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Comments

conEdison
a conEdison, inc. company

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December 8, 2006

VIA OVERNIGHT MAIL

Honorable Jaclyn A. Brilling
Secretary
State of New York
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 Brilling:

Pursuant to the Commission's Order Instituting Proceeding and Notice Soliciting Comments issued August 28, 2006 in the above-referenced proceeding, Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. hereby file an original and ten copies of their reply comments.

Please contact me if you have any questions regarding this matter.

Very truly yours,

Richard B. Miller

cc: Active Parties (via e-mail)

NEW YORK STATE PUBLIC SERVICE COMMISSION

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.	:

REPLY COMMENTS OF CONSOLIDATED EDISON COMPANY OF NEW YORK, INC. AND ORANGE AND ROCKLAND UTILITIES, INC.

Consolidated Edison Company of New York, Inc. ("Con Edison") and Orange and Rockland Utilities, Inc. ("O&R") (collectively, the "Companies") hereby submit these reply comments, as permitted by the Commission's August 28, 2006 notice ("Notice") in the above-captioned proceeding.[1]

As a preliminary matter, the Companies submit that it is important for the Commission in this proceeding to reaffirm its commitment to the vision adopted in its Policy Statement, that:

> [t]he 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.[2]

The Companies believes that their initial comments in this proceeding are consistent with this vision. Moreover, the initial comments of the other parties to this proceeding further demonstrate the reasonableness of the Companies' position in their initial comments and confirm that the Commission should continue its current flexible

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[1] By an additional Notice dated October 17, 2006, the Commission extended the date for reply comments to December 11, 2006.

[2] Case 00-M-0504, Development of Retail Competitive Opportunities, Statement of Policy on Further Steps Towards Competition in Retail Energy Markets, at 18 (August 25, 2004) ("Policy Statement").

approach to the development of competitive energy markets that allows for individual utility restructuring plans tailored to each utility's service territory. The submitted comments exhibited numerous conflicting views on the best way to hedge and, even within groups of parties that usually have common interests, such as ESCOs, generators, and consumer groups, there were disagreements on the best way to move forward. Given this lack of consensus, the Commission should continue its flexible approach to the development of competitive markets and hedging.

DISCUSSION

I. The Commission Should Adopt the Companies' Proposal that Calls for a Moderate Level of Hedging.

In their initial comments, the Companies requested the Commission to adopt a flexible electric purchasing policy, similar to the Gas Purchasing Policy Statement,[3] *i.e.*, that electric utilities should engage in a moderate level of hedging to mitigate volatility that will provide some protection to customers while also allowing some exposure to price signals and encouraging continued retail migration. This policy is the most appropriate to continue the evolution toward competitive retail markets.

Some parties have requested that the Commission adopt specific guidelines that would terminate the flexible policies that have been effective to date. For example, the Public Utility Law Project ("PULP") argues (at 5) that hedging employed by each utility "should be sufficient to eliminate all or virtually all price volatility for residential

[3] Case 97-G-0600, Statement of Policy Regarding Gas Purchasing Practices (April 28, 1998) ("Gas Purchasing Policy Statement").

customers."[4] CPB requests (at 3) that the Commission adopt a bright line rule that "[n]o more than 60% of a utility's supply requirements for smaller customers should be met with spot market purchases." In contrast, the ESCO commenters request that the Commission require utilities to cease or substantially reduce their hedging, including the suggestion by the Small Customer Marketer Coalition ("SCMC") (at 6-7) that only those residential customers who are low income or handicapped should receive the benefit of utility hedging.

The Commission should reject these proposals because there has been no demonstration that they make sense for any particular utility, let alone for all utilities. While the Companies understand the desire of some parties for uniformity, such uniformity should be limited to the basic business rules governing retail competition.[5] This is the balance that the Commission has struck to date between the need for uniformity and the need for flexibility, and this balance has worked well in practice.

In sum, the policy proposed by the Companies – a moderate level of hedging for mass market customers – best addresses the state of the markets and the conflicting claims of ESCOs and certain customer advocacy groups.[6]

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[4] PULP argues (at 5) that long-term price signals are more important for energy efficiency. But, short term price signals are not irrelevant solely because long term price signals are important. While long- term signals are important for making long term investments, all price signals have some relevance to consumers. This is particularly the case with respect to the system peak period where there is increasing interest in leveraging new technologies to improve system reliability and increase efficiency.

[5] These have been adopted in the following cases: (Case 98-M-1343, In the Matter of Retail Access Business Rules; Case 99-M-0631, In the Matter of Customer Billing Arrangements; Case 98-M-0667, In the Matter of Electronic Data Interchange; and Case 06-M-0647 – In the Matter of Energy Service Company Price Reporting Requirements).

[6] The same principle holds true for the ESCOs' claims that the Commission should more precisely define having "adequate competitive alternatives" such that hedging is no longer necessary. (*E.g.*, SCMC at 3). This determination can vary in different utility service territories; therefore, this claim is best resolved in individual utility rate cases.

II. The Proposal to Require Utilities to Implement Integrated Portfolio Management is Beyond the Scope of this Proceeding.

The City of New York ("NYC") states (at 1) that utility power-supply portfolios should be planned and managed to moderate consumers' exposure to sharp price spikes and improve the regional mix of generation, transmission and demand-side resources. In general, NYC's comments appear to be targeted to achieve infrastructure enhancements rather than manage price volatility. NYC discusses what it sees to be the weaknesses in the comprehensive reliability planning process ("CRPP") adopted by the New York Independent System Operator ("NYISO"), but the CRPP is not at issue in this proceeding, *i.e.*, the Commission did not ask for comments on the CRPP or whether long-term supply contracts are needed to finance infrastructure.

NYC's apparent goal is to require long-term contracts outside of the CRPP. This is impractical for utilities like Con Edison, where significant retail migration has already occurred. A long-term contract requirement would also eliminate one of the objectives in adopting a competitive market policy – that the risk of infrastructure investments should be borne by the investors of project developers and not by utility customers. Indeed, it was dissatisfaction with the long-term contracts entered into in the 1980's and 90's that was one of the major factors that led to industry restructuring. Mandated long-term contracts with prescribed prices resulted in overpayments and stranded costs that had to be recovered from utility customers. The current process, which relies in the first instance on competitive markets and then the NYISO CRPP, reduces the risk of overpayments because regulated solutions are implemented only when there is a reliability need that cannot be satisfied by the competitive market.[7]

In sum, NYC's proposal to have the Commission order utilities to implement integrated portfolio management is beyond the scope of this proceeding and should not be considered here. The CRPP already describes a detailed process to appropriately address needs in the context of a competitive market – and as such it would not help at this time to create a different process.[8]

III. The Commission Should Reject Any Proposal to Have Utility Shareholders Bear the Risks of Hedging.

Commission policy is that utilities should hedge to mitigate volatility on behalf of those customers who do not have adequate competitive alternatives. It is hornbook public utility law that utility companies are permitted to include in rates the reasonable costs of providing service, including the reasonable costs of hedging services. There is and can be no reasonable claim that commodity costs incurred in carrying out a reasonable hedging program are not part of the reasonable costs of conducting a utility business. In fact, investments made in utility infrastructure similarly "lock in" prices for utility service, hedging the cost of future supply. Accordingly, the gains or losses associated with hedging transactions should be fully flowed through to customers.

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[7] Moreover, NYC has its own leverage– its sizeable load – to encourage the kind of investment it would like to see. NYPA recently announced that it would award its 500 megawatt ("MW") RFP to serve New York City area governmental load to the owner of a power plant in New Jersey that would connect to Con Edison's West 49th Street substation.

[8] This is consistent with the current Con Edison electric rate plan, and NYC is a signatory to the Joint Proposal that comprises the Rate Plan. This Rate Plan provided for Con Edison to conduct a system reliability study, but also recognized that Con Edison would submit proposed reliability solutions to the Commission only "[i]f the NYISO Comprehensive Reliability Planning Process is rejected by the FERC, is abandoned or terminated, or fails to produce annual 'Reliability Needs Assessments' for the Company's service territory during the Electric Rate Plan." Joint Proposal at 75, adopted as ordered in Case 04-E-0572, Order Adopting Three-Year Rate Plan (March 24, 2005). The CRPP has proceeded and, accordingly, it would be contrary to the Rate Plan to adopt NYC's proposal.

The ESCOs complain that the existing policy results in unfair competition because their investors bear the cost of hedging. But ESCOs enter into such transactions voluntarily, only with customers they choose to serve, in return for a contractual commitment for a fixed term, and set the price charged to the customer to compensate for the risk taken. A utility, on the other hand, charges a cost-based rate to anyone who chooses to take service from it with no term commitment.[9]

Moreover, ESCO investors, have the opportunity to earn unregulated returns based on retail commodity sales, which adequately compensates them for the risk of losses. In this sense, hedging costs incurred by ESCOs are the same as all other costs incurred by ESCOs -- they are business costs incurred by non-regulated businesses. Moreover, the purpose of hedging is to manage volatility, not to obtain a price that will invariably be lower than the market price. As with any insurance policy, every hedge has an associated premium charge that raises prices and, therefore, over the long term, hedging will increase, rather than decrease, costs. Accordingly, utilities should not be required to absorb any financial risk as a result of pursuing strategies to manage price volatility on behalf of their customers.

IV. The Commission Should Firmly Reject the CPB Suggestion that the Current Con Edison Electric Rate Plan Motivates Con Edison to Provide "Unattractive" Commodity Service to Customers.

CPB suggests (at 4) that the retail migration incentives contained in Con Edison's current electric and gas rate plans "provide it with a powerful incentive to make its

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[9] SCMC claims (at 25) that the Commission required Central Hudson shareholders to bear the cost of hedging, but the order cited refers to a fixed price offering only. See Case 05-G-0311 – Petition of the Small Customer Marketer Coalition for a Declaratory Ruling Regarding the Fixed Price Option for all Customers with Annual Consumption Requirements Greater than500 Ccf Operating under Central Hudson Gas & Electric Corporation's Service Classification 1 and 2, Order Directing The Future Termination, Subject To Conditions, Of A Fixed Price Offer (July 22, 2005).

commodity service less palatable to consumers." According to CPB, "artificially degrading utility service in order to make the offerings of unregulated providers appear more attractive is not an acceptable means of promoting the development of retail competition. It is also not necessary." The Commission should explicitly reject this suggestion.[10]

While CPB is concerned that an incentive may exist to make the Companies commodity unattractive to retail customers, all incentive programs have some potential for adverse side effects (for example, incentives that focus on call center "speed of answer" could result in less focus on other aspects of utility communications functionality). The Commission's policy is to adopt targeted incentives and monitor utility performance to guard against such unintended consequences. While the Companies believe that the Commission's approach to the design and implementation of regulatory incentives has significant room for improvement,[11] the Companies do not believe the CPB's concern is reasonable due to the safeguards in place with respect to Commission monitoring and the Companies' efforts to conduct hedging programs prudently and in good faith.

V. Auctions and/or Other Competitive Market Transitional Measures Should Be Considered in Individual Utility Rate Cases Only.

Some parties suggest that utilities should be required to implement the auctions used in other states, such as the Basic Generation Service ("BGS") auction used in New Jersey. For example, the Independent Power Producers of New York (at 7), while not

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[10] Significantly, CPB voiced its support for the migration incentive when it filed its statement on the Joint Proposal that constitutes Con Edison's current electric rate plan, characterizing it as one of the pro-consumer measures contained in the plan (although CPB neither supported nor opposed the Joint Proposal). Case 04-E-0572, CPB Statement on Joint Proposal, at 5 (Dec. 15, 2004).

[11] In particular, the Companies believe that the Commission should reevaluate the risk to reward balance inherent in the Commission's policy of subjecting utilities to penalties but limiting incentives.

explicitly endorsing the BGS, states that "the Commission should require utilities to hedge their electricity procurement for residential and small C&I customers through wholesale competitive solicitations." Direct Energy, on the other hand, requests (at 3-4) that the Commission require all utilities to adopt a new bill levelization option that Direct Energy claims will reduce the overall volatility of utility bills. These proposals are best considered in individual utility rate cases.

The Companies do not consider it likely that a BGS-style auction would make sense in New York. While the BGS auction appears to work reasonably well in New Jersey (although customer groups have opposed it), the New York approach is choice, which includes service options from ESCOs such as green power and fixed prices. This ESCO framework has a greater potential for future competitive innovation and consumer benefit than is the case under the BGS framework. The Commission explicitly rejected the BGS in the Policy Statement (at 26) "because it unnecessarily prolongs the utilities' commitment to multi-year wholesale contracts and their role as a commodity supplier." The Companies believe that BGS in the format generally used could be said to work at cross purposes with retail access because it constitutes a 100% hedging approach that tends to discourage customers from participating in the retail access market.

CONCLUSION

Based upon the foregoing, the Companies request the Commission to adopt the policies recommended by the Company herein and in its initial set of comments in this proceeding. In particular, the Companies request that the Commission support a moderate level of hedging to mitigate volatility that will provide some protection to customers while also allowing some exposure to price signals and encouraging continued retail migration.

Dated: New York, New York
December 8, 2006

Respectfully submitted,

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By Its Attorney

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