

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a Session of the Public Service
Commission held in the City of
Albany on August 23, 2006

COMMISSIONERS PRESENT:

William M. Flynn, Chairman
Patricia L. Acampora
Maureen F. Harris
Robert E. Curry, Jr.
Cheryl A. Buley

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.

ORDER INSTITUTING PROCEEDING
AND NOTICE SOLICITING COMMENTS

(Issued and Effective August 28, 2006)

BY THE COMMISSION:

BACKGROUND

The role of competitive markets in the provision of
energy commodity supply services to retail customers was
recently considered in the Retail Market Policy Statement.¹

There, it was decided that:

The provision of safe, adequate, and reliable
gas and electric service at just and reasonable
prices is the primary goal. Competitive
markets, where feasible, are the preferred means
of promoting efficient energy services, and are
well suited to deliver just and reasonable

¹ Case 00-M-0504, Development of Retail Competitive
Opportunities, Statement of Policy on Further Steps Towards
Competition in Retail Energy Markets (issued August 25, 2004).

prices, while also providing customers with the benefit of greater choice, value and innovation. Regulatory involvement will be tailored to reflect the competitiveness of the market.²

The means for achieving that vision, and for transitioning to more competitive markets, were addressed extensively in the Retail Market Policy Statement. It was decided that, in the near term, utilities should maintain a balanced commodity supply portfolio -- characterized as neither 0% nor 100% hedged -- for serving residential and small commercial and industrial (C&I) customers.³ Larger C&I customers would be increasingly exposed to spot market pricing,⁴ a policy subsequently implemented in Case 03-E-0641,⁵ where tariffs for hourly pricing, a form of spot market pricing, were developed.

Issues affecting implementation of the utility commodity service policies for residential and small C&I customers were analyzed in the Retail Market Policy Statement. It was noted that protecting residential and small C&I customers against wide swings in energy spot market prices could be accomplished through supply portfolio management practices. While, over time, it was expected that the hedging activities undertaken in managing those portfolios could be eliminated as competitive markets developed, utilities were to continue hedging for any particular customer class until adequate rates

² Retail Market Policy Statement, pp. 18-19.

³ Retail Market Policy Statement, pp. 29-33.

⁴ Retail Market Policy Statement, pp. 32-34.

⁵ Case 03-E-0641, Mandatory Hourly Pricing, Order Denying Petitions For Rehearing and Clarification in Part and Adopting Mandatory Hourly Pricing Requirements (issued April 24, 2006).

and services were generally available to all customers of that class in the competitive market.⁶

It was noted in the Retail Market Policy Statement that price volatility mitigation measures for gas customers were in place on a more uniform basis than for electric customers. As discussed in the Gas Purchasing Policy Statement,⁷ gas utilities make significant use of storage, with storage facilities filled during spring and summer months when prices are typically lower, for later withdrawal to meet winter demand. Consequently, storage acts as a hedge against winter price volatility. Moreover, the Gas Purchasing Policy Statement reaffirmed earlier requirements obligating gas utilities to review their gas procurement practices and develop acquisition strategies, defined in guidelines the utility would develop for itself, that foster price stability.⁸ Gas utilities have been allowed to recover the costs of this hedging, including gains and losses on the value of the hedges, through the gas adjustment charge imposed on commodity customers.⁹ All firm utility gas customers, regardless of size, that take commodity from the utility do so at a mitigated price.

In comparison, many electric utilities continue to purchase electric supply under long-term contracts with independent power producers and the new owners of generating facilities that purchased those facilities from the utilities

⁶ Retail Market Policy Statement, pp. 32-35.

⁷ Case 97-G-0600, Gas Cost Volatility and Gas Purchasing Mechanisms, Statement of Policy Regarding Gas Purchasing Practices (issued April 28, 1998).

⁸ Case 97-G-0600, supra, Order Requiring the Filing of Proposals to Ameliorate Gas Price Volatility and Requesting Comments (issued June 7, 1997).

⁹ 16 NYCRR §720.65(d)(6).

upon divestiture. Those contracts, generally entered into prior to issuance of the Retail Market Policy Statement, act as multi-year hedges.

Moreover, electric utilities have executed varying hedging strategies, which have been monitored by Department of Public Service Staff (Staff), for the benefit of utility-selected classes of customers. It has been expected that the utilities will continually review the need for hedges, using mitigation of customer bill volatility as one of their criteria in making supply purchasing decisions, and taking into account changing circumstances, such as the expiration of the long-term contracts. The utilities have recovered the costs of hedging strategies, as well as the gains and losses on the hedges, through a variety of different charges and adjustment mechanisms, some imposed on only commodity customers and others collected from all customers through delivery bills.

The Retail Market Policy Statement prescribed that the state of energy markets be monitored, as those markets evolved and matured. Utility supply portfolio management policies could then be adjusted to conform to the circumstances present in a particular market at any given time. It appears that gas utility hedging practices are working well, albeit there are a few areas where existing practices might be improved upon. It appears that electric utility hedging practices deviate substantially among the utilities, with varying impacts on their customers and on the development of wholesale and retail competitive markets. To address those impacts, guidelines on supply portfolio management strategies should be developed for electric utilities.

DISCUSSION AND CONCLUSION

The ongoing implementation of hedging and other policies for the protection of residential and small C&I electric customers has raised issues in several recent rate proceedings,¹⁰ where parties have disputed the proper approach to formulating mechanisms for the recovery of commodity-related costs, including the costs of hedging arrangements, and the effects of hedging practices on customers and the development of competitive electricity markets. Similarly, in the recently-issued O&R Market Pricing Order, the utility was directed to modify its methodologies for calculating and posting the prices it actually charges electric commodity customers.¹¹

Of particular interest are disagreements in these proceedings over disclosure of utility supply portfolio price information. As discussed in the Retail Market Policy Statement, some degree of utility commodity price transparency is necessary if competitive retail commodity markets are to function properly. Customers and market participants must be able to obtain the price information necessary for making intelligent price comparisons.¹² The proper means for the disclosure of such information is a gas, as well electric, market issue.

Given the issues that have arisen in recent rate proceedings, and the O&R Market Pricing Order, it appears that

¹⁰ Cases 05-E-0934 and 05-G-0935, Central Hudson Gas & Electric Corporation, Order Establishing Rate Plan (issued July 24, 2006); Case 05-E-1222, New York State Electric & Gas Corporation, Recommended Decision (issued June 9, 2006).

¹¹ Case 06-M-0003, Strategic Power Management, Inc., Order Denying Complaint In Part and Directing Tariff Filing (issued August 2, 2006). The approaches adopted in that Order were specific to O&R, and are subject to reconsideration here.

¹² Retail Policy Market Statement, pp. 35-36.

additional steps should be taken to guide electric utilities in implementing the hedging policies, practices and procedures appropriate to reasonably protect residential and small C&I commodity customers against market price volatility, without impeding the evolution and maturation of competitive retail and wholesale electric markets. Guidelines could assist electric utilities as they select among spot market and longer-term contractual or financial instrument options in structuring their supply portfolios.

Further proceedings are needed to more fully develop the requisite guidelines for electric utilities. Some questions pertaining to gas utility portfolio management practices also require consideration.

A number of issues arise in connection with the development of guidelines. Among these are:

- 1) the extent to which guidelines for electric utilities should constrain their discretion, or allow them to exercise flexibility, in structuring their supply portfolios, while recognizing the impact that utility purchasing activities might have on the functioning of competitive electric markets;
- 2) the balance between the level of electric commodity price mitigation needed to appropriately protect customers from volatility and the level of exposure to volatility needed to appropriately send reasonably accurate price signals to those customers;
- 3) whether an index is needed to measure electric price volatility, how to establish an index if one is needed, and how to guide electric utilities in the structuring of their supply portfolios to comport with the limits indicated by the index;
- 4) whether electric hedging costs and the values achieved through the hedges, above or below spot market prices, should be recovered through commodity mechanisms from only those customers taking commodity from the

electric utility, or should be recovered through delivery mechanisms from all customers;

- 5) the cost elements that should comprise electric commodity charges to customers;¹³
- 6) for both gas and electric utilities, the length of the time period over which utilities should execute longer-term supply portfolio management strategies to mitigate volatility; and,
- 7) the appropriate level of gas and electric utility supply portfolio information that should be revealed to the public to promote price transparency, and the timing, process and procedures for doing so.

Implementation of the policy guidance regarding utility supply purchasing and pricing practices that results from this proceeding may require complex calculations or development of detailed mechanisms and processes, which might vary somewhat by utility. While additional administrative proceedings might be needed to adequately define and decide these complexities, any such proceedings will be structured to efficaciously implement any hedging policies, practices or procedures that may be adopted here.

Interested parties are invited to submit an original and ten copies of their comments on the issues discussed above to the Secretary by October 30, 2006. Reply comments may be filed by November 20, 2006. Persons intending to file comments or wishing to receive copies of the comments that might be filed should notify the Secretary in writing no later than October 2, 2006, so that a list of Active Parties may be timely posted to our Web site.

¹³The intent is to arrive at a uniform list of cost components that should be included in the commodity charges billed to customers taking service from the utility.

The Commission orders:

1. A proceeding is instituted to consider the policies, practices and procedures, discussed in the body of this Order, for utility energy commodity service to residential and small commercial and industrial customers.

2. Interested parties may submit an original and ten copies of their comments by October 30, 2006, to Jaclyn A. Brillling, Secretary, Public Service Commission, Three Empire State Plaza, Albany, New York 12223-1350. Reply comments may be filed by November 20, 2006.

3. Persons intending to file comments or wishing to receive copies of the comments of others are invited to notify the Secretary in writing no later than October 2, 2006. A list of Active Parties for this proceeding will be posted to the Web site prior to October 30, 2006. Any person filing comments shall serve copies to that list of Active Parties.

4. The deadlines provided for in this Order and Notice may be extended as the Secretary may require.

5. This proceeding is continued.

By the Commission,

(SIGNED)

JACLYN A. BRILLING
Secretary