

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

At a session of the Public Service  
Commission held in the City of  
New York on December 15, 2004

COMMISSIONERS PRESENT:

William M. Flynn, Chairman  
Thomas J. Dunleavy  
Leonard A. Weiss  
Neal N. Galvin

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 the  
Development of Retail Competitive  
Opportunities.

ORDER ON PETITIONS FOR CLARIFICATION OR REHEARING

(Issued and Effective December 15, 2004)

BY THE COMMISSION:

INTRODUCTION

On August 25, 2004, we issued a Statement of Policy on Further Steps Toward Competition in Retail Energy Markets in this proceeding (Policy Statement). On September 24, 2004, National Fuel Gas Distribution Corporation (NFGDC or the company) filed a Petition for Rehearing or Clarification, and Consolidated Edison Company of New York, Inc. jointly with Orange and Rockland Utilities, Inc. (Con Edison or the company) filed a Petition for Clarification.<sup>1</sup> On October 11, 2004, the Small Customer Marketer Coalition (SCMC) replied to the Con Edison and NFGDC petitions. On October 15, 2004, Consumer Power Advocates (CPA) filed comments in support of Con Edison's petition.

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<sup>1</sup> The National Energy Marketers Association (NEM) filed Comments in Support of the Commission's Policy Statement, but requested no relief in the nature of rehearing or clarification.

Parties' Positions

Con Edison contends that the Policy Statement is unclear regarding the utility's obligation to continue to provide commodity at hedged prices, especially with regard to its largest full-service customers. The petition requests that we clarify that each utility would "continue to hedge for all its full service customers (including its largest full service customers) until an evaluation of whether a utility should cease hedging for a particular customer class is complete . . . ." <sup>2</sup> Generally, the company is concerned that most large customers are not ready to be exposed to real-time pricing. <sup>3</sup> CPA supports the company's position, contending that hedges available to the utility ". . . are not currently available to customers at the same risk premium in the marketplace[.]", and such customers should not be exposed to unhedged prices until hedges equivalent to the utilities' are available to retail customers. <sup>4</sup>

Con Edison also requests clarification regarding the propriety of charging large customers the weighted average of the ISO's day-ahead or real-time hourly prices once a determination has been made that utility commodity prices for a particular service class should no longer be hedged. Con Edison further requests a clarification that it can enter into hedges of up to three years without having to prove that the hedge was not entered into for the purpose of suppressing competition. <sup>5</sup> Finally, the company seeks a clarification that we would accept petitions to approve longer term commodity or capacity contracts required for public policy purposes other than to provide a hedged supply of competitive commodity to its full-service customers. <sup>6</sup>

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<sup>2</sup> Con Edison's Petition, p. 2 (emphasis in original).

<sup>3</sup> Id., p. 8.

<sup>4</sup> Utility hedging ". . . should not be abandoned for a customer class until equivalent [i.e., hedged] rate services and plans are generally available to all customers in the class." (Policy Statement, p. 34).

<sup>5</sup> Con Edison's Petition, p. 9.

<sup>6</sup> Id., p. 11.

NFGDC asks for rehearing or clarification of the Policy Statement to reconcile it with the Public Service Law (PSL) and our 1998 Gas Purchasing Policy.<sup>7</sup> According to the company, the most recent Policy Statement requires a change from least-cost supply purchasing and volatility management to a new policy that exposes consumers of utility bundled services to shorter-term price signals. This, the company argues, appears to be inconsistent with its least cost purchasing obligations under PSL §§66-e(2) and 66-f(1).<sup>8</sup> Further, NFGDC argues, if the utility is successful in hedging and in purchasing at least cost, it may acquire a greater market share thereby impeding market development despite the utility's following or intending to follow Commission policy. According to the company, a utility should not be penalized for acquiring a greater market share (or otherwise slowing market development), unless there is clear evidence of an intent to achieve that result.<sup>9</sup>

NFGDC also raises a question regarding the "markets" we referenced in the discussion of the continued availability of a state-action exemption from antitrust claims.<sup>10</sup> Finally, the company requests that a procedure be established by which the propriety of the company's gas purchasing contracts could be determined in advance.<sup>11</sup>

In reply to Con Edison, SCMC contends that the Policy Statement clearly states that hedges should be eliminated now for all large commercial and industrial customers. SCMC opposes any new or additional proceedings to determine when hedging

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<sup>7</sup> Case 97-G-0600 - Request for Gas Distribution Companies to Reduce Gas Cost Volatility and Provide for Alternate Gas Purchasing Mechanisms, Statement of Policy on Gas Purchasing Practices (issued April 28, 1998)(Gas Purchasing Policy).

<sup>8</sup> PSL §66-e(2) requires the utility, when it is applying for a rate increase, to establish that there are no other dependable, lower-cost gas supplies available. PSL §66-f(1) provides us the authority to direct the utility to procure natural gas at the lowest available price.

<sup>9</sup> NFGDC's Petition, p. 6.

<sup>10</sup> Id., p. 5.

<sup>11</sup> Id., p. 6.

should be eliminated (or time-of-use, spot-market prices should be implemented), although it acknowledges that Con Edison could petition the Commission if it were in doubt. SCMC also opposes any pre-approval for Con Edison to enter into contracts of up to three years, and urges that such contracts not be allowed.<sup>12</sup>

As to NFGDC's petition, SCMC argues that the Policy Statement is consistent with the least-cost purchasing obligations of the PSL and the Commission's Gas Purchasing Policy. Rather than requiring the institution of a new purchasing policy, SCMC posits that the ". . . gas utilities are still obligated to follow . . . a portfolio approach for small consumers until such time as similar products are available . . . in the competitive retail market."<sup>13</sup> SCMC also argues that NFGDC's concern about a post-hoc contract disallowance is exaggerated, because that result would only occur if the utility entered into supply contracts for the purpose of undermining the development of competitive markets.<sup>14</sup>

#### Discussion

In addressing the utilities' obligation to undertake commodity purchasing using a hedged portfolio approach to limit volatility, we generally noted that the obligation to provide such a service would continue for a service classification "until equivalent rate services and plans are generally available [in the retail competitive market] to all customers in the class."<sup>15</sup> Such an issue might be explored in the context of a full rate proceeding, in response to the filing of a proposed tariff, in response to a petition from an interested party, or on our own motion.

Concerning specifically the largest usage electric customer classes served under mandatory time-of-use rates, we

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<sup>12</sup> SCMC's Reply, pp. 2-3.

<sup>13</sup> Id., p. 5.

<sup>14</sup> Id., pp. 5-6.

<sup>15</sup> Policy Statement, p. 34. We are not requiring that the utilities now offer a hedged retail service to any customer class which is not offered such a service or for which we have approved the elimination of a hedged service.

concluded that ". . . existing hedges should be allowed to expire without being renewed."<sup>16</sup> We did not direct that hedged retail prices be immediately eliminated, but rather that, as existing hedges (e.g., long-term contracts) expire, they not be replaced for this mandatory time-of-use class.<sup>17</sup> Therefore, for all mandatory time-of-use customers, once existing contracts for future supplies (or other hedging contracts) have expired,<sup>18</sup> utility rates should reflect spot-market prices (i.e., day ahead, real time, or other equivalent prices), and the net costs of any public policy contracts.<sup>19</sup>

For all other service classes, if hedged services are not broadly available from the retail market, utilities should continue to offer a volatility-hedged commodity service to the class, if such a service is currently offered. Considerations beyond the broad availability of hedged services may also be appropriate,<sup>20</sup> but, as we more fully explained in the Policy Statement, this is not the proper forum to establish definitively which factors will or will not be considered in examining these issues in a future proceeding.<sup>21</sup>

We also decline, at this time, to pre-approve any specific design of spot-market pricing for a service classification once it has been determined that hedged pricing is no longer required for the class.<sup>22</sup> We expect the utilities or other parties to propose approaches to setting retail rates

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<sup>16</sup> Id., p. 35.

<sup>17</sup> Similarly, the cost of new hedging contracts should not be included in the utilities' rates for such classes.

<sup>18</sup> Existing Con Edison contracts for future supply will not all expire for a number of years.

<sup>19</sup> Policy Statement, pp. 35-36.

<sup>20</sup> For example, the market's maturity may also be examined based on the factors in Straw Proposal 2 (Policy Statement, Appendix B), as well as others. We will determine on a case-by-case basis when a market is sufficiently robust that hedging services should be eliminated.

<sup>21</sup> Policy Statement, p. 34.

<sup>22</sup> The specific approaches suggest by Con Edison could be acceptable, depending on the circumstances.

that would flow-through spot-market (or other short-term market) prices, when such pricing is deemed appropriate.

In the context of a further request for clarification, Con Edison argued that utilities should be allowed to enter into electric commodity contracts for a three-year term and that we should declare now that all such contracts have not been entered into for the purpose of suppressing competition. The company's request for such a declaration is denied. While we do not consider three-year contracts per se anti-competitive, the reasonableness and purpose of such contracts can only be measured against the circumstances existing when the contracts are executed.<sup>23</sup> For example, a three-year contract designed to minimize volatility as a portion of a utility's portfolio could certainly be an acceptable hedge, depending inter alia on the size of the contract as compared to the forecast of full-service customer demands during the contract period. Such determinations cannot be made on the basis of this record, but we expect the utilities to consider these issues in proposing multi-year rate plans or as significant long-term hedges expire. More broadly stated, we intend to continue monitoring the procurement contracts of gas and electric utilities to ensure, among other things, that their practices are not anti-competitive.

Con Edison also asks that we clarify that petitions would be entertained to review the need for long-term contracts for commodity or capacity required for public policy purposes (e.g., to maintain system reliability, reduce environmental impacts, etc.).<sup>24</sup> While nothing in the Policy Statement prevents the utility from filing such a petition, we expect that any relief requested would be consistent with the principles established in this proceeding, including the discussion set forth below on NFGDC's request that we approve supply contracts in advance of their execution.

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<sup>23</sup> We generally expect that long-term contracts executed for public policy purposes would significantly exceed three years in length.

<sup>24</sup> Policy Statement, pp. 35-36.

NFGDC's allegation that we are changing our commodity purchasing policies in a manner inconsistent with the PSL is incorrect. First, we are not changing our policy regarding gas commodity purchasing to minimize volatility as expressed in our 1998 Gas Purchasing Policy. Second, as we noted above, changing the commodity service offered to a customer class from hedged to spot-market pricing, will likely require tariff amendments or other approvals. Reviewing such proposals will require, among other things, an examination of the maturity of the retail market in the utility's territory and for the affected customer class. As retail markets develop, it may become advisable to limit a utility's commodity offering to spot-market pricing, but this record does not identify any specific instances where new tariffs for this purpose should be adopted now.

We also find no conflict between our recent Policy Statement and the PSL. The Policy Statement concludes that the most effective approach to meeting the just and reasonable rate requirement of PSL §65 is to foster the development of competitive markets.<sup>25</sup> The transition to competitive markets, however, is a gradual, ongoing process. At the same time, we have recognized that the extent of market regulation required during the transition to competitive markets will depend on the extent to which a competitive market exists.<sup>26</sup> These two statutory directives--just and reasonable rates and protection from monopoly power--are the bases for our review of hedging contracts, and the stage of the transition to competition is simply another factor to consider when entering into a hedging contract.<sup>27</sup>

It should also be noted that a utility's obligation to demonstrate that there are no lower priced, dependable and adequate supplies of gas than the supplies it has purchased

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<sup>25</sup> Policy Statement, p. 2, 18-21.

<sup>26</sup> "Regulatory involvement will be tailored to reflect the competitiveness of the market." (Id., p. 19.)

<sup>27</sup> PSL §§66-e(1) specifically directs us to monitor the utilities' gas procurement to preclude anti-competitive activities.

(PSL §66-e(2)) and our authority to require the procurement of natural gas at the lowest available price (PSL §66-f(1)), remain the standards for the company's procurement, not the company's retail rates. Retail rates must be just and reasonable (PSL §65(1)), a standard that may be met by spot-market or unhedged, procurement-cost pricing, if the retail market is sufficiently robust, or by volatility-hedged pricing, if it is not.<sup>28</sup> In either event, the utility must purchase commodity at least cost, whether the purchase is in the spot market or a futures market. Therefore, we find no inconsistency among the Policy Statement, the Gas Purchasing Policy, or the PSL. NFGDC's petition for rehearing on these issues is denied.

NFGDC also requests the establishment of a procedure where we would review its gas purchasing practices and approve them prior to the execution of a supply contract. We will not grant this request. NFGDC's concern that, in the absence of such a pre-approval procedure, a *post-hoc* disallowance of volatility-minimizing supply contracts would result, is dispelled by the results of our monitoring of gas procurement portfolios since 1998.<sup>29</sup> Further, we doubt that such a process would be practical. Even an expedited regulatory review prior to entering a contract could be insufficiently rapid to match the speed of the competitive market movements. Accordingly, NFGDC's request that we approve supply contracts in advance of their execution by the utility is denied.<sup>30</sup>

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<sup>28</sup> The extent to which hedging should be, or, as a practical matter, may be eliminated could depend on the industry (gas or electric), the service classification, or the extent of the development of the retail market. We will further examine these details as rate changes are proposed.

<sup>29</sup> Contract cost disallowances remain possible, of course, but they should not materialize so long as the utilities prudently comply with our procurement policies and avoid taking actions for the specific purpose of constraining or precluding the development of the retail gas commodity market.

<sup>30</sup> As discussed above, however, we will entertain as appropriate petitions to examine the need for long term contracts other than for the purpose of limiting commodity volatility.

Finally, NFGDC argues that we have not clearly identified the competitive markets to which we referred in the discussion of our market monitoring responsibilities.<sup>31</sup> The markets with which we are concerned are those identified as offering competitive or potentially competitive services in our Order Directing Filing of Embedded Cost Studies in this proceeding.<sup>32</sup>

The Commission orders:

1. Consolidated Edison Company of New York, Inc.'s Petition for Clarification and National Fuel Gas Distribution Corporation's Petition for Clarification of the Statement of Policy on Further Steps Toward Competition in Retail Energy Markets are granted to the extent set forth herein, and are otherwise denied.

2. National Fuel Gas Distribution Corporation's Petition for Rehearing of the Statement of Policy on Further Steps Toward Competition in Retail Energy Markets is denied.

3. This proceeding is continued.

By the Commission,

(SIGNED)

JACLYN A. BRILLING  
Secretary

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<sup>31</sup> Policy Statement, p. 43.

<sup>32</sup> Issued November 9, 2001, Attachment A. Considerable agreement was reached among the parties regarding the categories of potentially competitive services set forth in that order.