

**STATE OF NEW YORK
PUBLIC SERVICE COMMISSION**

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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 :
: :
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**INITIAL BRIEF OF
THE NATIONAL ENERGY MARKETERS ASSOCIATION**

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This Initial Brief is submitted by The National Energy Marketers Association (NEM) in the above-referenced proceeding, as provided for in the Note of the Administrative Law Judges dated March 16, 2001.

I. Process

In its Order Instituting Proceeding in the instant matter, the Commission directed that a collaborative process be utilized to examine the, "future state of the gas and electricity industries in New York and the role of the regulated utilities, including provider of last resort and related issues. . . . [and] to better understand the specific constraints on or obstacles to market development that may now exist, along with policy options for their removal."¹ The Commission requested, "recommendations for guiding transition to the end-state market."²

As a result of the collaborative process, the "Concepts, Issues and Views of the Future: Report on the Parties' Collaborative Efforts," was developed. The Report discusses three models for the industry end-state: Model 1: utility remains in the commodity and retail business; Model 2: utility exits the commodity function; and Model 3: utility exits the retail and commodity functions.³

¹ Case 00-M-0504, Order Instituting Proceeding, issued and effective March 21, 2000, page 4.

² Id.

³ Case 00-M-0504, Concepts, Issues and Views of the Future: Report on the Parties' Collaborative Efforts, dated April 3, 2001, pages 14-21.

The parties also commented on a strawman proposal developed by Staff to serve as framework for reaching consensus. Finally, the ALJs requested briefs on whether the Commission may direct the utilities to cease providing commodity service and whether the Commission may require that customers be switched from utility service to that of ESCOs. It is within this context that this brief is submitted.

II. Vision

1. In creating a vision of the future energy markets, should we choose a model for the end-state or adopt a more generalized standard?

NEM cannot overstate the costs and the risks (price, financial and political) that are being imposed on competitive suppliers and onto NY consumers by the multiple, concurrent "piecemeal" resolutions to the fundamental issues surrounding the exit of utilities from the merchant function and the separation of natural monopoly functions from functions that can clearly be outsourced and provided on a competitive basis. The longer it takes and the more and more bifurcated the restructuring issues, the higher the costs that NY consumers will be forced to pay for energy.

NEM asserts that in the long term, all consumers in restructured energy markets should be served by energy service providers at competitive prices, and it is desirable to get to that end state as quickly as possible.

Furthermore, it is imperative to set a date certain by which to complete the transition to a competitive market. The longer it takes to implement competitively restructured energy markets, the higher energy costs will be. Investment capital must have both political and financial certainty in order to be competitively deployed for the benefit of New York consumers.

Attendant with the examination of industry end-state models is an analysis of the provider of last resort function. NEM asserts that the POLR function can and should be a competitively bid function and should reflect all of the political, social and reliability concerns of providing Last Resort service.

2. Should the concepts underlying the Gas Policy Statement (Cases 93-G-0932, 97-G-1380, issued November 3, 1998) be adopted for electricity?

The concepts set forth by the Commission in the Gas Policy Statement were as follows:

The most effective way to establish a competitive market in gas supply is for local distribution companies to cease selling gas.

Without separation of the monopoly gas distribution function and the competitive merchant function the LDCs would likely remain dominant providers. The elimination of regulated LDC merchants would also address "level playing field" issues between LDCs and marketers. Thus, separation of the LDC distribution function from the competitive merchant function would maximize competition and customer benefits. Additionally, the regulation of a competitive function should be unnecessary.⁴

NEM strongly supports a bottom-up approach to unbundling and applauds the Commission's efforts and recognition of the need for such an approach in its recent Order.⁵ As every utility in the state discloses a breakout of each cost center the marketplace will have a fully transparent understanding of what each consumer is paying for each product and service that is currently bundled in regulated rates.

In the transition, utility services must be priced in such a way as to accomplish the same result. Until such a full bottoms-up zero rate base analysis is completed, each NY consumer should be given a shopping credit equal to the fully embedded costs of each competitive product, or service currently bundled in regulated rates so they can shop for a better rate from competitive suppliers. Consumers should not be forced to pay monopoly rents associated with competitive services.⁶ The sooner each NY resident is given shopping credits equal to their current monopoly prices to shop for competitive services, savings are possible and likely.⁷

**3. Should utilities be allowed to remain in markets that become competitive?
If yes, are there ratemaking consequences regarding the monopoly versus competitive services the regulated utility is supplying?
If no, how and when should they be removed?**

The state should not grant utilities a monopoly or competitive advantage to provide competitive products, services, information and technology. Utilities should perform solely natural monopoly functions. Essentially, regulated utilities

⁴ Cases 93-G-0932 and 97-G-1380, Policy Statement Concerning the Future of the Natural Gas Industry in New York State and Order Terminating Capacity Assignment, issued and effective November 3, 1998, page 4.

⁵ Case 00-M-0504, Order Directing Expedited Consideration of Rate Unbundling, issued and effective March 29, 2001.

⁶ Consumer shopping credits should include the full costs of competitive products, services, information and technology required to serve retail customers that are currently included in utilities' rates. For example, a list of such costs, that is by no means exhaustive, includes the cost of procuring energy; installed capacity (on kWh basis); transmission and ancillary services; retail load shape factor costs; costs of risk management; scheduling costs; pool operating costs; transmission and distribution system line losses; costs of load forecasting; environmental disclosure; costs of negotiating and managing supply contracts; costs of regulatory compliance and litigation; taxes; administrative and general costs; customer service; billing; bad debt; collections; marketing; and a competitive return on risk capital.

⁷ See attached article entitled, "Energy Policies for the 21st Century," by Craig G. Goodman, Energy Markets, April 2001, Page 70.

should sell regulated distribution services on a "no frills" cost of service basis. Regulations, tariff structures, interconnection rules, back up rates and operational protocols should be designed to permit competitive, non-utility suppliers to provide each of the products, services, information and technology that are not natural monopoly functions.

NEM asserts that at a minimum, the following services can be opened immediately to competition: supplying energy and related products, services, information and technology, last resort services, customer care, billing and metering, energy peaking, distributed generation, storage and imbalance services, on-site generation, demand side management and all manner of efficiency products and services.

4. Should the telephone model - that is, the obligation to serve and the application of telephone consumer protections to all competitors - be adopted in the energy markets in the end-state?

Historically, utilities have been given a regulated return on capital in exchange for an "obligation to serve" the public. Historically, this obligation has encompassed what is recognized in the context of a restructured utility industry to be many services: the supply of natural gas or electricity (referred to jointly throughout this paper as energy), the transportation or distribution of that energy, billing, metering, balancing and all manner of peripheral products, services, information and technologies. NEM submits that in a competitively restructured market the obligation to serve should be converted into an obligation to connect and deliver. That is, while the utility should and will continue to provide transportation services for all customers, it is not in the public interest for the state to continue to grant franchise monopolies or competitive advantages to monopolies to supply products, services, information and technologies that are in fact competitive businesses.

III. Market Transition

1. Should commodity ratemaking mechanisms, especially regarding hedging, differ for small and large utility customers in the near term? For example, should greater hedging be provided for small customers and less or none for large customers?

NEM is concerned about the effect that ratemaking mechanisms which provide greater hedging for small customers and pass-through of hourly market electricity prices for large customers will have on the development of the competitive market. Incumbent utilities have relationships with large customers that prevent effective competition. NEM asserts that a competitively restructured energy market should transfer real-time rate and usage information to customers so that they can make decisions about their consumption. Ownership and access to meters and usage data should not be considered a natural monopoly function

exclusive to the utility. Customers and their competitive suppliers must have real time access to consumption data in order to implement price-responsive products and services. Regulatory certainty as to the timing and terms of the transition to a restructured market will permit competitive suppliers to offer fixed price contracts to even the smallest customers and hedge accordingly.

2. Should the approach taken in Gas Policy Statement on hedging (Case 97-G-0600, issued March 28, 1998) be adopted for electricity?

The Commission concluded in its Statement of Policy regarding Gas Purchasing Practices that:

Local distribution companies have many ways to meet their loads; they should consider all the available options for purchasing gas and assess the benefits of each approach. Options may include short or longer term fixed price purchases, spot acquisitions, the use of financial hedges, and contracts which provide for flexibility in the amount of gas taken over the term of the agreement. . . . Any utility without a diversified gas pricing strategy will have to meet a heavy burden to demonstrate that its approach is reasonable.⁸

NEM agrees that hedging should be a part of the portfolio of any energy supplier. However, when utilities exit the merchant function, then this function can be furnished by the competitive market. In a competitive market, unregulated entities must take all forms of risk to succeed and profit. In fact, the Commission in the Hedging Policy Statement discussed that, "[a]s to positions relative to competitors, it appears that marketers, unlike most LDCs, are making substantial use of strategies to mitigate price volatility."⁹ Furthermore with respect to the Provider of Last Resort function a hedging requirement as well as a reserve requirement can be included as part of the request for competitive proposals.

IV. Public Benefit Programs

- 1. Should the relative allocation of NYPA residential hydropower benefits be examined as a potential source of inexpensive power for a lifeline rate (or for other use in a low-income program)?**
- 2. Should a Public Benefit Programs Council, similar to the Competition Council described in the second straw proposal, be created during the transition to competitive markets to facilitate coordination of low-income**

⁸ Case 97-G-0600, Statement of Policy Regarding Gas Purchasing Practices, issued and effective April 28, 1998, pages 4-5.

⁹ Id. at page 4.

and other public benefit programs and/or to provide advise on future programs?

The 1970s demonstrated that price and allocation rules do not work and indeed exacerbate the problem. NEM supports the proposition that market-based solutions such as super-aggregation can and should be utilized to the maximum extent possible to address the needs of low-income consumers effectively and to allow low-income customers access to lower prices in the most efficient way possible. Programs could be developed that bid out aggregated low income groups either as part of POLR service or a separate service. It is important, however, that POLR service, as a whole, not be designated as a subsidized rate in order to address low income concerns. A subsidized POLR service would both undermine competition and unnecessarily increase the cost of providing assistance to low income individuals. To date, other industries have delivered as much as 50% savings to consumers and there are few, if any, government-funded programs that could have delivered such savings to low income groups.

V. Public Input and Outreach

VI. Conclusion

NEM urges the Commission to adopt an industry end-state model that defines the role of utilities to provide only those functions that are natural monopoly functions and that allows all other products, services, information and technology to be provided by competitive suppliers. Additionally, such a model should be implemented expeditiously by a date certain to provide investment certainty and to maximize the benefits of price competition to consumers.

Respectfully submitted,

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