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UGI Energy Services, Inc.

comments

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March 19, 2004- via overnight delivery

Honorable Jaclyn A. Brilling
Secretary to the Commission
NYS Department of Public Service
Three Empire State Plaza
Albany, NY 12223-1350

Case No. 00-M-0504 -- Proceeding on Motion of the Commission Regarding Provider of Last Resort Responsibilities, the Roles of Utilities in Competitive Energy Markets, and Fostering the Development of Retail Competitive Opportunities

Dear Secretary Brilling:

Enclosed are ten (10) copies of UGI Energy Services, Inc.'s response to the Commission's January 27, 2004 Notice Seeking Comments in the above referenced cases.

Very truly yours,

Jodi S. Larison

Jodi S. Larison
Senior Business Development Manager
UGI Energy Services, Inc.

cc: All Active Parties

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION
CASE 00-M-0504

Case No. 00-M-0504 -- Proceeding on Motion of the Commission Regarding Provider of Last Resort Responsibilities, the Roles of Utilities in Competitive Energy Markets, and Fostering the Development of Retail Competitive Opportunities.

COMMENTS OF UGI ENERGY SERVICES, INC.

In accordance with the procedures established in the Commission's January 27, 2004 Notice Seeking Comments ("Notice"), UGI Energy Services, Inc. ("UGIES") hereby respectfully submits it comments for consideration by the Commission in the captioned proceeding. UGIES respectfully states as follows:

On the official service list in this proceeding, the e-mail address for Jodi Larison should be changed from jweissman@gasmark.com to jlarison@gasmark.com.

UGIES is a corporation organized and existing under the laws of the Commonwealth of Pennsylvania, with its principal place of business at Wyomissing, Pennsylvania. UGIES sells natural gas and related energy products and services to retail consumers on thirty-five (35) gas utility ("LDC") systems in eight (8) eastern states, including New York. UGIES is an Energy Services Company ("ESCO") in New York, serving approximately 500 New York commercial and industrial customers behind the following LDCs: Central Hudson Gas & Electric Corporation, Corning Natural Gas Corporation, National Fuel Gas Distribution Corporation, New York State Electric & Gas Corporation, Niagara Mohawk Power Corporation ("NIMO") and Rochester Gas & Electric Corporation. The responses and comments submitted below are based on UGIES' experiences serving small and large commercial and industrial gas customers in New York and other states and are reflective of its vision of an ideal retail energy market for these types of customers. UGIES is not taking any position as to whether these concepts are or are not appropriate as to residential gas customers or as to any class of electric customers.

At the outset, UGIES notes that the marketing of natural gas supply and related services to customers behind LDC systems is not a new business in New York. As stated on page 18 of the July 13, 2001 Recommended Decision ("RD") in this case, the marketing of gas to commercial and industrial customers in New York has been occurring for all large customers since the mid- to late- 1980's and for all customers since the mid-1990's. The existence of local natural gas production, multiple natural gas storage reservoirs and the web-like grid of multiple interstate pipeline facilities that crisscross the state create an inherent natural advantage for the development of competition, which benefits retail consumers in all customer classes. The maturity of the retail natural gas business in New York, as evidenced by the large numbers of customers and suppliers now participating in the market, provides assurance that the marketplace is operating to the economic advantage of consumers, residential, commercial and industrial alike.

From this perspective, UGIES regards the Commission's initiative to review its rules and policies with respect to energy supply and competition as extremely timely. In its Notice, the Commission recognizes that "Continuing to remove barriers to competition and to provide a level playing field for competitors will likely be necessary for all customer classes, . . ." UGIES submits that the Commission's approach should be to look to refine unmanageable programs in slow developing markets rather then to completely revise the existing rules and regulations.

UGIES hereby responds to the specific statements and questions raised in the Commission's notice:

<u>VISION STATEMENT</u>

The Commission's Notice sets forth its broad vision for the development of retail energy markets, as follows.

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 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.

UGIES generally supports the proposed Vision Statement and its emphasis on enhancing competition while retaining reliable service at a reasonable cost for consumers but UGI suggests changing the last sentence of the Vision Statement to read: "***The Commission will administer its oversight responsibilities and work with utilities and other industry stakeholders to develop policies, rates and service offerings that promote the competitiveness of the market.***" This change would emphasize the Commission's proactive role in the continuing development of retail energy markets.

<u>SPECIFIC COMMISSION QUESTIONS</u>

<u>Retail Markets:</u>

1) **Based on experience to date and, particularly, developments in the retail markets over the past 3 years, what specific actions should now be taken to increase customer choice? Which actions would be most appropriate for the**

residential and small commercial customer classes? What are the expected benefits and costs of such actions?

UGIES maintains that a strong foundation for customer choice and competition is already established among the LDCs in New York. However, some LDC programs are more flexible and administrable than others. In order to increase natural gas customer choice for commercial and industrial customers both small and large, UGIES recommends that the Commission work to develop and adopt changes to LDC tariffs and uniform business practices to uniformly establish economically fair and operationally manageable LDC programs across the state. UGIES sates that an economically fair program is one that eliminates cross subsidization and which charges the same delivery charges for both LDC and ESCO sales -- the only difference in the rates charged being the commodity charge including interstate delivery which would be charged by either the LDC or the ESCO. By developing rates in this manner, the LDC commodity charge would then be a true "price-to-compare" thereby creating a level playing field. Furthermore, the LDCs "price-to-compare" should be based on its monthly cost for commodity plus the associated upstream transportation and storage charges. LDCs should in no case be able to offer multiple commodity pricing options nor is there any reason that the non-commodity (delivery) charges charged to customers of LDCs should vary from those charged to the customers of ESCOs.

Recognizing variations in customers due to size and service type, for small, non-telemetered commercial and industrial gas customers, an operationally manageable program would include the following aspects:

- Daily customer delivery volume defined by the LDC;
- Provision of daily delivery volume by the LDC to the ESCO, whether provided monthly or daily, on a timely basis -- allowing the ESCO enough time to make timely adjustments and nominations;
- Monthly true-up of customer delivery imbalances, even if that true-up occurs sixty (60) days later in order to accommodate meter reading schedules;
- Cash-out or cash-in of the monthly true-up, at a defined index price using the index price for the month to which the true-up applies;
- Capacity release is offered to ESCOs as an option but is not mandatory;
- If released capacity is required/used it should travel with the customer; during months the customer is with the LDC the capacity should be the LDC's responsibility and during months the customer is with an ESCO the capacity should be the ESCO's responsibility -- the capacity should be released only for the period the customer is with the ESCO;
- If released capacity is required/used it has to be released on a timely basis so that ESCOs can properly cover requirements and timely nominate; and
- All firm customers would be treated the same, i.e. there would not be special and costly rules associated with "Human Needs" customers.

UGIES would note at this point that the NIMO PSC No. 219 Gas Service Classification No. 7 Small Volume Firm Gas Transportation Service program incorporates all of the above noted aspects of what UGIES defines as an operationally manageable program for small, non-telemetered commercial and industrial customers and as such, it can serve as the model for other LDC programs in the state.

Aspects of programs for these types of customers, which make them unmanageable, include the following:

- Requiring deliveries of actual volumes where telemetering is not installed;
- Requiring telemetering on accounts where the usage volume does not justify the costs of the metering;
- Quarterly, semi-annual or annual reconciliation;
- Reconciliation of prior period deliveries based on changes to required deliveries in a current month; and
- Mandatory capacity release programs requiring ESCOs to take a portfolio of small transportation and storage quantities on multiple upstream pipelines.

The conclusions of the RD in this docket regarding proper utility pricing mechanisms remain valid in the current retail market. On page 38 of the RD, the Judges stated: "We strongly recommend that utility energy rates remain tied to energy costs.... If this approach is adopted, the utilities will have no profit incentive to remain in the commodity...field...". UGIES agrees. By basing LDC commodity prices on commodity costs and on a monthly or other real time basis, stranded costs will be avoided/minimized. If LDCs are permitted to offer hedged/fixed pricing, customers will be incented to switch back and forth between utility service and competitive supply service. As noted by the Judges: "If the market prices fall below the utility-hedged price, migration to ESCOs should be brisk; but as soon as the price relationship reverses, customers will flock back to utilities. A stable market will have difficult time forming under these circumstances, and additional problems are created by the possibility of stranding costs of the utilities' hedges...". (RD, p.77)

It is also UGIES' opinion that it is too early in the development of the small commercial and residential natural gas market to remove the LDC as the POLR. However, the Commission's long-term objective should be to establish stability, price transparency and enough suppliers in the market so that there is no need to designate a POLR provider for any class of service.

For larger, telemetered commercial and industrial customers, an operationally manageable program would be similar except that the ESCO having access to usage data would be required to develop daily delivery quantities based on customer usage and would use its own upstream capacity to serve customer requirements rather then released capacity from the LDC. As with small customer markets, reasonable LDC scheduling requirements and timely, market-based imbalance true-up mechanisms are needed for competition to thrive.

UGIES believes that the competitive supply market for larger, telemetered commercial and industrial gas customers has developed to the point where the

Commission can remove the LDC from the supply function without the need to designate a POLR. Since the time when the RD was issued, the transparency and sophistication of the large customer market has significantly evolved. UGIES and other ESCOs offer a variety of fixed price and market-based commodity products that allow customers to effectively manage the risk of both price volatility and supplier default. In addition, many industrial and some commercial customers possess dual fuel capability, and fuel switching for economic as well as reliability reasons is common in today's market. Many telemetered commercial and industrial customers have continuously contracted for competitive supply service, without disruption, for more than a decade. The performance of the large customer market proves the Judges' pronouncement from three years ago that: "If the Commission desires to take any immediate action to remove utilities as competitors in any market, gas service for industrial and other large-use customers is the place to do so." (RD at p.50). The Commission should begin to investigate the necessary steps for removing LDCs as the POLR for larger telemetered commercial and industrial customer classes.

2) Are there features at individual utility retail access programs, such as Orange and Rockland Utilities (O&R's) "Switch and Save" Program, that could have applicability to other service territories? If so, please explain.

As to effective LDC commodity pricing, UGIES would point to the Basic Gas Supply Service ("BGSS") pricing of New Jersey's four (4) gas LDCs. This BGSS pricing concept was developed through a collaborative process which included the New Jersey gas LDCs, the New Jersey Board of Public Utilities and other interested parties.

As an example on how this pricing works, UGIES offers the following: Elizabethtown Gas Company ("E'Town") applies its BGSS-Monthly ("BGSS-M") rate to its General Delivery Service, Large Volume Demand and Electric Generation Firm service classifications. As stated on E'Town's website, this BGSS-M price is effective on the first day of each month and is designed to recover the cost of gas supplies the Company purchase for these customers and is a straight dollar-for-dollar pass-through of the gas costs, taxes and assessments connected with the purchase and sale of gas. In E'Town's tariff, Section II, First Revised Sheet No. 86A, it further outlines how the BGSS-M price is developed including stating that the Gas Cost Component:

> "...shall be the arithmetic average of (i) the NYMEX Henry Hub gas contracts closing price for the last trading day prior to each respective month and (ii) the weighted-average of the estimated Inside FERC prices for the respective locations where purchases of gas for the ensuing month are projected to be made, as adjusted for the variable cost of fuel and transportation to the city gate delivery points of the Company."

All other New Jersey gas LDCs have similar monthly pricing structures for multiple service classifications, as well as other monthly pricing mechanisms for other service classifications such as those pertaining to large dual fuel customers. As a final note on pricing, since these BGSS-M rates such as the one offered by E'Town which is outlined above are based on indices, they are market-based rates that do not include the effects of commodity hedging.

As to program structure, on an overall basis, UGIES finds the NIMO PSC No. 219 Gas Service Classification No. 7 Small Volume Firm Gas Transportation Service program to be the best such program in which it currently participates, in all jurisdictions in which it participates in such programs, for serving small, non-telemetered commercial and industrial customers. As indicated in its answer to Question 1 above, UGIES feels that this program includes all the aspects which it outlined in its answer to Question 1 above, as to what creates an economically fair and operationally manageable program for these types of customers. Furthermore, UGIES would like to emphasize that two very important features of this NIMO program are its monthly true-up and cash-out or cash-in of the monthly true-up, at a defined index price using the index price for the month to which the true-up applies.

3) **What, if any, barriers exist for customer aggregation programs (e.g., those using affinity groups) and what should the Commission do to remove those barriers? Should additional pilots be established?**

A key component to the proper functioning of competitive markets is the ability of customers and suppliers to make individual contracting decisions based on their specific needs and capabilities. When there is price transparency in the market, the aggregation of customers by suppliers occurs naturally. UGIES' believes that the Commission should not allow LDCs to aggregate commercial and industrial customers for ESCOs. Aggregating customers is the responsibility of the ESCOs who want to serve those customers.

UGIES also believes that no more pilots are needed, as there have been enough pilots for all market participants to be aware what is needed to develop a robust retail market. The competitive gas supply market is already well established.

4) **Should the Commission facilitate coordination of the Department's and the utilities' education campaigns with ESCOs' marketing campaigns? How best can this be accomplished? The program includes features such as: qualified ESCOs provide pricing discounts for two months to new customers; when customers call, the utility, upon customer consent, switches customers to ESCOs; the utility purchases ESCOs' Accounts Receivable, without recourse; and the utility provides a consolidated bill to include ESCOs' commodity charges.**

Again, the competitive market for commercial and industrial gas customers in New York is well established. Customers know they have choices, and are very sophisticated in negotiating prices and services to meet their specific needs. UGIES' opinion is that marketing to and education of customers/potential customers is the responsibility of the ESCOs who want to serve those customers and that under no circumstance should ESCOs be required to coordinate their marketing programs with any LDC program.

Utility Commodity Pricing and Portfolio Management:

5) Assuming the Commission establishes guidelines for electric utility retail commodity pricing and wholesale supply portfolio management, similar to its guidelines in the gas industry, what should be addressed in those guidelines? To what extent should the guidelines vary for small versus large customers? For example, should hedges be assigned to smaller customers so they face more predictable prices, letting larger customers be more exposed to price volatility?

UGIES' opinion is that the Commission should revisit its Statement of Policy Regarding Gas Purchasing Practices issued on April 28, 1998 ("Policy"). UGIES feels that application of this type of Policy to utility pricing should be reduced rather than increased. Most of UGIES' opinions as to pricing supporting this position can be found in its answers to Questions 1 and 2 above, as well as below in answer to this Questions 5.

Furthermore, UGIES does not support LDCs having the ability to offer multiple pricing options. The offering of fixed price options ("FPOs") by LDCs can only hurt the continuing development of competitive markets. After the price associated with a FPO is set, the market will either be above or below that price. If the market price is above the FPO price, customers will seek service from the LDC and ESCOs will have no reason to remain in or enter the market while if the market price is below the FPO price, while customers may seek to obtain pricing from an ESCO, ESCOs would not be encouraged to dedicate the resources to remain in or enter a the market knowing that in a set time i.e. with in a year or two, the FPO price will be reset and will once again be either above or below the market price. LDCs have the regulatory assurance of profitability, and may use below-market fixed price offerings to drive competitors off their systems. UGIES strongly contends that FPO offerings by LDCs create uncertainty and instability in the competitive market

UGIES feels that as long as an LDC provides commodity, both its costs and pricing should be market based and that, as long as there is a viable market in which to sell, ESCOs will enter that market and create the other products and services i.e. hedging that the customers in that market desire.

6) Should the Commission require or encourage programs whereby utilities purchase supply for their retail customers through an auction process?

Should the auction process be used to select alternative commodity suppliers for blocks of utility sales customers' load?

UGIES opposes LDC auctions. Auctions are another form of customer aggregation and fixed pricing by LDCs. Auctions encourage wholesale markets at the expense of retail market development and lead to reduced LDC commodity purchase transparency. Wholesale suppliers may be willing to discount commodity sales prices to LDCs with the assurance that they can "make it up in volume" as the successful bidder. Thus, the true per-unit price of energy purchased through an auction is distorted. Moreover, commodity price auctions inhibit competition. LDC's buying supply for large blocks of customers are exercising monopoly power. ESCO's serving smaller aggregated loads will not be able to compete with LDCs on price, and, ultimately, competitive choices will be forced out of the market. Finally, as noted by the RD, auctions are burdensome and wasteful. The Judges noted, on page 54 that: "[A]uctions are...a huge administrative effort..." and "If that ESCO did not win the competitive bid in the next round of bidding, a significant investment might be stranded, and unlike a utility, the ESCO would have no one to bill for those costs." UGI views LDC auctions for commodity supply as a step in the wrong direction.

7) Should all utilities' commodity purchases be considered public information as to price, terms and conditions?

Yes. UGIES believe that price transparency is essential to the proper functioning of a competitive market. There is no reason why information related to LDCs commodity purchases should not be public information.

8) What is the potential impact on retail competition of increased long-term (i.e., > 1 year) wholesale contracts purchased to fulfill the requirements of full-service utility customers?

Utilities should be permitted to contract for, and recover the cost of, upstream storage and transportation capacity on a long-term basis. Pipeline capacity is constrained in many parts of the state and, until major new pipeline construction occurs in the state, capacity will have value in the market – whether held by utilities in their traditional POLR function or released to ESCOs. There is little risk to long-term capacity contracting. Moreover, long-term capacity commitments by the LDCs, with the assurance of cost recovery are needed to encourage new pipeline construction in New York.

However, UGIES believe that permitting LDCs to enter into long-term gas purchase contracts will encourage speculation, create the risk of stranded costs or exit fees, and inhibit competition. The potential impact on retail competition of increased long-term wholesale contracts to fulfill the requirements of full-service LDC customers would be to create a pricing situation similar to that of an FPO or auction and which would inhibit the development of the retail market.

9) **How should differences between the wholesale market price of the commodity and the retail price of electricity under a utility's manâged portfolio be reflected in end-user rates (i.e., should the difference be an adjustment to the utilities' delivery or commodity rates)?**

As UGIES' answers are based on its experiences marketing to commercial and industrial gas customers and as UGIES has limited electric marketing experience, UGIES will not offer any suggestions on this issue.

10) **If migration creates either a gap or a surplus between the utility load and the load covered by the portfolio contracts, and in selling the excess or purchasing the difference the utility experiences either a gain or loss, how should that gain or loss be treated in rates?**

UGIES sees two distinct areas where a gap or surplus between utility load and load covered by portfolio contracts could occur. One area is capacity and the other is commodity.

As to capacity, if LDCs must hold a certain amount, they should get recovery for the capacity they hold but only after being responsible to use best efforts to mitigate their capacity costs by selling unutilized capacity. An efficient wholesale capacity release mechanism already exists for reallocating utility-held capacity that is idled due to migration. LDCs should be allowed to pass through prudent capacity costs to core-market customers, with the corresponding obligation to mitigate capacity costs through capacity release.

For those markets/segments that are not yet developed enough for the LDC to fully exit the provision of commodity service, then the LDC needs to perform its function of buying and selling commodity in a prudent and cost-effective manner. LDC's should be permitted to fully recover prudent commodity costs incurred as a result of being the commodity provider. UGIES emphasizes that the LDC recovery of commodity costs should only apply to prudently incurred costs that have been fully mitigated. To the extent that an LDC suffers stranded commodity costs as the result of the movement of marketers to competitive transportation, the recovery of such costs then should be spread equally among all of the LDCs customers and should not be recovered in any circumstance through exit fees or migration riders as all customers benefit from the availability of competitive supply alternatives and exit fees and migration riders only serve to impede competition. If the LDC liquidates unneeded supply at an economic gain, that gain should be shared between the LDC and its customers.

As stated, UGIES maintains that in the perfect deregulated environment, LDCs should not be permitted to offer multiple pricing options to a single class of customer, and should not provide FPOs. However, If the LDC should decide to purchase commodity in order to provide a FPO or for any other reason, the company's shareholders should bear the financial risk of liquidating un-needed gas purchase obligations.

The final point UGIES wants to raise related to this issue is that when LDC recovery mechanisms are utilized, they must be appropriate in that the LDC recovery mechanisms need to be developed so that they do not create a disincentive for customers to purchase from an ESCO.

11) Is an incentive mechanism needed for the utility to minimize its commodity costs? How would such a mechanism function? For example, many SC 3A customers in Niagara Mohawk's service territory are currently charged day-ahead hourly market prices.

No. LDCs earn a regulated return as part of base rates, and already have the incentive to reduce operation and maintenance expense between rate cases so as to over-recover costs. The commodity purchase function should remain revenue neutral. UGIES restates that LDCs should only provide true market based commodity pricing based on their monthly market based purchases. On page 19 of the RD, the Judges recognized that the Commission has stated that the proper role of utilities in commodity purchasing is as follows: "The most effective way to establish a competitive market in gas supply is for local distribution companies to cease selling gas." Therefore, providing an incentive to an LDC related to commodity sales would run counter to the Commission's stated objective.

12) Would some level of long term contracts as a component of electric or gas utility portfolios help to ensure incremental infrastructure gets built when needed to meet expected demand?

Yes. As stated, long-term capacity contracts encourage investment in capacity and get needed capacity built. In the current market environment LDCs with regulated cost recovery mechanisms are in the best position to make long-term capacity commitments. ESCOs cannot be expected to contract for storage and transportation capacity on a long-term basis, because the competitive market is changing all the time and ESCOs have no assurance of future cost recovery. Capacity release permits pipelines to reallocate their long-term capacity entitlements to third party suppliers as the competitive market evolves.

13) Is there a need for a greater commitment regarding gas pipeline capacity from ESCOs serving gas customers?

• If the utility is acquiring capacity for ESCO-served loads on its system, should there be a minimum commitment that the marketers must make to take that capacity?

• If ESCOs are providing their own capacity, should they be required to commit to providing the utility with access to that capacity if they exit the utility's retail program, or turn substantial load back to the utility? If yes, please explain how.

If the LDC holds capacity for customers that elect to take competitive supply, customers should be allowed to provide notice that they will be switching from LDC to ESCO service in order to allow the LDC an opportunity to reduce its capacity commitment associated with serving the customer. As stated previously, capacity release should be an option for the ESCO, not a mandatory requirement. However, if an ESCO were to choose to utilize released capacity, the term for which the ESCO should have to commit to the capacity should be no longer than the length of the customer's contractual commitment to the third-party supply. Therefore, during months the customer is with the LDC the LDC charges for the customer include the upstream capacity costs and for months that the customer is with the ESCO, the ESCO charges for the month include the upstream capacity. The release of capacity from the LDC to the ESCO can be recallable under certain circumstances, for example, should the LDC need to recover the capacity if the customer unexpectedly returns to LDC service – such as in the event of a supplier default.

However, if ESCOs are serving customers using their own contracted capacity they should not be required to provide the LDC with access to that capacity. Suppliers have no incentive to hoard unutilized pipeline capacity. Furthermore, if an ESCO no longer needs capacity to serve certain customers behind a specific LDC and if that capacity was primary to the LDC serving those customers then the capacity's market value will be highest if used to deliver to the LDC that serves those customers. If the LDC needs capacity, they can obtain that capacity in the market the same as any other party.

<u>Other:</u>

14) Are there any other issues related to the further development of retail markets that have arisen since the RD was issued that may be relevant to this proceeding and are not being addressed in another forum? If so, please identify them.

UGIES submits the following:

1) LDC transportation programs need to be manageable. They can not require ESCOs to take releases of multiple pieces of capacity and storage, to the point

where it is not only impossible to apportion on costs but also a costly administrative burden for the ESCO.

2) As has been done in Maryland (Baltimore Gas & Electric and Washington Gas Light), programs for small commercial transportation should offer storage.

3) As has been done in other jurisdictions, programs for small commercial transportation should offer load-balancing tools at a fair rate.

UGIES would like to thank the New York Department of Public Service and other parties for considering its input on these important issues which effect the development of robust transportation markets. UGIES respectfully reserves the right to file additional comments in response to comments filed by other participants and to participate in future conferences and other proceedings involving these important issues.

Respectfully submitted,

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Dated: March 19, 2004