

# Public Utility Law Project of New York, Inc.

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December 11, 2006

Hon. Jaclyn A. Brillling  
Secretary  
NYS Public Service Commission  
Three Empire State Plaza  
Albany, New York 12223-1350

Re: 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.

Dear Secretary Brillling:

The Public Utility Law Project (“PULP” or “Project”) is a not-for-profit legal services organization which has appeared in numerous matters before the Public Service Commission representing the interests of low income residential ratepayers on gas, electricity, and telephone issues. In response to the Commission’s August 28, 2006 Order Instituting Proceeding and Notice Soliciting Comments (“August 28 Notice”) in this case, PULP filed on November 17, 2006 its initial comments on seven questions which were set forth explicitly in this notice. We provide this letter in accordance with the August 28 Notice to set forth our comments in response to the comments of other parties that were also filed on or about November 17.

At the outset, PULP has identified several conclusions drawn in its initial comments that should be restated in response to the comments submitted by others. First, PULP’s November 17 comments emphasized distribution utilities that provided measurable consumer benefits through their commodity purchasing practices should not be restrained from using these strategies simply to “protect” the “competitive market”. PULP comments at 4. Several comments of several other parties suggest that this priority should be reversed and that the “competitive market” must be protected from utility hedging practices even if the distribution utility could actually be saving consumers’ money. As in its initial comments, PULP argues strongly that the test of whether a particular distribution utility commodity purchasing

strategy should be encouraged is whether the practice is saving consumers' money. If it is, the implementation of that strategy can not be trumped, and consumers deprived of this benefit merely because of the impact it may have on the operations of the "competitive market".

Second, several commenters have suggested that the provision of a hedged price to residential consumers deprives them of an economically useful price signal when prices spike. As PULP described in its comments and wishes to reemphasize here, a volatile commodity price could lead to consumer investment decisions that are inconsistent with the medium and long term price signals in the energy market. PULP comments at 4-5. When this occurs efficient investments are not pursued by consumers and the overall performance of the market is degraded.

Third, some commenters continue to attack utility hedging practices because these practices increase consumer costs in comparison, over the long run, with unhedged prices. As PULP has emphasized in its comments, the utility hedged product is not the same product as the unhedged utility supply. Accordingly, there is no reason to expect the prices to be comparable. The hedged product offers the customer price stability which the unhedged product does not. This characteristic has value to the customer and should be reflected in an incrementally higher price. The correct comparison is between the distribution utility's hedged product and the hedged product offered by ESCOs. If, in this comparison, the distribution utility's hedged product is cheaper, there is no reason to deprive the consumer of this benefit.

Fourth, several comments have used the comment process as a platform to advocate for PSC supervised auction processes as the preferred means that the utility should use to acquire the commodity it sells to its customers. Of course the Commission will recognize that this question – whether and to what extent the utility should or may use an auction process to acquire commodity which will be resold to its customers – is far beyond the scope of the commission's questions and of this proceeding.<sup>1</sup> PULP reemphasizes in these reply comments the shortcomings of the highly abbreviated processes being used here. The processes in set forth in the August 28 Notice are, in PULP's view, insufficient to address the complicated issues raised by utility hedging, and, a fortiori, grossly insufficient to address commodity auctions such as are being described by other commenters.

Length of hedge vs. length of contracts used to create hedge. As at least one party points out the length of the utility planning cycle – the length of the hedge – is different from and not completely described by the length of the contract obligations the utility could create to

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<sup>1</sup> Indeed, beyond the question of whether utility commodity auctions should be used to purchase commodity, there are a myriad of questions that would have to be raised in order to even begin to understand the implications for consumers. For example, how would the auction be structured? Are there other jurisdictions in the United States using auctions for this purpose? How are these jurisdictions similar to or different from New York? Are these auctions used to purchase all or only some of the needed commodity? How is that proportion determined? Are utility affiliates permitted to participate in the auctions? Are there other types of suppliers or middlemen prohibited from participating? What are the market rules? Who defines the market rules? What enforcement provisions are available in the event of a market abuse? Who administers the auction to assure that a fair price is obtained? Can all bids be rejected? Who defines the characteristics of the products actually being sold in the auction? These issues and many more would have to be understood and resolved before a formal auction market could be instituted to make these utility purchases.

execute its hedging plans. In short, a utility's long term contract could extend for several years, even though consumer prices are hedged on an annual basis and could change from year to year. In PULP's view and as stated in our initial comments, the price stability resulting from the utility hedge should be longer than the intermittent price spikes that occur during a heating season or a capability period. This price stability need not, however, provide a multiyear price freeze. Indeed, even if the utility hedge were intended to provide price stability over a year, the existence of the hedge should not actually "freeze" prices and prevent all price changes in that period. A well designed hedge would allow some long term price effects to be reflected in the hedged price so that the transition from one hedged period to the next would be less discontinuous.<sup>2</sup>

Under-market contracts. The comments of at least one generator (FPL Energy, LLC at p. 4), suggest that below market supply agreements that a utility may make and flow through to customers would be detrimental to consumers. PULP strongly disagrees with this conclusion. Even under a pure market theory, the resource optimizing function of the market is only achieved if consumers actually get their commodity at the lowest price possible. If a below market price is available to the consumer, market efficiency can only be achieved if the consumer takes that price in preference to the "market" price that otherwise could prevail.

Notions of "market liquidity", *i.e.*, the movement of customers from one supplier to another, which FPL invokes in support of its condemnation of under-market contracts is plainly misplaced. Indeed, the opportunity for the consumer to move to the lowest cost provider for the service that it seeks is the hallmark of "market liquidity". If the more attractive offer comes from the utility, rather than an ESCO, because the utility has obtained "under-market" supply arrangements, any restrictions that prevent the consumer from obtaining the benefits that can be offered because of the utility's purchase are actually a restriction on market liquidity and unrepresentative of the consumer's best interests.

Budget billing. Intelligent Energy, Direct Energy Services and other commenters in this proceeding have suggested that "budget billing" is in some fashion equally as protective of consumers as and a substitute for a hedged utility commodity product. Plainly, this is not true.

On the most basic level, each residential customer's bill is calculated based on the price and quantity for the commodity supplied to the customer during the applicable billing period. To the extent that price and quantity are constant from month to month, the customer's bill will also be constant or fixed from billing period to billing period. To the extent that either the customer's usage or the price offered to the customer changes from month to month, then the customer's bill will also fluctuate. For the customer to avoid these bill fluctuations, he or she must avoid changes in both price and quantity. Budget billing was intended to and is capable of addressing fluctuations in the customer's usage. It was in not

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<sup>2</sup> One method for reflecting long term price changes in the utility's hedged price is to include long term contracts as part of the overall supply portfolio. In other words, contracts longer than one year are useful additions to the utility portfolio – even though the portfolio goal is simply to moderate price changes over, for example, a one year period - because they will bring to the portfolio price some of the long term commodity price changes. A well constructed portfolio would have some long term supply arrangements and a portion of that portfolio segment would expire (and be replaced by similarly long term supplies) each year.

intended and is ineffective in eliminating the bill fluctuations associated with month to month price changes.

Budget billing (or levelized payment plans) are offered to residential electric and gas customers in accordance with PSL § 38 which requires “[e]very utility corporation or municipality shall offer residential customers a budget billing plan or levelized payment plan for payment of charges for gas or electric service.”<sup>3</sup> In its regulations, the Commission repeats this requirement and states that “[t]he plan shall be designed to reduce fluctuations in customers’ bills due to seasonal patterns of consumption.” The regulations do not say that utility budget billing plans under PSL § 38 are intended to reduce price related fluctuations in bills. In light of this regulatory guidance, it is hardly remarkable that utility budget billing plans do not provide bill stability for customers exposed to price variability.

For the distribution utilities, the applicable budget billing (or levelized payment) plans are set forth in their tariffs.<sup>4</sup> As these tariffs make clear, there is no intent in the implementation of levelized billing plans to allow the customer the opportunity to smooth or moderate the bill impacts of price variability. Indeed, the companies may expressly reserves the right to make changes in the budget billing schedule of payments based on “known or projected” changes in the price of commodity. By definition, this is not providing an unhedged, market price.

Finally, implicit in any hedged price offer is the possibility that, at some future time while the offer is in effect, the commodity price in the market will differ from the commodity price underlying the fixed price offer. The shifting of the risk associated with such a market shift is a key element of any hedged price offer. With these offers, the customer likely pays some premium in price in order to shift the risk of higher prices to his or her seller. Budget billing, however, was not intended to and does not provide a shift in the risk from market fluctuations. Because there is no shift in risk, the budget billing option is simply not a substitute for the distribution utility’s (or for the ESCO’s) hedged price offer.

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<sup>3</sup> Under PSL § 38, every distribution utility and ESCO is required to offer any residential customer a budget billing plan. The nature of the plans are set forth in 16 NYCRR § 11.11. Under the statute and the regulations there is no difference between the requirements for the budget billing plan that must be offered by the distribution utility to its customers and for the plan that must be offered by the ESCO to its customers.

<sup>4</sup> As an example, the provisions to describe the Central Hudson plan are as follows:

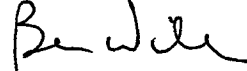
The customer’s annual billing will be estimated at the applicable unit prices for estimated usage in the preceding 12 months. The customer will be “budget” billed each month for 12 months an amount equal to one-twelfth of such estimated annual billing.

During the budget year the customer’s actual usage will be billed regularly under the applicable service classification. If at the end of the 12 months the amount of the budget billing is less than that corresponding to the amount resulting from the regular billing under the applicable service classification of the customer’s actual usage, then the customer shall pay the deficiency. If the amount of the budget billing is greater than such regular billing, the company will apply the excess as credit against future bills.

In order to minimize the amount of over or under payment to be adjusted on the customer’s twelfth (final) bill of the budget year, the Company will, at the end of six months, review the budget balance and, based upon known and/or projected rates, adjustments, and usage, reestimate the remaining bills. The Company will also review the budget balance if basic rates, adjustments, or usage changes occur at other times during the budget year. Either of these reviews can result in mandatory revisions to the stipulated monthly budget payment.

In conclusion and in accordance PULP's earlier comments, we urge the Commission to undertake more conscientious and detailed examination of the benefits which are currently unavailable to residential gas and electric customers because of the Commission's policies discouraging or prohibiting distribution utility hedged price service offers. At the conclusion of that study, PULP urges the Commission to reinstitute the availability of such offers.

Very truly yours,



Ben Wiles

Cc: All parties  
Secretary (original and ten copies)