

**STATE OF NEW YORK
PUBLIC SERVICE COMMISSION**

**Case 06-M-1017 Proceeding on Motion of the Commission as to Policies,
Practices and Procedures for Utility Commodity Supply
Service to Residential and Small Commercial and
Industrial Customers**

**Reply Comments by
The City of New York**

December 11, 2006

Introduction

Based on its review of the initial comments submitted in this proceeding, the City believes that the Commission should take the following steps:

- Require utilities to continue and systemize multi-year contracts, to reduce volatility in power-supply service prices.
- Establish a system for long-term planning by region and statewide.
- Explicitly give utilities the responsibility to contract for new resources, as needed to pursue such strategic policy goals as reliability of supply, promotion of competition, reduction of market prices, diversifying fuel supply and reducing pollution and CO₂ emissions.
- If a particular utility is unable or unwilling to contract for new resources, or if long-term contracts are found to impose excessive costs, promote the development of some other entity to take on the planning and contracting function.
- Allow utilities to collect market costs from their generation-service customers, and to collect or credit the difference between market prices and the costs of long-term strategic contracts from all delivery customers, including those served by competitive suppliers.
- Encourage utilities to work with customer groups in developing procurement plans and long-term regional planning.

Contracting for the Supply Portfolio

Most parties advocate that the utilities should develop appropriate hedging strategies for their supply portfolios:

- “A defined portfolio management approach...for utility supply procurement for small-customer classes would be a preferred approach” (Assemblyman Tonko at 5).
- “The Commission should call for a moderate level of hedging” (Con Edison at 5).

- Central Hudson Gas & Electric (at 3) is proud of its efforts to “limit volatility through various hedging products.”
- The Independent Power Producers of New York (at 3) “agrees with the Commission that electric utilities should continue to offer hedged service to small use customers”.
- “The Commission should encourage electric utilities to ladder short, medium and long-term contracts to reduce the risk that the portfolio price will vary significantly from average spot market prices” (IPPNY at 5).
- The NRG Companies (at 6) envision a system in which “wholesale suppliers...serve the electric utilities’ retail load requirements on a multi-month, annual, and/or multi-year basis. This will greatly benefit retail consumers because it will provide a true market-based mechanism to provide reduced price volatility at the lowest reasonable cost. The retail customers will be protected from price volatility....”

The utilities should procure a mix of spot, short-term, medium-term and long term hedges to promote price stability and market improvements

In the special case of New York City, it would be better to meet most of customers’ supply requirements under bilateral contracts. This will promote price stability, increase market competition, and offset the potential for the incumbent generators to use their market power to manipulate spot market prices and expose a large portion of the portfolio to excessively high spot prices. To facilitate these transactions, the Commission should allow Divested Generation Owners to participate in bilateral contracts (subject to reporting and limitations described in the City’s initial comments), where it can be demonstrated that such contracts benefit consumers, reduce market power and encourage competition.

The discussion of utility power-supply contracts in the initial comments covers both (1) long-term contracts to insure adequate supply and other policy goals and (2) shorter-term contracts to stabilize the costs of the utility power-supply services. The following section of these comments addresses the need for the longer-term contracts; short-term hedging is discussed below.

Long-Term Contracts

Consumers' interests would be best served by instituting some form of long-term planning and procurement to induce new resources and thereby meet important objectives such as enhancing reliability, moderating prices and reducing pollution and greenhouse gases.

Unless the utilities procure new resources, not much new generation will be built, since ESCOs are unlikely (and perhaps unable) to sign utility-scale PPAs and there are few if any generators willing to build on a merchant basis. The outlook for expansion of inter-regional transmission will be even bleaker.

The City's position is supported in whole or in part by many of the parties in this proceeding.

- Longer term contracts between suppliers and utilities are important to facilitate investment in new and needed existing generation, to assure reliable service to consumers, and to reduce consumer exposure to price volatility. Applying a structure that uses a mix of short and long-term wholesale supply contracts will benefit retail consumers by reducing volatility, intensifying competition, and by helping to provide the necessary forward price signals for continued investment in generating resources (IPPNY at 4).
- “The short-term markets operated by the NYISO are necessary but not sufficient to ensure the resource adequacy of the State of New York, in part due to regulatory uncertainty. Thus, an additional benefit of competitive procurement and portfolio requirements is the ability to ensure resource adequacy for the State of New York. This Commission must assume a proactive role in ensuring adequate resources are developed, and, given the long lead time for new generation and the current load forecasts, the need for decisive action is acute” (NRG at 5).
- Wholesale contracts of one to three years “may not provide for resource adequacy in the long term. Thus, either in addition or as an alternative to such standardized products, the Commission should require the electric distribution utilities to procure electricity through a mix of short, medium, and long-term wholesale supply contracts through competitive solicitations. Proposals should be evaluated on the basis of their ability to meet state policy objectives while producing the lowest increment in power and power system

costs. As noted above, the Commission should also ensure that the electric utilities establish diverse supply portfolios—diverse in terms of duration, suppliers, location and fuel supply. In addition, the Commission could identify a specific set of technologies, or air-emission characteristics, thus furthering the policies of the state. Developing a diverse portfolio of competitively-procured resources will benefit retail consumers by reducing price volatility, intensifying competition, and helping to provide the necessary forward price signals for continued investment in generating resources” (NRG at 8).

- In its comments, FPL urges a balanced approach incorporating some longer-term contracts (at 1, 11), noting (at 5) the “significant benefits to longer-term contracts” include “facilitating investment in new...generation,...ensuring reliability and reducing price volatility.”¹

Long-Term Planning

While the Commission did not specifically identify resource planning as an issue for this proceeding, several parties besides the City point out in their comments the important role of planning for optimizing the utility supply portfolio and support reintroduction of a planning process as an essential part of integrated portfolio management. For example,

- The comments from Assemblyman Paul Tonko (at 2) recommend that the Commission require utilities to engage in planning “to protect customers from the volatility or level of the price for capacity and energy procured on their behalf,” and indicates that the Legislature may enact legislation to that end.
- The NRG companies (at 14) suggest that all utilities be compelled to file a long-term competitive procurement plan with the Commission.

The Commission should direct the utilities to implement a comprehensive planning process for the following purposes:

¹In its comments (at 4), FPL worries that “long-term bilateral agreements for supply may lock in below-market prices for a period of time,” leading to “rate shock.” FPL is wrong if it is suggesting that customers are better off with high prices today and high prices tomorrow, rather than low prices today and high prices tomorrow.

- identify the need for additional energy and capacity resources throughout the forecast horizon, to maintain or improve reliability, moderate costs, increase competition, and reduce emissions;
- develop a strategy to meet these resource requirements, including scheduling competitive solicitations;
- set targets for energy-efficiency and demand-response programs;
- promote renewable resources as required to meet renewable portfolio standards;
- meet environmental goals for emissions of pollutants and greenhouse gases;
- optimize the mix of transmission versus generation investments, especially in load pockets;
- comply with State-wide (and where applicable, as in New York City, regional) energy plans and policies.

The preferred portfolio should perform well under a range of future conditions. The planning methodology can be developed based on best practices that have been adopted elsewhere. Important stakeholders, such as the City of New York, should serve in an advisory role to set planning objectives and develop criteria for RFP selection.

The utility resource plan should generally provide a guide for resource procurements, indicating the amount of resource additions what would be helpful in various locations and at various times. For example, if the plan indicated that transfer capability into Zone J could be increase by capacity and energy resources located anywhere in Zones G through K, the power-supply solicitations could be structured accordingly.

In many situations, the utility's resource plan will need to address regional issues, probably through a multi-utility study that can be referenced by all affected utilities. For example, the Con Edison resource plan should include a comprehensive study of SENY transmission requirements, in cooperation with (as appropriate) NYISO, LIPA, NYPA, CHG&E, and PJM (including the transmission owners in northern New Jersey). Transmission should be included in the utility plans unless and until the NYISO adopts a regional electric transmission planning

process that can implement additions to improve markets and reduce congestion, as well as maintain grid reliability.

The Commission should allow utilities to build, or contract with others to build, projects shown in their resource plans, and to recover the costs under traditional regulated cost recovery.²

It is critical that some form of planning for the supply side should be reinstated as soon as possible to meet the need for new resources in southeast New York beginning around 2011. The Commission should direct the utilities to reestablish or upgrade their planning functions as an essential part of an overall integrated-portfolio-management approach.

Benefits of Long-Term Contracts

The initial comments of the City and other parties describe the benefits of long-term contracts with staggered terms. For example, the NRG Companies (at 8) urge the Commission to require the electric utilities to include long-term contracts in a diverse portfolio, to “intensify competition, and help to provide the necessary forward price signals for continued investment in generating resources..., ensuring the resource adequacy of the state.” The NRG Companies also point out the role of long-term contracts in bringing new resources on line:

Long-term contracts may be necessary to procure new or repowered generation that can bring reliability, energy efficiency and environmental benefits to the system...Long-term contracts allow the investor to finance the unit based upon a definite revenue stream associated with the unit. (NRG at 12–13)

and the benefits of longer-term contracts in lower retail prices:

The longer the term of the contract, the lower the ultimate cost is for the electric customers because the recovery of fixed costs is spread out over the contract period, with a significantly reduced risk premium for the uncertainty of the post-contract period. (NRG at 12–13)

Con Edison acknowledges (at 10) that “the Commission should allow up to three-year” supply contracts, but its comments suggest that even longer periods

²The Commission may also consider incentive mechanisms in some situations.

may be beneficial. Con Edison (at 10) asserts, “Seasonally adjusted prices show upward and downward movement within a three-year period,” without offering any evidence that the movements are limited to three years. Certainly, New York has not yet seen the downward movement that would offset the upward movements that began in 2003. Con Edison is correct (at 10) that “lengthier hedges can extend over historic price cycles and therefore can moderate volatility more effectively than shorter-term hedges;” by Con Edison’s own reasoning, contracts spanning more than one of its acknowledged three-year price cycles would be justified.

Not all of the utilities acknowledge the value of long-term contracts. While CHG&E (at 3) is correct that it cannot “purchase at prices below those generally available in the markets,” it seems to ignore the possibility that its contracting can help bring on new generation that would relieve constraints in southeast New York, resulting in lower prices becoming generally available in the markets. Contrary to CHG&E’s opinion (at 4), “utility purchasing activities” can “be properly described as impacting the functioning of the markets.”³

Power Procurement and Equity for Generators

Some of the generators erroneously argue that utility power procurements should be “non-discriminatory,” in a manner that would undermine the purpose of long-term contracting:⁴

- “It is crucial that contracts be available to existing and new resources alike, on an equal, nondiscriminatory basis” (IPPNY at 4).
- “The Commission should ensure that competitive solicitations are transparent, nondiscriminatory and open to all resources, including new and existing generating capacity” (IPPNY at 5).

³While CHG&E (at 3) asserts that “all would agree that the NYISO’s markets are competitive,” the City’s Initial Comments demonstrated that those markets, especially in Zone J, are far from competitive.

⁴Interestingly, other generators, such as NRG, recognize that new and repowered resources have benefits additional to those of existing units, and support utility procurement directed to achieve specific purposes.

- “A truly competitive process would be non-discriminatory, i.e., open to all suppliers, existing and new” (KeySpan at 2).

These same generators acknowledge that the value of long-term contracts is that they can promote “continued investment in generating resources” (IPPNY at 4), to address “reliability, environmental considerations, fuel diversity or market-power mitigation” (KeySpan at 3). Since simply reshuffling entitlements to existing resources cannot achieve these goals, RFPs for long-term contracts should often be targeted to new resources.

Of course, the new resource can be at an existing plant site, or even represent the additional energy and capacity associated with repowering or replacing an existing generator. The owners of existing generators should be treated fairly in the procurement process, but they should only receive contracts if they can provide the required benefits.

The Contracting Party

In most cases, the utility is uniquely qualified to take on the role of signing long-term contracts to bring on new resources and flowing those costs through to all customers in their service territories. No other entity currently has the continuing relationship with all customers and the ability to recovery costs. Competitive suppliers have only short-term relationships with consumers, serve only a fraction of customers in the service territory, and are in no position to sign long-term contracts with resource developers. Accordingly, the Commission should direct the utilities (most importantly for the City and for near-term supply requirements, Con Edison) to plan and procure long term contracts for market improvements on behalf of all consumers.

Some utility commenters (e.g., Central Hudson at 12) argue that they cannot be expected to take on long-term commitments in the face of the Commission’s policies that encourage customers to change from the utility to third-party suppliers. This argument is not relevant so long as the utility flows through to all customers the difference between market prices and the costs of long-term resource. The compatibility of long-term contracts and competition is discussed in the following section.

Central Hudson raises the objection (at 13) that signing long-term PPAs can cause rating agencies to downgrade utility credit ratings, resulting in higher costs for consumers.⁵ While this *may* be a legitimate concern, it can be addressed using appropriate regulatory mechanisms based on best practices that have been adopted elsewhere.⁶ On balance, long-term PPAs should lower, not raise, supply costs to consumers by reducing the cost of financing for third-party generation and transmission projects.

If a particular utility is unwilling or unable to serve as the contracting party for long-term purchases, the Commission should work with other parties (including the Legislature, as necessary) to identify or create another entity to serve as the legal counterparty for resource developers. In some situations, especially for providing statewide benefits, NYPA might serve that role. In other cases, a special-purpose entity might be more appropriate. For example, a Southeast New York Power Authority might be created to contract for generation and transmission projects to relieve the SENY transmission limitations discussed in the Comprehensive Reliability Plan (which might involve building generation in Zones G, H and I), as well as to relieve supply constraints into the City.

In any case, the non-utility purchasing entity would either (1) take title to the energy, capacity and other products covered in the purchased-power agreement, sell the products into the markets, and compute the loss or gain on those transaction, or (2) pay (or receive from) the resource owner the difference between the contract price and the market value of the products.

⁵No party suggests that this possible effect would be a concern for shorter-term contracts of up to a few years. Central Hudson's rationale for its opinion is difficult to follow, as it includes assertions (at 13) about "unregulated counter-parties" who "lever the balance sheet of the regulated entities" and complaints that an "unregulated entity gets the return on investment" that it makes to serve the utility, as if earning a return on investment were illegitimate.

⁶Central Hudson (at 12) accepts that the financial costs are relevant only for contracts of more than three years). As noted in the City's initial comments, the Connecticut DPUC recently found that this concern did not require any special ratemaking for new long-term contracts.

In either case, the utility would simply serve as the billing agent for the purchasing entity, flowing through to customer bills the charge or credit, without taking title to power.⁷ The utility would have no obligation to the resource developer, and its only obligation to the purchasing entity would be to remit the payments (if any) received from ratepayers for the purchases.

Consistency with Retail and Wholesale Competition

While some utilities expressed concern that their signing additional long-term resource contracts would impede retail competition and customer migration to competitive suppliers, these goals can be entirely compatible.

Con Edison asserts (at 3) that “it would be a mistake to adopt strict guidelines for hedging that could restrict flexibility and potentially impede additional migration.” The City agrees that it would be a mistake to adopt strict guidelines for hedging that would unnecessarily impede additional migration. But if each utility offers each rate class a single generation-service product designed to serve the needs of that class, competitive suppliers should be able to attract all the customers who desire other products: those with more or less hedging, longer contract terms, different rate design, a greater renewable power component, etc. If the competitive suppliers are more efficient than the utilities, they should be able to compete effectively with the utilities even for customers who would be content with the utility’s single generation-service product.

Con Edison (at 5) expresses a preference for limiting hedging to “a moderate level” to “leave some room for customers to be exposed to market price signals, rather than completely insulate customers from such signals.” Similar concerns are expressed by FPL at 10 and SCMC at 10–12. This comment suggests that hedging eliminates all cost signals; in fact, utilities with highly hedged supply portfolios differentiate retail prices by month and even by time-of-use, reflecting the prices charged in the market months or years earlier. The only market price signals that

⁷This would be similar to the relationship of Con Edison to the New York City Public Utility Service and the County of Westchester Public Utility Service Agency.

are not flowed through to customers are price shocks, which provide more disruption than useful information.⁸

KeySpan-Ravenswood (at 3) cautions that “the Commission should not seek to stabilize retail energy prices at the expense of a competitive wholesale market.” Niagara Mohawk expresses similar concerns (at 8). These concerns are misplaced. Under the City’s proposal, the utilities would use long-term contracts to stabilize retail energy prices while simultaneously stimulating a competitive wholesale market, particularly in Zone J, where competition has heretofore been very limited.

Cost Allocation for Long-Term Contracts

Prudence Standards

The City agrees with CHG&E (at 6) that cost recovery for utility power procurement should be judged “in light of the reasonably-known factual picture from a prospective (not after-the-fact) vantage.” Those determinations would be easier for the Commission and less risky for the utility if the procurement process is developed with input from customer representatives.

Allocation of Net Costs and Benefits

One of the important issues in this proceeding is the extent to which customers served by competitive suppliers should share in the differences between (1) the spot price of power and (2) the costs of power supply contracts and other utility resources. The City’s position is as follows:

- Short-term power costs, incurred to serve only the utility’s power-supply customers, should be recovered only from those customers. This category includes ISO charges, spot purchases, forward contracts for periods ranging from a day to a few years, and any related financial hedges.

⁸Con Edison may be conflating rate design with risk mitigation, as does CHG&E (at 9). Even real-time energy pricing is consistent with hedging; the customer can pay the hedged price for a baseline usage and pay (or save) the real-time price for the difference between the actual and baseline usage.

- The costs of long-term strategic resource acquisitions, incurred to serve the interest of all customers in the service territory, should be recovered from all customers.

Similar positions are found in other parties' comments:

The costs resulting from competitive procurement should be recovered from those customers who benefit from the procurement. This approach would pass through the costs only to those customers who are part of electric utilities' load. However, where new generation is procured through a long-term procurement contract, all customers on the electric utility system are receiving the reliability benefit provided by the new generation.... The Commission should evaluate whether capacity costs should be unbundled from the energy commodity (and the provision of ancillary services) and applied as a non-bypassable wires charge that is paid by all customers. (NRG at 10–11)

The Commission should consider whether all capacity service is essentially a reliability service that is best...converted into a non-bypassable system charge to all customers in the zone. Certainly, such an approach would best enable the Commission to ensure the long-term resource adequacy of the state. (NRG at 11–12)

Rather than the capacity costs that NRG suggests be charged to all customers, the difference (positive or negative) between market prices and resource costs should be charges to all customers. Otherwise, NRG's position is essentially the same as the City's.

The Small Customer Marketer Coalition and Retail Energy Supply Association (at 19–22) would go even further, flowing all hedging costs and benefits to all customers.

Several parties contend that the cost and benefits of utility hedging programs should be allocated only to utility's power-supply customers, based on their interpretation of "cost causation" (e.g., Con Edison at 9; Consumer Power Associates at 2; FPL at 10). This approach is appropriate for short-term hedges (including short-term contracts) procured to protect the utility's power-supply customers from short-term price volatility. In the case of long-term contracts for market improvements, the costs are incurred to benefit all customers. The evaluation of potential strategic long-term contracts should reflect the benefits to all customers, and the costs and benefits of the contracts should be recovered from

all customers. In the case of strategic long-term contracts, the concept of “cost causation” yields the same allocation as does the allocation principle of “beneficiary pays.”

Similarly, Central Hudson (at 11) states that it is “axiomatic that the costs that any particular group of customers causes the utility to incur should be recovered from that group.” Central Hudson applies this rule to the short-term purchases for customers taking power-supply service and concludes that those costs should be recovered from those customers. Applying the same rule to long-term purchases from new resources, which benefit all customers, would lead to recovering the net costs of those purchases from all customers.

Con Edison (at 7) argues that “the impact of a utility’s hedges on its full service customers is increasingly diluted if they are spread over all customers.” Again, that point is relevant to short-term hedges intended specifically to mitigate short-term price volatility specifically for the utility’s PSS customers, but not for long-term contracts to improve the market for all customers.

Nor would “retail-choice customers be ‘double-hedged,’ [resulting in] retail-access customers paying twice for hedging that turned out to be above-market after a significant market price decline.” Under the City’s approach, the retail-choice customers would not be double-hedged from either the utility’s short- or long-term contracts. They would pay nothing for the short-term hedges procured for the utility generation service. As for the utility’s long-term contracts, competitive suppliers would be aware of the effects of those contracts in increasing supply, reducing prices, increasing wholesale competition, and reducing risk, and adjust their hedging to reflect the improved supply situation.

Con Edison (at 9) argues that the January 23 2006 order in Case 04-E-0572 shows a Commission preference for collecting all generation costs from generation-service customers. That order actually concerns only the flow-through to customers of ISO charges and credits to reconcile bills from previous months. Those short-term costs are the direct result of the loads of customers on generation service, and benefit customers on competitive service only to the extent that those

costs were necessary to keep the generation service available for returning customers.⁹

Long-term resources, in contrast, provide the following substantial benefits to all consumers, whether their generation service is provided by the utility or a competitive supplier in any particular month. The benefits to all electric customers in the service territory include at least the following:

- Contracts for new resources will result in the development of additional supply, improve reliability, diversify supply, reduce the cost of new entry, and lower market prices for all customers in the service territory (and often beyond).
- The increase in resources, especially in Zone J, will improve the competitiveness of the wholesale generation market, reducing market abuse and the continuing need for market mitigation.
- The utility contracts will generally be for periods much shorter than the resource life, so a resource built under long-term contract with the utility may be serving competitive suppliers under short-term contracts a decade later.
- Customers who have moved from the utility service to a competitive supplier may have been served by the same resource in the past.
- Any particular competitive-supplier customer may be back on utility service and be served by the contract resource in the future.

Since all customers receive these benefits of long-term contracts, the cost-causation and beneficiary-pays concepts of cost allocation lead to the conclusion that all consumers, not just the customers that remain on the utility's power-supply service, should share in the net cost or credit for those contracts. For example, the Commission adopted an appropriate ratemaking approach in the case of Con Edison's long-term PPA with SCS Astoria Energy, in which any differential between contract prices and market prices is allocated to all consumers through the

⁹Based on those benefits, the Massachusetts DTE has concluded that reconciliation in utility power-supply costs (positive or negative) should flow to all customers (DTE 99-60-C).

wires charge. This approach should be retained for future long-term PPAs procured specifically for purposes of market improvements.

Similarly, if Con Edison procures additional inter-regional transmission capacity it will benefit all consumers in New York City, not just Con Edison's supply customers, and the costs legitimately should be passed through to all consumers. For example, LIPA's long-term transmission capacity contract for the Neptune Project benefits all consumers on Long Island.

The Independent power Producers of New York (at 5) cites the Commission's order in the NYSEG rate case, Case 05-E-1222, to support its position that hedging costs should "be allocated to only those customers that cause the costs incurred." However, in that case, the Commission was dealing with the treatment of short-term hedges for the stabilization of prices, associated with the "transition away from the utility-provided fixed price service [and] NYSEG's assumption of the role of the primary hedger in the market" (Case 05-E-1222 at 20). If competitive suppliers attract most of the customers of the utility, they can become the primary hedgers in the market, with respect to short-term power supply. Limiting cost recovery for short-term hedges to the PSS customers thus makes sense. Nevertheless, since competitive suppliers are unlikely to ever enter into truly long-term contracts, that function will continue to be borne by the utility (or some surrogate) for all customers, and the related costs and benefits should flow to all customers.

The Benefits of Hedging Utility Power Supply

Distinct from long-term contracts for market improvements, the purpose of hedging, in the form of shorter-term contracts setting prices months or years in advance, is to stabilize prices to consumers. To the extent that residual utility customers benefit from stable prices, the utilities should have broad discretion to hedge their supply portfolios. A significant majority of the comments submitted by other parties, including the utilities, supports this position.

Hedging, such as contracts for power supply over months or years, does not increase the expected cost of power. Central Hudson notes (at 14) that its hedging, including long-term purchases, "has been dramatically in customers' favor."

In August 2004 the Commission, in its “Statement of Policy on Further Steps Towards Competition in Retail Energy Markets” (Case 00-M-0504) noted,

new supply contracts should focus on mitigating price volatility. Over time and commensurate with wholesale and retail market development, we expect utility hedging to be eliminated, but it should not be abandoned for a customer class until equivalent rate services and plans are generally available to all customers in the class.

Several commenters refer to this Commission Policy Statement as though it implied that hedging should now be restricted (e.g., National Grid at 2–4, SCMC at 4, Con Edison at 1–2). The Commission has long expressed its hope that the competitive market will provide power-supply services equivalent to the best that the utilities can provide their customers. If that condition had been met, there would be power-supply offers as attractive in cost and stability for all customer classes, and a large fraction of each class would have switched to taking generation service from competitive suppliers. As demonstrated in the following table, which summarizes current migration levels, these conditions have been met only for the largest customers. Indeed, given the costs of acquiring and dealing with residential and small commercial customers, it is not clear that competitive suppliers will ever be able to serve those small customers as efficiently as the utilities can.¹⁰

¹⁰The Small Customer Marketing Coalition (at 14–17) suggests that hedging is inherently much more expensive for competitive suppliers than for utilities. Hence, competitive suppliers may never be able to provide the services desired by many customers as efficiently as utilities.

Percentage of Customers Served by Competitive Suppliers, September 2006

Utility	U	Total		Non-Residential Large TOU		Non-Residential Small & Street LGT		Residential	
		Customer Accounts	Sales	Customer Accounts	Sales	Customer Accounts	Sales	Customer Accounts	Sales
CH		1.6	2	48.3	8		2		1
G&E		%	8.8%	%	2.8%	4.3%	0.6%	1.1%	.2%
Con Edison		1	4	82.2	8	18.6	4		9
Edison		0.1%	3.0%	%	9.9%	%	6.8%	8.7%	.2%
NY		9.0	4	70.6	6	22.4	5		8
SEG		%	2.0%	%	6.5%	%	6.2%	7.3%	.4%
Nat'l		8.	3	49.3	6	21.2	4		8
Grid		8%	6.8%	%	8.6%	%	5.4%	6.6%	.3%
O&		29.	3	21.1	3	32.3	4	29.3	3
RU		7%	7.7%	%	8.0%	%	5.0%	%	1.2%
RG		21.	5	68.0	6	40.4	6	18.7	3
&E		2%	4.1%	%	1.3%	%	8.3%	%	1.9%

Source: NYDPS, New York State Electric Retail Access Migration Reports, September 2006

While Con Edison (at 3, note 6) claims that “Con Edison serves about 50% of the total electric load in its service territory,” this value includes the long-standing NYPA and municipal power-supply arrangements. Con Edison actually provides generation services to a majority of its traditional load and the vast majority of its customers. If, at some point, competitive suppliers demonstrate the ability to meet utility generation prices and terms for small customers, the Commission can decide to phase out the hedging of generation supply, or to provide the residual utility generation load with less-volatile hedged power.

Some commenters suggest that the mere offer of competitive generation service is sufficient evidence of an adequate competitive market. For example, Con Edison (at 4) defines “adequate market alternatives” as “competitive suppliers that offer fixed price or hedged alternatives.” This approach ignores the cost of the service. If competitive suppliers were to charge 10% or 20% more than the utility for comparable services, abandoning the utility service would impose massive costs on consumers and the state’s economy.

As Consumer Power Advocates explains (at 1), “retail access has always been promoted on the basis of increasing customers’ choices, but that implies that those choices would be *better* choices, not the false choice of exposure to unnecessary risk.”

The Small Customer Marketing Coalition has a seemingly contradictory position on utility hedging, since it acknowledges that utilities are inherently better able to hedge than competitive suppliers (at 14–19), but opposes utility hedging (at 4 and elsewhere), but wants competitive suppliers customers to participate in whatever utility hedging occurs (at 20–25).

Customers should move to competitive suppliers when the suppliers demonstrate efficiency and creativity, providing services equivalent to or better than utility service. Consumers should not be forced into a marketplace of misery by regulatory mandates that make utility service unpalatable. The years since the Policy Statement have demonstrated the volatility of market prices and the need for enhancing, not reducing, hedging of power-supply costs.

Procurement Process

The full-requirements approach to power supply discussed by Constellation (at 2–3) and NRG (at 7–8) works well elsewhere, and may be preferable for relatively small utilities (such as CHG&E). However, it is not clear that it is superior to the existing procurement approaches of the large New York utilities.

Even if some utilities move towards procurement of standardized products (full-requirements, round-the-clock energy, etc.), the City does not believe that the declining-clock auction advocated by PSEG (at 3) and mentioned by FPL (at 5–6) would have any advantages over the RFP solicitations similar to those used in Maryland, Connecticut, Maine, Massachusetts, and elsewhere, and described generally in the IPPNY comments (at 4) and FPL (at 6–8). Declining-clock auctions raise additional issues. They are subject to gaming by bidders, can be difficult to review, and are expensive to administer.

Transparency

Con Edison argues (at 11) that utility “hedge practices should remain a trade secret. Disclosing utility hedge practices would allow all interested wholesale market participants to buy or sell positions before the utility attempted to do the same, impairing the financial results of the utility’s hedge program and increasing full-service customers’ costs.” The City is puzzled by these assertions, since most restructured utilities in the Northeast have public hedging strategies, consisting of

fixed patterns of purchases for annual or multi-year full-requirements contracts. This is true for Maine, Massachusetts, Connecticut, Rhode Island, New Jersey, Maryland, Delaware, and the District of Columbia. None of these states have reported problems with other wholesale market participants having adverse effects on the financial results of the utility's hedge program. Con Edison's concern seems excessive.¹¹

The utilities should provide two types of information on its hedging strategy. First, to allow customers to select between utility and competitive power-supply services, the utility should provide information on how much of its supply has been procured, and the prices it expects to charge, for at least the next year. Currently, if a competitive supplier offers a Con Edison customer a particular contract (e.g., 10¢/kWh for the next year, or the average of 9¢/kWh and the monthly spot price) in December 2006, the customer has no way of knowing what the actual Con Edison comparable Market Supply Charge might be past January 2007, or even how large the adjustments to the January MSC might be. More information would be conducive to informed competition.

Second, competitive suppliers and other market participants should be informed of the nature and length of the utility's long-term contracts. Exact contract terms need not be revealed, but information related to the likely operation of the resource (including the owner's incentive under the PPA) should be available.

Procedural Issues

One of the immediate issues facing the Commission is how to proceed in developing power-procurement strategies and overseeing implementation. Con Edison (at 4) urges that "The Commission should provide broad guidance and then work with each utility on a case-by-case basis given the differences in their service

¹¹The same is true for CHG&E's concern (at 7) that procurement guidelines would somehow "cause counter-party market participants to alter their pricing strategies to bake higher profit levels into products that would appear to be favored by the guidelines, on the premise that utilities would be driven to those products by the guidelines." It is not clear how CHG&E thinks this could happen, especially were CHG&E correct in its sweeping pronouncement that NYISO markets are competitive.

territories, customer bases, and rate structures, among other factors.” The City suggests that the Commission start by instructing each utility to work with Staff and representatives of their major customer groups in developing proposed strategies and mechanisms.

This process might resemble the collaboratives proposed by IPPNY (at 6), although competitive suppliers, generators and other non-customer market participants would be limited to the role of technical advisors. The collaboration would result in a joint filing with the Commission, supplemented by filings by the individual parties where consensus cannot be reached. The purpose would be to clarify technical issues and present the Commission with a small set of policy decisions.

While Con Edison recognizes that it needs outside assistance in developing procurement strategies, not all utilities are so humble. CHG&E describes its efforts to procure power in a manner that will “deliver customer satisfaction” (at 3), the importance of “the engagement and exercise of management’s expertise...to deliver services and products satisfying its customers’ preferences” (at 5), to deliver “what the utility’s customers desire, not regulatory guidelines developed generically and remotely from customers’ preferences” (at 6). The Company asks that it be “free to determine and provide the kinds and degrees of price mitigation that its various groups of customers desire” (at 7), and that it, and not the Commission, “should be free to determine the kinds and degrees of price mitigation that [its] customers may prefer” (at 9) and “identify and respond to customer preferences” (at 16). Central Hudson apparently believes that it is in the best position to know what customers want. CHG&E is silent as to the source of its expertise, but some form of consultative process with the representatives of its customers would seem to be useful in determine what they want and how do demonstrate that the utility is providing it.

As CHG&E notes, the market for risk management techniques and processes may change, and the Commission should not preclude adjustment of procurement strategies as the market evolves.

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Respectfully submitted,

/s/ Paul Chernick

Paul Chernick
President, Resource Insight
5 Water Street
Arlington, MA 02476
Phone: (617) 864-9200
Fax: (781) 646-1506
pchernick@resourceinsight.com

/s/ Michael J. Delaney

Michael J. Delaney, Esq.
Vice President-Energy
New York City Economic
Development Corporation
110 William Street, 4th Floor
New York, New York 10038
Phone: (212) 312-3787
Fax: (212) 312-3915
mdelaney@nycedc.com