STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Policies, Practices and Procedures for	**)**	
Utility Commodity Supply Service to	**)**	**Case 06-M-1017**
Residential and Small Commercial and	**)**	
Industrial Customers	**)**	

PETITION FOR REHEARING AND CLARIFICATION OF THE NATIONAL ENERGY MARKETERS ASSOCIATION

The National Energy Marketers Association (NEM) hereby submits a Petition for Rehearing and Clarification of the Commission's April 19, 2007, Order [hereinafter "Order"] issued in the above-referenced proceeding. There is little question amongst the deregulated energy community that the New York Public Service Commission has emerged as a leader of progressive retail energy policies. NEM appreciates the thoughtful efforts of this Commission over the course of many years to implement competitive retail policies to facilitate the provision of energy choice to New York consumers. That having been said, NEM is concerned about the potential impacts on retail market development of certain aspects of the Order issued in this case. NEM urges the Commission to grant rehearing and/or clarification of the issues discussed herein to preserve the benefits that have been achieved for consumers thus far and to ensure that an environment continues to exist to provide those benefits in the future.

There appears to be a significant conflict between ratepayer-subsidized volatility mitigation measures and the public interest in accurate market prices to drive technology innovation and reduce demand. Also, ratepayers that subsidize monopoly risk-taking should be given full and fair disclosure of the actual costs and risks they are being forced

to bear. Accordingly, and as discussed in more detail herein, NEM respectfully requests that the Commission reform and/or clarify its Order consistent with the following:

1. Continued ratepayer subsidies of risk free utility hedging for mass market customers is contrary to Commission policy and significant advances achieved in competitive market development. If a utility decides to enter the commodity market, it should do so with shareholder risk capital. Utility hedging should begin to be progressively phased out for mass market customers given the achievements in retail market development;
2. To permit a utility to compete in an otherwise competitively risk-managed commodity market with all of its costs and risks borne by captive ratepayers is unquestionably anti-competitive and significantly disadvantages any investor who does not have access to risk-free capital.
3. Electric utility hedges, if permitted, should be of limited duration;
4. The purpose of volatility measurement standards should be explained; and
5. The gas and electric utilities should both be required to provide after-the-fact reporting of hedging activities.

1. Continued Ratepayer Subsidies of Utility Hedging Costs and Risks that are not Fully Disclosed to Mass Market Customers Are Contrary to Commission Policy and Significant Advances Achieved in Competitive Market Development

The Commission determined in the Order that, "Utility hedging for the benefit of mass market customers shall continue."[1] However, very few mass market customers really know how much premium they pay in their utility bills to provide a "risk free" means for a monopoly to maintain or grow its market share. How can price transparency be truly meaningful unless consumers can see real prices and create the demand for innovation, efficiencies and renewables in a competitively sustainable marketplace that avoids imposing higher regulatory costs and risks? Given a chance, investors will compete to provide current monopoly services. If utilities disclosed itemized embedded costs, others might provide the same services for a lower cost. That is why price transparency and

[1] Order at 12.

near real time price signals create the demand for the solutions. Good policy begets good results.

NEM submits that recent Commission findings on the growth in the competitiveness of the retail electric market for millions of consumers should be supported with renewed vigilance against unfair trade practices or anticompetitive market/rate structures. At a minimum, the Commission should be pleased that implementing best practices alone doubled the number of competitive suppliers serving New York State consumers.

In the Retail Policy Statement this Commission defined "workably competitive markets" as "retail and wholesale markets, uninfluenced by the potential or actual exercise of market power, where customers have a variety of supplier choices and the choice of a number of different products and services."[2] In August 2004 when the Retail Policy Statement was issued the Commission found that, "In each major service territory, there are at least three ESCOs providing electricity and five providing gas service; most service territories have many more."[3] On the specific subject of utility portfolio management and price volatility vis a vis residential and small commercial and industrial customers, the Commission committed to continue to monitor market development, "and as the markets continue to mature, we expect that the hedges providing price volatility protection for these customers will be allowed to expire as well."[4]

Recently, as part of its Order initiating Case 07-M-0458, this Commission made revised findings as to the state of competitive market development. These findings are quite impressive and a testament to the actions this Commission and supporting stakeholders

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[2] Case 00-M-0504, Retail Policy Statement, August 25, 2004, n. 21.

[3] Case 00-M-0504, Retail Policy Statement, August 25, 2004, page 13.

[4] Case 00-M-0504, Retail Policy Statement, August 25, 2004, page 35.

have taken to implement best practices to facilitate consumer migration. The Commission noted that,

> Currently, more than 100 ESCOs, including companies that are large and well-capitalized, are eligible to do business in New York. **In each of the service territories of the six major combined utilities, at least six electric and six gas ESCOs are actively serving customers. These ESCOs serve more than 1.3 million customer accounts, with about 40% of New York's electric usage and 46% of gas usage met by ESCOs or from other alternatives to utility supply. Competitive markets have continued to grow over the past year, with an overall statewide increase of about 44%** in the number of electric customer accounts moved to ESCOs (a 15% increase in load) and an 18% increase for gas customer account movement (a 4% increase in load). (emphasis added).
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> Mass market customers are trying retail access in increasing numbers. The highest retail access penetration rate for residential customers in a single service territory has reached 37%. Statewide, ESCOs now serve about 11% of the residential electric customer accounts in New York, with only one utility service territory falling substantially below the 10% figure. For gas customers, the statewide residential penetration rate is approaching 10% with migration below 1% at just two of the eleven gas companies offering retail access. **Over the past year, the statewide increase in residential electric customer movement is 55% (a 41% increase in load) and the increase in residential gas customer movement is 19% (albeit load decreased)**. These figures indicate that the retail energy marketplace is established in New York and is continuing to expand.[5] (emphasis added).

The Retail Policy Statement envisioned incenting utilities to reallocate credit, capital and resources into reliability and infrastructure upgrades. Risk management of volatile commodities and long term hedging strategies is clearly a function that requires risk capital invested expertly. Utilities have far greater public value transmitting and delivering energy than they do as commodity risk managers. The phasing out of utility hedging for mass market customers is clearly appropriate as competitive market

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[5] Case 07-M-0458, Order on Review of Retail Access Policies and Notice Soliciting Comments, April 24, 2007, pages 4-5.

development has progressed remarkably. This Commission, by its own findings, has recognized that market maturity has indeed continued since the issuance of the Retail Policy Statement. Accordingly, the decision to deepen the electric utilities entrenchment in the competitive merchant function by determining they should continue to engage in portfolio management services for mass market customers is inconsistent with the achievement of significant market development milestones.

At a minimum, the Commission should recognize that since the competitive retail market has continued to develop, consumers continue to be offered an increasing variety of price and service offerings, and ESCO market participation continues, that utility hedging should begin to be progressively phased out for mass market customers. The costs of utility hedging in the interim should be borne by utility shareholders, and the risks should be fully disclosed to ratepayers. Simply stated, the Commission itself created a record that strongly supports decreasing reliance on utility competitive commodity functions. The time is now to further enable utilities to exit the merchant function role, not to entangle them more deeply into that role.

2. The Impact of Utility Hedging is Unquestionably Anti-Competitive and Does Significantly Disadvantage Competitors

NEM strongly disagrees and believes the Commission was in error in its finding that, "The impact of a hedged utility commodity rate on the competitive market is not anti-competitive and does not significantly disadvantage competitors."[6] NEM submits that this finding is incorrect in at least two aspects. First, it presumes that the utilities are appropriately considered "competitors" to ESCOs in the retail commodity markets. In

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[6] Order at 13.

fact, a number of references throughout the Order seem to be premised on this faulty assumption. The Retail Policy Statement stated a clear preference that utilities, "be replaced by ESCOs when markets become workably competitive."[7] In essence, utilities should exit competitive supply-related functions over time and focus their resources on monopoly delivery services. During this transitional period, the utility should not be viewed as an ESCO competitor, nor should it be expected or required to increase its competitive supply-related functions to perform as an ESCO competitor. NEM urges the Commission not to further complicate the retail market transition or to penalize utilities that have prudently recognized the advantages of focusing on monopoly delivery functions. In sum, utilities should not be ESCO competitors. They should be ESCO allies and partners in realizing the benefits of competition for New York consumers. NEM urges the Commission not to create market constructs that place competitive products and services at a competitive disadvantage. Nor should the Commission create market constructs that prevent an ESCO-utility partnership from forming.

The second area warranting rehearing is the finding that utility hedging, "does not significantly disadvantage competitors." If a utility hedges 100% of its supplies and ratepayers pay 100% of the costs, then a regulated monopoly is permitted to maintain or grow its market share at no cost or risk to its investors and all of the costs and risks shifted to the mass market consumer. NEM submits this is quite a significant disadvantage to ESCOs. The Commission did discuss some disadvantages in the Order but discounted them, primarily based on the faulty assumption mentioned above that ESCOs are competitors of utilities, that market competitors should compete based on an

[7] Case 00-M-0504, Retail Policy Statement, page 18.

even playing field, and therefore, if ESCOs hedge so should utilities. As noted above, ESCOs and utilities are not and should not be competitors in the retail commodity market. Moreover, the playing field is far from being anywhere near level. It is steeped in favor of the utilities, although implementation of best practices has ameliorated this discrepancy to some degree.

Particularly in view of the unlevel playing field, subsidized, risk-free utility hedging is unquestionably a significant disadvantage to ESCOs. When a utility hedges, it does so risk free, and captive utility ratepayers bear the risk at an undisclosed cost premium (rather than utility shareholders). In comparison, marketers bear the risk of their purchasing decisions (for better or worse), and do not have a captive customer base to recover it from. Unless and until a utility and its shareholders fully bear the risk of utility hedging activities, marketers will be significantly disadvantaged and certainly no level playing field will exist.

Additionally, marketers are deterred from entering the market when utility hedging significantly skews rates away from market-based pricing signals. The utilities' ability to enter into hedges that eliminate or greatly limit marketers' ability to economically serve consumers, generally without notice, is also a significant disadvantage. While the Retail Policy Statement stated that, "if it is determined that a utility has entered into a long term contract to retain market share or to otherwise impede the development of a competitive market, the costs of those contracts may not be recoverable from ratepayers,"[8] NEM submits that it is difficult to discern how to distinguish utility hedging that does or does not fall into that category.

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[8] Case 00-M-0504, Retail Policy Statement, page 34.

3. Electric Utility Hedges, if Permitted, Should Be of Limited Duration

With respect to the duration of electric utility hedges, the Commission decided a utility-specific approach was needed.[9] The Commission determined that, "Instead of adopting a proscriptive limitation on the length of utility hedging arrangements, electric utilities are advised that they may enter into hedges of the appropriate length for the purpose of constraining volatility."[10] However, the Commission did expressly reject proposals to limit electric utility hedges to no longer than one month.[11] The Commission provided the utilities with a great deal of discretion in structuring their portfolios. Herein lies the problem, without providing some sort of minimal guidelines as to the appropriate mix of short term and long term hedges, it seems likely that the utilities will engage in relatively few spot market purchases. That being the case, utility rates will bear little resemblance to current market conditions.

In contrast, the Commission found that, "[a]s to gas utilities, existing hedging practices are working well. . . . As a result, the existing policies, including limiting hedging arrangements to a term of about a year in length, shall remain in place."[12] NEM submits that it is an error, if electric utilities are permitted to continue to hedge, to allow those electric utilities to engage in hedges of significantly longer duration than gas utilities. The Commission did not offer a rationale for the distinction. If utility hedging is permitted for the purpose of smoothing potential price volatility, why is it rational to distinguish between the level of hedging/volatility that electric customers are exposed to versus that which natural gas customers are exposed to? It's not.

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[9] Order at page 15.
[10] Order at page 24.
[11] Order at 14.
[12] Order at 25.

The current focus in New York and across the country is on empowering energy consumers to engage in demand response. NEM also notes the historic high energy prices in the market. It seems unwise to require utilities to lock-in prices, i.e., constrain volatility, at these high levels. Moreover, because utility hedging will blunt price signals it will disincent meaningful demand response. These results are particularly serious given the potential of price responsive demand to moderate high energy prices.

4. The Purpose of Volatility Measurement Standards Should Be Explained

The Commission declined to establish a "generally applicable volatility index" for the electric utilities. Instead, it directed that, "each electric utility develop standards and goals for measuring and constraining volatility in a collaborative or other administrative process, subject to annual Staff review of the strategies for achieving the goals."[13] NEM opposed the creation of an electric price volatility index in its comments, largely because of two interrelated concerns. First, it is widely recognized that regulatorily-determined rates cannot and should not be looked upon as an adequate predictor or substitute for competitive market dynamics. Unforeseen events, like the recent Hurricanes Rita and Katrina will occur, and have impacts on market pricing. The ability of any stakeholder group to develop an index that can adequately capture these types of events, as well as all of the other factors effecting electric pricing, seems a daunting task indeed.

Relatedly, the Commission did not clearly explain the overall purpose of the utility-specific volatility measurement standards. Obviously, it is intended that the standards are meant to guide utility purchasing behavior. But what if the utility portfolio deviates from the standards? The consequence is unclear. In other words, whether the volatility

[13] Order at 17.

measurement standards are intended to be aspirational in nature or an ironclad obligation or something in between should be clarified as well as the potential Commission actions and utility penalties that will result should deviations occur. The threat of possible regulatory intervention to "correct" utility pricing that is in not in conformance with volatility standards would have a substantial negative impact on continued retail market development. It would increase costs substantially - increase costs of capital and the costs of providing energy by increasing the cost of regulation. The increased costs and risks to market participants of Commission market intervention cannot be overstated. NEM urges the Commission to clarify and explain the purpose of volatility measurement standards in this regard.

5. The Gas and Electric Utilities Should Both be Required to Provide After-the-Fact Reporting of Hedging Activities

NEM supports the Commission's determination that electric utilities be required to provide after-the-fact reporting, at least quarterly, of their hedging activities in order to promote price transparency.[14] In contrast the Commission decided that, "As to gas utilities, adequate after-the-fact reporting is already required. Gas utilities submit aggregate price data on a monthly basis as required by our regulations. Moreover, gas utilities already share their hedging plans annually with Staff in advance of executing their hedging strategies, as in the process suggested above for electric utilities. Therefore, no changes to gas utility information reporting requirements are necessary."[15] In our initial comments, NEM supported after-the-fact reporting for both of these entities. NEM submits that there is no rational basis for distinguishing between the electric and

[14] "Reporting requirements should provide for the release, at least quarterly, of price information in an aggregate form, while masking the identity of the individual market participants." Order at 28.

[15] Order at 29.

gas utilities and the appropriateness of requiring after-the-fact reporting of hedging activities to promote greater price transparency for market participants. Accordingly, NEM urges the Commission to require the gas utilities to also provide such reports to market participants.

6. Conclusion

NEM respectfully requests the Commission to grant rehearing/clarification consistent with the recommendations set forth herein.

Sincerely,

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