is ill advised. Accordingly, the Committee proposes exploration of two additional alternative approaches, namely amendment of the current structure of the market to facilitate (1) LSEs or (2) an SPE entering into long-term PSAs with non-rate base sponsors of new generating plants and thus assisting such developers to build new generating capacity. The choice between these two financing options will require careful analysis, including an open process with comments from all stakeholders, on the advantages and disadvantages of each option.

In addition to spurring construction of new generation capacity, the Committee recommends that the State re-instate some form of energy planning. New York faces critically important energy planning challenges in the coming years in order to ensure the provision of affordable, reliable and clean energy. The State must ensure adequate generating capacity and the transmission and distribution capacity necessary to avoid constrained areas, such as those that currently exist in downstate New York, while simultaneously protecting the State's environment and reducing global warming. New York needs to

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<sup>52</sup> Alternatively, the facilitation of investment in transmission capacity in order to improve the transfer of power from upstate where it is surplus to downstate where it is needed may be an equally effective way to address capacity issues in southeastern New York.

maximize the benefits of fuel diversity, energy efficiency, renewable energy, new technologies and energy security, while strengthening the State's economy.

The State should supplement – not supplant – the NYISO's existing planning processes by reestablishing the essential elements of the state energy planning process that existed prior to the expiration of Article 6 of the Energy Law. There is no requirement, however, to reenact a law similar in detail to Article 6. Rather, State-administered energy planning should provide the opportunity for State agencies to work collaboratively to analyze and respond to emerging trends and problems, with ample opportunity for public input, and to make appropriate recommendations for administrative, executive and legislative action. We do not pretend that nothing has changed since the expiration of Article 6. Rather, the new process should be designed to build upon changes that have taken place with the advent of more competitive markets, to take advantage of the planning completed by the NYISO and to respond to the critical need to assure the adequacy of supply, forestall price increases and reduce environmental impacts. The Committee would be pleased to provide its expertise as the State develops the details of a new State planning process.

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February 9, 2007

### **Abbreviations**

CPUC	California Public Utility Commission
Con Edison	Consolidated Edison Company of New York, Inc.
DPS	Department of Public Service
ESCO	Energy service company
FERC	Federal Energy Regulatory Commission
ICAP	Installed capacity
LSE	Load serving entity
MW	Megawatt
NYISO	New York Independent System Operator
NYPA	New York Power Authority
Commission	New York Public Service Commission
NTAC	NYPA Transmission Adjustment Clause
PJM	PJM Interconnection, L.L.C.
PSA	Power supply agreement
RSC	Regional state committee
RNA	Reliability Needs Assessment
RFP	Requests for proposal
SPE	Special Purpose Entity