

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

RECOMMENDED DECISION BY ADMINISTRATIVE LAW  
JUDGES JEFFREY E. STOCKHOLM AND JOEL A. LINSIDER,  
AND MICHAEL CORSO, CHIEF OF RESIDENTIAL ADVOCACY

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  
Development of Retail Competitive  
Opportunities.

NOTICE OF SCHEDULE FOR FILING EXCEPTIONS

(Issued July 13, 2001)

Attached is the Recommended Decision in the above proceeding of Administrative Law Judges Jeffrey E. Stockholm and Joel A. Linsider, and Michael Corso, Chief of Residential Advocacy, together with a copy of the Commission's rules governing the procedures to be followed. Briefs on exceptions will be due in hand to the undersigned and all active parties on August 10, 2001 and briefs opposing exceptions will be due in hand to the undersigned and may be mailed to all active parties on August 28, 2001.

JANET HAND DEIXLER  
Secretary

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PUBLIC SERVICE COMMISSION

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RECOMMENDED DECISION

BY

ADMINISTRATIVE LAW JUDGE JEFFREY E. STOCKHOLM

And

MICHAEL CORSO, Chief of Residential Advocacy

And

ADMINISTRATIVE LAW JUDGE JOEL A. LINSIDER

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JEFFREY E. STOCKHOLM, Administrative Law Judge  
MICHAEL CORSO, Chief of Residential Advocacy  
JOEL A. LINSIDER, Administrative Law Judge:

I. INTRODUCTION

A. Background and Procedural History

The Commission instituted this proceeding in March 2000 "to address the future of the competitive natural gas and electricity markets and the role of the regulated utilities in such markets; to identify and suggest actions to eliminate obstacles to the development of such markets; and to provide recommendations regarding provider of last resort and related issues, all as described [in the Commission's order]."<sup>1</sup> In its order, the Commission reviewed the progress made thus far in opening energy markets in New York State to competition and in addressing the associated issues, but it noted as well that some issues could be fully resolved only after retail markets have begun to develop.<sup>2</sup> It summed up the purpose of the proceeding as "to refine our concept of the mature competitive retail energy

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<sup>1</sup> Case 00-M-0504, Order Instituting Proceeding (issued March 21, 2000), Ordering Clause 1.

<sup>2</sup> The past year in the energy markets demonstrates that some issues may not be recognized or will not be known in advance as the transition to competitive markets develops. This fact requires flexibility in the oversight of the market and the ability to change direction, adopt new policies, or abandon established ones should circumstances so require. The great benefit of the administrative approach to energy market restructuring undertaken in New York is the flexibility the approach allows, as demonstrated by the breadth of available policy options discussed in this recommended decision.

markets (especially the future role of the regulated utilities) and to identify and remove obstacles to its achievement."<sup>3</sup>

The Commission provided several types of specific guidance for this proceeding. First, it stated that the proposals and solutions offered here must be consistent with its established values and principles:

1. The benefits of competition, including increased customer choice, should be available to all customers as soon as possible.
2. Safe and reliable energy supplies and services, provided in a manner that preserves environmental values, should be available to all New Yorkers on reasonable terms.
3. Consumer protection issues, including those associated with Public Service Law §30 et seq. (the Home Energy Fair Practices Act (HEFPA), and other public policy programs, including low-income assistance programs, must be addressed.<sup>4</sup>

Second, the Commission posed a detailed series of questions on which it sought the parties' guidance, adding that other issues might be discussed as well if found by the Administrative Law Judge to be consistent with the intended scope of the proceeding.<sup>5</sup> These questions are presented and discussed later in this recommended decision.

Finally, with respect to process, the Commission instructed the Office of Hearings and Alternate Dispute Resolution (OHADR) to "structure the proceeding in a manner that will achieve comprehensive results as efficiently as possible."<sup>6</sup>

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<sup>3</sup> Id., p. 2.

<sup>4</sup> Id., p. 4.

<sup>5</sup> Throughout the process, procedural rulings were issued directing and redirecting the parties' efforts and further refining the issues and policy options under consideration.

<sup>6</sup> Id., p. 5.

It went on to stress the importance of receiving a wide range of views:

To foster the broadest and most innovative thinking possible, [OHADR] should solicit input in a collaborative process from all interested parties, including competitors, business and residential consumers and consumer groups, environmental and low-income interests, governmental groups, and the utilities. Because the views of these groups are critical to our efforts, we encourage the use of new technology and other new outreach approaches to foster the development of a complete range of policy options and comprehensive public input.<sup>7</sup>

As described below, the proceeding has been conducted as a broadly based collaborative, inquiring into the issues identified by the Commission, as amplified by the Administrative Law Judges.<sup>8</sup>

#### B. The Process

The proceeding was conducted in a collaborative fashion, and, despite concerns voiced at the outset, all parties made a commendable effort to put their litigation positions aside and to cooperate in good faith during the process.<sup>9</sup> It should also be noted that many parties who served on committees and subcommittees, and especially those who served as committee

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<sup>7</sup> Id., pp. 5-6.

<sup>8</sup> The administrative law Judges assigned to this proceeding are Jeffrey E. Stockholm and Joel A. Linsider. Joining them as a hearing officer is Chief of Residential Advocacy Michael Corso. As used in this recommended decision, the term "Judges" refers to the three case managers.

<sup>9</sup> The proceeding was divided into three phases: information gathering, analysis of policy options, and litigation where disagreements continued. A more detailed description of the process is contained in the report and appendices prepared by the parties ("Concepts, Issues, and Views of the Future: Report on the Parties' Collaborative Efforts (April 3, 2001)), and even more detail can be obtained on the case web site at <http://www.dps.state.ny.us/00m0504/00m0504>).

chairs,<sup>10</sup> contributed many hundreds of hours doing research, writing reports, planning and presenting material at subcommittee, committee, and plenary meetings, attending Executive Committee meetings, and coordinating all these activities among the various committees and subcommittees. The result of this broad-based effort is the voluminous April 3, 2001 report entitled "Concepts, Issues, and Views of the Future: Report on the Parties' Collaborative Efforts"<sup>11</sup>, with its even more voluminous set of Appendices dated February 15, 2001. It is fair to say that all of the material facts, allegations, and analyses adduced as important by any party have been reflected in the April 3 Report in a reasonably objective manner.<sup>12</sup>

The April 3 Report (and Appendices) and the web site

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<sup>10</sup> The organizations who volunteered individuals to serve as committee co-chairs during the proceeding included Amerada Hess, Consolidated Edison Company of New York (2 chairs), New York State Consumer Protection Board, Department of Public Service Staff, New York State Energy Research and Development Authority, Niagara Mohawk Power Corporation (2 chairs), Public Utility Law Project, and the Small Customer Marketer Coalition. The efforts of these individuals were indispensable to the process.

<sup>11</sup> Hereinafter the "April 3 Report."

<sup>12</sup> The April 3 Report is a cooperative work product of the parties. While we provided some guidance and direction based on the Commission's initial order, performed some minor editing, compiled the various report sections into a finished product, and strove to maintain a level of objectivity in the statements and claims advanced, the substance in the April 3 Report was provided by the parties themselves.

contain a detailed description of the facts<sup>13</sup> gathered and the analyses performed by the parties, but it does not contain consensus recommendations on either the long-run vision of the competitive markets or the more immediate steps the Commission should take to foster the market's development.<sup>14</sup> In an attempt to develop consensus, Staff agreed to circulate a Straw Proposal (which did not necessarily reflect the views of Staff itself or any other party) and to meet with the parties to determine what

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<sup>13</sup> A few parties have argued that the April 3 Report should not be considered "evidence" or that it does not constitute a record on which the Commission can make policy decisions, because the material in the report was unsworn and was not subjected to cross-examination or other formal litigation procedures. These concerns were aired at the prehearing conference on March 14, where we assured the parties that we recognized the limitations on the record developed here, in which the evidence adduced was neither attested nor subjected to cross-examination. But while facts or arguments not subjected to such scrutiny may carry less weight, their essential nature as evidence is not thereby transformed. Furthermore, this is a quasi-legislative proceeding (indeed, one party at the conference used the analogy of a legislative hearing) in which no hearing is required. The Commission has considerable discretion to base its policy determinations on evidence and expressions of opinion that go beyond sworn and cross-examined testimony. Finally, proponents of all viewpoints were allowed to include in the report their own views of the facts and arguments, making for a balanced and voluminous collection of information on the basis of which policy decisions can be reached in this case.

<sup>14</sup> A consensus statement was reached regarding low-income programs (April 3 Report, p. VII-38). Further, significant support was garnered for unbundling rates, and the Commission has already moved ahead to begin that effort in a separate track of this proceeding (Case 00-M-0504, Proceeding Regarding Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets, and Fostering the Development of Retail Competitive Opportunities - Unbundling Track, Order Directing Expedited Consideration of Rate Unbundling (issued March 29, 2001). In addition, the parties generally agreed that consumer protections were required concerning ESCO prepayment plans for gas or electric commodity, and a notice requesting comments on a Staff proposal in that area has been issued.

level of agreement might be possible.<sup>15</sup> Again, unanimous agreement could not be reached, but a second version of the Straw Proposal<sup>16</sup> garnered either full or partial support from a great many parties.<sup>17</sup> Following further discussions on SP2 and at the March 14, 2001 Prehearing Conference, the parties reported mixed enthusiasm for further collaborative efforts, with many suggesting that the most efficient use of their efforts would be to establish a briefing schedule on the policy

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<sup>15</sup> Rather than seek reactions to the proposal from all parties in an open session, Staff chose to meet individually with interest groups and, occasionally, with individual parties. Some parties complained that this process violated the Commission's settlement rules and guidelines. In our Procedural Ruling issued December 26, 2000, we found the process adopted to be consistent with Commission precedent. Conversations in the context of a collaborative proceeding are not settlement discussions within the meaning of the Commission's rules. (Case 95-G-0050, Proceeding to Investigate Standards and Procedures for Reviewing Gas Purchasing Practices, Order Deciding Petition for Rehearing (issued June 1, 1995), p. 2, n. 1)

<sup>16</sup> Straw Proposal 2 (hereafter SP2) is set forth as Appendix A.

<sup>17</sup> Staff and some other parties contend that SP2 represents a "majority" position, while others note that many parties disagreed with at least some aspect of the proposal. A review of the briefs suggests that most parties supported most of the SP2 provisions, but a few opposed all of its provisions.

issues.<sup>18</sup> Initial briefs on policy issues were therefore scheduled for April 13<sup>19</sup> and reply briefs were due May 14.<sup>20</sup>

Appendix B contains a summary of the arguments raised in the parties' briefs, and, accordingly, a recitation and attribution of each of the party's arguments will not be undertaken in this text. Nevertheless, all of the arguments raised by the parties have been considered in the preparation of this recommended decision.

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<sup>18</sup> Initial briefs on legal issues related to Commission authority had previously been filed on February 16, 2001. At the March 14 prehearing conference, April 4 was set as the date for reply briefs on legal issues. Further procedural background related to our consideration of legal issues is set forth below, in the section on legal issues.

<sup>19</sup> Initial policy issue briefs were received from Association for Energy Affordability and Pace Energy Project (AEA); Consolidated Edison's Company of New York, Inc. and Orange and Rockland Utilities, Inc. (Con Edison); Consolidated Edison Solutions (Con Edison Solutions); Consumer Protection Board (CPB); Dynegy Marketing and Trade (Dynegy); 1st Rochdale; Joint Brief of the Small Customer Marketer Coalition, Amerada Hess Corporation, TXU Energy Services and Smartenergy, Inc. (Active Marketers); Brooklyn Union Gas Company d/b/a KeySpan Energy Delivery New York and KeySpan Gas East Corporation d/b/a KeySpan Energy Delivery Long Island (Keyspan); Multiple Intervenors (MI); National Fuel Gas Distribution Corporation (NFGDC); National Energy Marketers' Association (NEM); New York Energy Service Providers Association (NESPA); New York State Electric & Gas Corporation (NYSEG); New York State Energy Research and Development Authority; (NYSERDA); Niagara Mohawk Power Corporation (Niagara Mohawk); Public Utility Law Project (PULP); Rochester Gas & Electric Corporation (RG&E); Staff of the Department of Public Service (Staff); Texas Eastern Transmission Corporation (Texas Eastern); and Westchester County (Westchester).

<sup>20</sup> Reply briefs were received from The Attorney General of the State of New York (Attorney General); Con Edison; Dynegy; 1st Rochdale; Active Marketers; KeySpan; MI; NFGDC; NESPA; NYSEG; Niagara Mohawk; PULP; RG&E; Staff; Texas Eastern; and Utility Workers Union of America, AFL-CIO, Local 1-2 and International Brotherhood of Electrical Workers, Local 97 (Unions).

In addition to the foregoing procedures, and consistent with the Commission's direction, a wide variety of outreach approaches were used to gather the broadest and most innovative thinking possible. That effort began in the summer of 1999 with on-site visits across the state with every type of interested party. Those site visits culminated in a November 1999 Report,<sup>21</sup> which ultimately led to the Order Instituting Proceeding. As committees were established to address the three substantive areas identified in the Order, a fourth committee was formed to plan and coordinate public input and outreach efforts.<sup>22</sup> Existing market research was reviewed, roundtables, forums, and focus groups with residential and business customers were undertaken, surveys of low-income advocates and municipal officials were completed, and new primary research consisting of a substantial telephone survey was conducted by a nationally recognized research firm.<sup>23</sup> In total, the public outreach and input effort in this case is one of the most ambitious such efforts ever undertaken in a Commission proceeding.

In addition, this case made extensive use of the internet and collected an enormous amount of information on a case-specific web site. Among other materials, the web site contains plenary agendas and presentations; committee and Executive Committee minutes, meeting agendas, report drafts, and meeting schedules; bibliographies of relevant Commission opinions and orders and professional articles; and copies of all

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<sup>21</sup> Stakeholder Views on Competition: From Transition to the End-State, a copy of which is available on the case web site at [www.dps.state.ny.us/00m0504/Stakeholder.htm](http://www.dps.state.ny.us/00m0504/Stakeholder.htm).

<sup>22</sup> April 3 Report, Section VIII.

<sup>23</sup> The Center for Research & Public Policy was chosen for the study based on its prior experience in energy restructuring matters and following a comprehensive competitive bidding process. Funding for the research was provided through NYSERDA (April 3 Report, pp. VIII-6 through VIII-14 and Appendix VIII-C).

rulings and notices in the case.<sup>24</sup> Further, communication among the parties, the Committees, and the Judges was conducted almost exclusively using the Internet, without which the aggressive schedule in the case could not have been undertaken.

C. Issues Related to Process

A few utility parties raised concerns regarding the process in addition to those noted above.<sup>25</sup> Some argued that the legal issues should have been addressed and decided at the outset, rather than left to a separate briefing schedule at the end of the process. Some expressed concern that the scope and focus of the proceeding had varied, with fact gathering in Phase I, policy analysis in Phase II, and an examination of the Straw Proposals and briefs on policy matters in the last phase. The additional questions we posed as the case progressed were also seen as contributing to the inconsistency of the proceeding's scope. According to KeySpan, a more consistent focus and prioritization of issues could have led to wider participation in the case by marketers actually selling commodity in New York.

These concerns are unfounded. With respect to the scope of the proceeding, we attempted to focus or redirect the parties' efforts as the proceeding progressed on the basis of what the parties had produced to that point. We expanded or added questions at the first plenary (May 5, 2000), on the basis of solicited input from the parties; at the beginning of the analytical phase (October 18, 2000), on the basis of the facts developed by the parties in the first phase of the process; and prior to briefing (March 14, 2001) on the basis of the analyses performed by the parties. The process would have been less productive had it been prevented from responding to new issues

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<sup>24</sup> [www.dps.state.ny.us/00m0504/00m0504](http://www.dps.state.ny.us/00m0504/00m0504). When this proceeding is completed, it is contemplated that the contents of the site will be downloaded to a CD to provide a permanent record of the proceeding.

<sup>25</sup> KeySpan's detailed appendix to its initial brief (summarized in Appendix B) contains the most comprehensive criticisms.

and nuances that arose as we went forward. Finally, KeySpan's comment about lack of participation is misplaced. Several of the largest, active, independent ESCOs now doing business in New York did participate in the case (see, e.g. Active Marketers); and the active ESCOs most noticeable by their absence were the utility affiliates, whose appearances during the case were rare.

Others allege that significant events in the energy industry over the past year were not adequately considered by the parties and that the impact of these events are unacknowledged in the April 3 Report. Some expressed frustration with what they viewed as eight or more years of regulatory proceedings to open the retail markets. One party noted that there was no clear definition of a collaborative, and NYSEG accused Staff of "negotiating with the parties in bad faith", failing to be "forthcoming throughout the process," and "pulling the wool over the eyes of the parties" in allegedly "disguising" its support for SP2. Another utility suggested that the ambitious schedule adopted in the proceeding disrupted the work flow process and may have led to deficiencies in some areas.

These procedural complaints are likewise groundless. With respect to the nature of the collaborative, a short training program on collaborative processes and ADR was given at the first plenary meeting of the parties and was available upon request throughout the proceeding. The nature of the process should have been clear to all parties throughout. Beyond that, we took pains during the proceeding to refer to unfolding developments in the industry and its markets and to encourage parties to take them into account. Finally, we reject as groundless the complaints about the efforts of the Staff team. The team and its leadership operated honestly and forthrightly with all parties and had no preconceived agendas beyond identifying the best possible policies for the Commission to consider. It brought its best thinking to this case for the parties to review and, unlike its critic, did not issue its own grand solution in an independent white paper, nor did it brief extensively to a document that had not been submitted to the

parties in the case for their scrutiny.<sup>26</sup> Nor has Staff embarked on a sizeable public relations effort to sell its proposals, opting instead to trust its ideas to the crucible of the legally established process.

In contrast, the majority of the non-utility parties (and at least one of the utilities) believed that the process met the challenges presented in an effective manner given the complexity of the issues, the number of parties, and the multiplicity of views and interests. The following excerpts are from the parties' briefs and are set forth in Appendix B.

The CPB stated that the Judges " . . . correctly permitted neither large groups to overwhelm the concerns raised by smaller groups, nor allowed smaller groups to offer unsupported proposals or concerns." It also noted that the April 3 Report is " . . . a comprehensive compilation of facts and analyses of policy options regarding a wide range of issues and views."

1st Rochdale expressed the view that the process was helpful in delineating key issues and providing the basis for substantive proposals such as SP2.

The Active Marketers stated that: "The collaborative process has been extremely useful in elucidating positions of the parties, refining issues of concerns, as well as creating potential solutions which after adoption by the Commission could be implemented in a reasonably efficient manner."

MI stated: "Given the importance and the complexity of the issues being addressed, and the diversity of interest being represented by the numerous active parties, the collaborative process probably worked as well as reasonably could be expected in this proceeding." It also noted that this process differed from prior collaborative approaches in that the parties here succeeded in "working productively and without animosity on framing and analyzing the relevant issues and trying to understand the interest, concerns and positions of the other parties."

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<sup>26</sup> Compare NYSEG's Initial Brief, pp. 3-10; NYSEG's Reply Brief, pp. 7-8, 9-13.

PULP stated that the process has been "singularly adept in following the interest of the parties to explore various alternative scenarios and to provide useful new information that has not been available previously."

Staff noted that the proceeding benefited in a number of ways from the unique approach undertaken. Staff identified the scope of the case, the number of parties, the orientation of the issues, and the public interest implications as unprecedented challenges. Pointing to the support garnered by SP2, Staff concludes that it has been a "successful collaborative process that exceeded all reasonable expectations."

The process developed for this proceeding faced a number of daunting challenges. The breadth of short-term and long-term, gas and electric issues to be resolved among a large group of parties with vastly differing interests rivals the largest policy cases ever undertaken by the Commission. Not only were answers needed for these highly complex and intricately interrelated issues for the markets to continue developing, but answers were needed in just over a year from the commencement of the case to guide the development of multi-year rate plans for the next phase of restructuring. A policy proceeding of this breadth completed in just over a year is unprecedented, regardless of the quality of the process, and in this case we believe that quality was reasonably high.

The process, however, was not perfect. The substantial flexibility given to the parties to develop the substance of the April 3 Report necessarily suffered to a certain extent from a lack of structure. Nevertheless, the administrative structure, requiring multiple levels of approvals for write-ups through the Committees, Executive Committee, and plenary, gave all parties multiple opportunities to influence the contents.

The ambitious schedule was also a factor in limiting the number of analyses that could be undertaken and issues that could be addressed. However, it is not clear that more time and further analyses would have produced a significantly better

result; but it is clear that further significant delays would jeopardize the value of the undertaking.

In our view the process worked well considering the purposes for which it was intended. It was highly unlikely at the outset that complete agreement on policy recommendations would be achieved among all the disparate parties. Accordingly, a litigation process based on briefs and reply briefs was contemplated from the beginning. It was more important, in our view, to have the parties collaborate on identifying and analyzing the potential policy options so that they and the Commission could have the benefit of the best thinking and views available. To be certain that attractive options were not precluded or ignored due to the existing state of the Public Service Law, legal impediments were not considered in reviewing available policy options, and briefs on the legal issues were placed in a separate track at the end of the proceeding. The underlying assumption was that legislation would be forthcoming if it were needed to implement the best possible policies.

In the final analysis, the success of the process should be measured by its output: SP2 and the April 3 Report and appendices. The report contains all the best thinking of the parties, all the facts deemed significant, and all the analytical observations the parties believed appropriate. Without that report and the months of cooperation, collaboration, and teamwork it took to develop, the production of SP2 would not likely have been possible. Those who suggest the Straw Proposal could have been created earlier in the case misunderstand the extent to which it drew on the process from which it emerged and to which its timing permitted it to take account of the important events that transpired in the energy industry during the course of the proceeding.

II. STATUS OF THE MARKETS AND "LESSONS LEARNED"

In each of the three broad areas identified by the Commission for investigation,<sup>27</sup> it posed the question of what has worked and what has not. As restructuring progresses, the unique characteristics of the gas and electricity markets has led to a number of different problems at both the wholesale<sup>28</sup> and the retail level. Any plan to move the markets forward must take account of this experience as well as the basic characteristics of the markets.

We examine in this section fundamental market characteristics, impediments to achieving "workably competitive" wholesale markets, and some of the basic difficulties that have been experienced in developing retail markets. The discussion is based on the experience in New York and elsewhere with respect to restructuring energy markets, as collected by the parties during the first phase of this case.<sup>29</sup> In our view, these "lessons learned" are critical to bear in mind in deciding the appropriate policy direction for the future.

An inherent characteristic of the energy markets that distinguishes them from other markets is the absence of any significant elasticity of demand or supply. In most markets, if prices rise, and especially if they rise by an order of

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<sup>27</sup> That is, the future role of the regulated utilities in the end-state; retail competition development; and public benefit programs.

<sup>28</sup> The Commission instituted this proceeding to examine policy options in the retail markets, but as the case developed it became clear that the problems encountered in the wholesale markets must be considered in charting a near-term course for the retail markets.

<sup>29</sup> At plenary meetings in July and August 2000, a variety of parties sponsored presentations on the experiences in New Jersey, California, Ohio, Texas, Pennsylvania, Connecticut, Georgia, Massachusetts, Maryland, New Zealand, England and Wales, and Sweden. In addition, Staff from the Office of Communications put on two different presentations on the experience in the telephone industry.

magnitude as has electricity on-peak,<sup>30</sup> demand for the product will fall in some proportion to the rise in price.<sup>31</sup> But owing to the lack of real time electricity pricing information, consumers do not know what price they will be required to pay as they use the commodity on a daily basis. Only when the bill arrives the following month will those costs become known. Further, except where time-of-use pricing is applied, the impact of the true cost of electricity at peak times is further hidden by the averaging of all costs over a month of usage. Because monthly average costs per kWh are used to bill customers, even those who do conserve during the peak day will only save the average cost per kWh conserved, not the peak-day kWh cost.<sup>32</sup> Therefore, the lack of real-time pricing information and the design of most rates denies consumers the knowledge they need to react to prices as well as the proper economic incentives to do so. Thus, demand changes little despite significant price increases.<sup>33</sup>

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<sup>30</sup> It was recently reported that Duke Energy charged a record \$3380 per MWh in the California wholesale market earlier this year. This price is 100 times the average wholesale price in 1999.

<sup>31</sup> The elasticity of demand is measured by the change in quantity demanded caused by a specified change in price.

<sup>32</sup> Perhaps more importantly, those who decide to consume more on the peak day will only pay the much lower monthly average kWh price for that usage rather than the much higher cost per kWh which that usage imposed.

<sup>33</sup> Advanced metering technology is slowly changing this result. A few large-use customers have the requisite real-time information and rate designs to allow them to make appropriate economic decisions. The development of demand-side bidding programs where large-use customers are paid to reduce or eliminate usage at peak hours, will also help develop greater demand elasticities. Unfortunately, it will take a significant number of years for these approaches to be adopted throughout the mass market.

The supply side also has very little price elasticity.<sup>34</sup> As demand increases, and especially as it begins to equal or exceed supply, prices rise, but the amount of supply can not immediately respond. Increasing supply can only be obtained through new generation, new imports with associated new transmission capacity, or broad-scale energy efficiency measures and demand side bidding programs. These efforts can take years. During the interim, supply will not increase despite precipitous price increases.

While each of these characteristics alone would be sufficient to cause market problems (including significant volatility), the lack of meaningful elasticities on both the demand and the supply side, coupled with increasing shortages of supply, is a recipe for disaster. As demand equals supply on-peak, the price of electricity in the wholesale markets, if not otherwise capped, could rise without limit. Furthermore, these market characteristics could allow suppliers with even a very small share of the overall market to exercise significant market power, to raise prices to uneconomic levels<sup>35</sup>, and to extract excessive profits.

Analogous though less severe problems exist in gas markets. While demand elasticity for natural gas is likely greater than for electricity,<sup>36</sup> it is nevertheless limited due to the essential nature of the product for heating during the peak

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<sup>34</sup> Price elasticity of supply is measured by the change in the amount of supply that is caused by a specified change in price.

<sup>35</sup> Prices well beyond those needed to spur increases in supply are uneconomic and serve no valid purpose.

<sup>36</sup> Unlike electricity users, gas customers can know the price they will be required to pay as they use the commodity. Some utilities post their prices for the upcoming month on the web a few days before the beginning of the month. It is also possible for customers to lock in a price for a fixed period, thereby knowing what price they are paying for the commodity as they are consuming it. Further, there are energy substitutes for gas, in contrast to the case with respect to electricity.

winter months. Of more concern, however, is the limited and inelastic supply of pipeline capacity from liquid market points to the local distribution companies.<sup>37</sup> If the utilities' long-term contracts for that capacity are released to trade in a competitive market and if demand equals or exceeds supply, the prices bid for that inelastic supply could rise to the same type of uneconomic levels as experienced in the electric markets.

The past year has made clear the consequences of requiring customers to buy all (the San Diego experience; some Niagara Mohawk large customers) or a portion (Con Edison) of their supply from such wholesale markets.<sup>38</sup> Markets characterized by largely inelastic supply and demand where demand is approaching or is equal to supply are not workably competitive and will not produce just and reasonable rates. Until supplies increase (generation and transmission for electricity and pipeline capacity for gas), ratepayers should be provided some measure of protection from those markets.<sup>39</sup> Once supply exceeds demand sufficiently to eliminate the exercise of excessive market power, the markets can become workably competitive and will likely produce just and reasonable rates.

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<sup>37</sup> These pipeline capacity issues and potential solutions are being explored in detail in Case 97-G-1380, Issues Associated with the Future of the Natural Gas Industry and the Role of Local Gas Distribution Companies. It is our intent here to describe the problems and explore their impact on the policy options proposed for fostering retail markets.

<sup>38</sup> The flexibility of New York's administrative approach to restructuring has resulted in most gas and electric utilities having multiple sources of supply as well as the ability to hedge prices, protecting ratepayers, in part, from the extreme volatility of such markets.

<sup>39</sup> The Commission in 1998 strongly urged the gas utilities to diversify their gas purchasing practices, including the hedging of supply, to provide consumers some measure of protection from market volatility (Case 97-G-0600, Request for Gas Distribution Companies to Reduce Gas Cost Volatility and Provide for Alternate Gas Purchasing Mechanisms, Statement of Policy Regarding Gas Purchasing Practices (issued April 28, 1998) (hereinafter Gas Purchasing Policy Statement).)

Another important lesson gained from the energy and telephone restructuring experiences is that retail market transformation, especially for small-use customers,<sup>40</sup> can be expected to take a long period. Although it has been almost 20 years since Judge Greene ended the long distance monopoly, the monopoly provider at that time still retains a majority of the market (AT&T). In electricity, England's market has been open for retail competition for 10 years, yet only 40% of the customers have migrated from their original monopoly supplier. Natural gas retail markets in New York were opened for large customers in the mid- to-late 1980's and for all customers in the mid-1990's. While most large customers have now migrated to non-utility suppliers, the overall gas customer migration rate in New York as of March, 2001 was only 6.4%. Electricity markets in New York have been partially open for a couple of years, but have been fully opened for all utilities only this year. The overall electric customer migration rate for the state as of March 2001 is 3.9%. It seems clear that, unless customers are somehow forced to leave the utility or are provided some form of incentives for doing so, it could take a decade or longer before a substantial majority of residential customers leave the utility for other commodity suppliers.

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<sup>40</sup> Retail competition has developed much more rapidly for large customers, and there is no reason to believe that 100% migration of those customers away from utility-supplied commodities can not be achieved in relatively short order once the wholesale market problems noted above are solved.

Concern over a slow rate of market development<sup>41</sup> and the widespread belief that markets will not develop unless the utilities are required to exit<sup>42</sup> have led other States to attempt a variety of remedies. In Georgia, gas rates were raised to provide incentives for customers to leave, and those who remained were then assigned to non-utility suppliers on a market-share basis. Lack of market infrastructure due to the rapidity of the transition has caused some significant problems, but a retail market has been created in which the utility is not a competitor. Pennsylvania fixed utility rates above market costs (for most utilities),<sup>43</sup> thereby providing an incentive for customers to migrate. It also assigned customers in blocks to a provider of last resort (POLR) chosen by competitive bid, unless the customer refused to participate in advance (negative check-off). This plan has recently suffered from market prices

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<sup>41</sup> Utilities, ESCOs, and others desiring to reap the benefits of competitive markets are concerned about the slow pace of progress to date. Some utilities express extreme concern over what they see as their intolerable "half-in/half-out" status during the transition. (There is no evidence to suggest, however, that this status is unprofitable). ESCOs are hesitant to invest the sums needed to develop the required infrastructure if a large portion of the customers will not be migrating to the competitive market for years. Others argue that a long transition will simply increase costs for all involved: utilities, ESCOs and customers.

<sup>42</sup> For example, the Commission has stated: "The most effective way to establish a competitive market in gas supply is for local distribution companies to cease selling gas." (Case 93-G-0932, Issues Associated with the Restructuring of the Emerging Competitive Natural Gas Market, and Case 97-G-1380, Issues Associated with the Future of the Natural Gas Industry and the Role of Local Gas Distribution Companies, Policy Statement Concerning the Future of the Natural Gas Industry in New York State and Order Terminating Capacity Assignment (issued November 3, 1998) (hereinafter Gas Policy Statement), p. 4.)

<sup>43</sup> Pennsylvania set the utility rates in an administrative proceeding. For most utilities, the rates were above market prices and substantial migration occurred until market prices exceeded the utilities' rates.

exceeding all of the utilities' rates causing customers to migrate back to the utilities. Massachusetts froze the eligibility for residential class rates at a specified time, and no new customer or customer returning from an ESCO is permitted to return to the rate regulated class. Ultimately, there will be no one on the regulated utility rate, but the process could take decades. Texas is proposing to move all utility customers who have not chosen a supplier as of a certain date to an ESCO affiliated with the utility. The regulated utility would become solely a "pipes and wires" company. The difficulties this approach might encounter--beyond the anger of irate customers who are switched without having given permission--are yet to be seen.

Unrealistic expectations concerning the timing of market development (either too long or too short) can have serious consequences to the public, and can, in the extreme, result in the worst of all possible outcomes--the creation of an unregulated monopoly. If competition is assumed to develop very rapidly and wholesale market prices are imposed on customers without regulatory intervention and from a market that is not workably competitive, higher prices and rates that do not meet the statutory standard of just and reasonable are likely. On the other hand, if a long transition is assumed and significant regulatory control continues to be exercised over prices, competition and its benefits could be stifled indefinitely. Further, if cost-of-service regulation is removed for the competitive undertakings of the utilities before robust competition emerges, or if customers are assigned to ESCOs on the basis of market share in territories where one supplier is clearly dominant,<sup>44</sup> we run the risk of creating an unregulated

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<sup>44</sup> The concern in this regard expressed by some parties is that the utility affiliate using the utility name will attract the vast majority of customers and cripple competition. While company specific statistics have been held to be trade secrets, the market shares held by utility affiliates in the territory of the affiliated gas or electric utility vary widely, ranging from little above zero to little below 100%.

monopoly rather than a competitive market. A realistic assessment of the likely duration of market development for each of the service classes is an essential consideration in defining a realistic transition plan.

Finally, the approach taken by the Commission in the telecommunications transition to competition may be instructive regarding the regulatory philosophy needed to both protect consumers and foster markets during such a period. The Commission adopted four overarching principles for the transition to competition; they are worth setting forth in full:

1. The goal of ensuring the provision of quality telecommunications services at reasonable rates is primary.

The primacy of this particular goal is of fundamental importance. While other goals in this proceeding may be important, even critical, to various parties, their attainment must not come at the expense of this primary goal.

2. Where feasible, competition is the most efficient way by which the primary goal may be achieved.

We have a long and successful history of enabling the development of competitive markets and seek here to establish a framework for further competitive development.

3. Regulation should reflect market conditions.

Our regulatory framework must be designed for the present transitional market, not for yesterday's monopoly nor for the fully competitive market that may ultimately develop. As such, rules should not be imposed which perpetuate or assume monopoly conditions; neither should regulatory protections be abandoned merely on the promise that the market may eventually provide them.

4. Providers in like circumstance should be subject to like regulation.

Similar regulation should be expected for providers with similar market power. Differential regulation may be appropriate and necessary where significant market power differentials exist.<sup>45</sup>

We recommend that the foregoing considerations be borne in mind in deciding among the policy options discussed below.

### III. VISION OF FUTURE RETAIL MARKETS

As previously noted, this proceeding was designed to address three general policy areas, the first of which is "the future of the competitive natural gas and electricity markets and the role of the regulated utilities in such markets."<sup>46</sup> To that end, the Commission promulgated a series of questions to be answered, which questions were expanded, clarified, and focused by the Judges as the proceeding progressed.

The questions raised by the Commission and the Judges first will be set forth below, followed by a review of the analyses performed (April 3 Report, pp. VI-18 to VI-47) and briefs filed by the parties (see Appendix B summary). The final portion of this section contains our recommendations.

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<sup>45</sup> Case 94-C-0095, Issues Related to the Continuing Provision of Universal Service and to Develop a Regulatory Framework for the Transition to Competition in the Local Exchange Market, Opinion No. 96-13 (issued May 22, 1996), pp. 3-4.

<sup>46</sup> Order Instituting Proceeding, Ordering Clause 1.

A. Questions Examined

The questions as posed by the Commission are set forth below in bold, with the Judges' embellishments shown in italics:<sup>47</sup>

**What is the role of the utilities in a competitive market?**

**Should monopoly utilities sell products or services that are available from competitive vendors? If so, on what terms** (*e.g., standard offer, wholesale flow-through, or "market value" pricing*)? **If not, when and how should the utilities' provision of such products and services be halted?** *Can regulatory incentives be designed to make it in the utilities' interest to exit these functions?*

**Is it efficient for the utilities to continue as providers of last resort? If not, how would that function, including consumer protection, be carried out?**

*How would the new POLR provider be chosen? What would be the likely impact on consumer costs of substituting a POLR provider for the utility? Should the utility transition out of the POLR function, and if so, how and over what period? If the utility provides only transportation, what consumer protections must be provided by the utility and the commodity supplier? Are there legal constraints to changing any of the existing POLR functions?*

*What are the functions included within the utilities' existing POLR role? Define all functions within the POLR responsibilities. Should existing programs for those on life support equipment or for the elderly, blind, or disabled be included?*

*What role should consumers' interests or desires play in determining utility product and service offerings? Should prepaid meters be allowed: By the utility? By the non-utility POLR? By any ESCO?*

**What responsibilities, if any, should utilities have in developing competitive markets, e.g., monitoring**

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<sup>47</sup> The questions and their evolution can be tracked in the April 3 Report Appendices, Appendix I.

**and verifying customer switches among suppliers;  
inspecting meters installed by competitors?**

**What has been the experience in other states and other  
countries; what works and what doesn't?**

The following questions were posed for the analysis phase:<sup>48</sup>

1. *Once the fully competitive retail markets have developed, should the utilities continue to offer products or services otherwise available in such markets? To state it differently, should we move to Model 2 once a fully competitive market has developed for a product or service? For the purposes of this question, a "fully competitive retail market" exists when a fully competitive wholesale market is operating without significant exercises of market power, when retail consumers have multiple choices of suppliers and prices, and when the regulated utility is no longer the dominant market supplier (i.e., when a substantial portion of customers have migrated to other suppliers).*
  - *How do the costs and benefits of the alternatives change if customer classes are treated differently from one another? For example, are the costs and benefits different if utilities do not offer such products/services to the industrial and/or commercial classes, but continue to offer them for the residential class?*
  - *How are the costs and benefits affected if some utilities continue to offer such products/services and others do not?*
  - *How are the costs and benefits affected if different arrangements are made for the gas and electric sectors?*
2. *If the utilities no longer offer commodity, should all utility-customer retail relationships be severed? In other words, what would be the costs and benefits of moving from Model 2 to Model 3?*

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<sup>48</sup> Ruling on Scope and Process for Phase 2 (issued October 18, 2000).

3. *Assuming the utilities are not providing commodity (Model 2) or are providing no retail services at all (Model 3), by whom and how should HEFPA protections for residential customers be provided?*
  - *If HEFPA protections are provided by all ESCOs serving residential customers, are there any activities governed by HEFPA (such as the physical connection and disconnection of customers) that should remain the exclusive province of the utility? If HEFPA costs were unbundled, what costs would be included?*
  - *How, if at all, should consumer protections be amended in the final state? Consider, among other things, limiting or otherwise changing HEFPA, or instituting anti-slamming rules, truth in advertising requirements, "report cards" on ESCO complaints, or publicly available costs comparisons.*
4. *Should utilities be totally freed from residually performing functions transferred to marketers? Can or should this be done over time and by customer class as the market develops? Are there statutory changes required for this result?*

The following additional questions were posed for the analysis phase at the request of the parties.<sup>49</sup>

- *Which provider of last resort roles and responsibilities, if any, should be transferred from the utility to other entities as movement occurs toward a competitive market? Are there any POLR roles and responsibilities that should be required of all ESCOs?*
- *What are the necessary steps to accomplish the foregoing transfer(s)?*
- *How, if at all, should POLR responsibilities be substantively changed in a competitive market?*

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<sup>49</sup> Further Ruling on Scope and Process for Phase 2 (issued November 6, 2000).

- *Should POLR issues be resolved differently for different customer classes?*

The following questions were posed at the March 14, 2001 prehearing conference for consideration in the parties' policy briefs:

1. *In creating a vision of future energy markets, should we choose a model for the end-state or adopt a more generalized statement?*
2. *Should the concepts underlying the Gas Policy Statement (Cases 93-G-0932, 97-G-1380, issued November 3, 1998) be adopted for electricity?*
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?*
4. *Should the telephone model, that is, the obligation to serve and the application of telephone consumer protections applied to all competitors, be adopted in the energy markets in the end-state?*

B. End-State Policy Options

Most parties agree that choosing an end-state vision of the retail energy markets and thereby reaffirming the Commission's commitment to retail competition are critically important. Some ESCOs argue that investments in New York are unlikely unless the Commission's support for retail competition, its vision of the end-state market structure, and a clear blueprint for getting there are clearly expressed. In addition, the competitive end-state must be known in order for effective transition plans to be adopted and implemented in the numerous multi-year rate plans likely to come before the Commission in the near future; if a reasonably defined end-state is not identified, transition plans cannot be rationally formulated. It is therefore deemed critical for the Commission to adopt or

to reaffirm<sup>50</sup> its vision of the end-state for the retail energy markets.

At the outset it should be noted that no party supports a complete reregulation of the retail markets<sup>51</sup> and most express confidence that competition will ultimately provide significant benefits to consumers. Nevertheless, the parties have provided a very broad range of policy options in this area. A few have suggested that the pervasive problems in the wholesale markets and the lack of experience in the nascent retail markets make it premature to set these policy goals. Others urge the Commission to adopt an end-state in which the utilities are removed from all retail functions (commodity, billing, metering, customer care, etc.) on the grounds that such an end-state offers the greatest level of potential savings. In between these extremes are the potential adoption of the Gas Policy Statement for electricity (thereby removing the utilities from the "merchant function"<sup>52</sup>), the approach recommended in SP2 (thereby removing the utilities from the commodity market and ultimately from all retail functions if certain preconditions

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<sup>50</sup> The Gas Policy Statement sets forth this vision in the gas industry, but it states that the utilities should be out of the merchant function in 3-7 years (from 1998). Two basic problems with this policy statement have been identified by the parties: the schedule for achieving the end-state appears unduly optimistic; and, for the next several years, it does not appear that competitive markets will be possible for critical pipeline capacity.

<sup>51</sup> KeySpan suggests that if the Commission does not allow it to get out of the small-use customer retail market over the next 12-18 months, it might as well return the small-use customer market to full regulation for the foreseeable future. It adds that it does not support this option.

<sup>52</sup> As used by the Commission in the Gas Policy Statement it seems clear that the term "merchant function" refers to the sale of the gas commodity as well as the pipeline capacity needed to bring the gas to the city-gate. It is not simply limited to commodity, as some parties have used the term in briefs, nor is it broad enough to cover all retailing activities, as other parties have used the term.

are met), or the adoption of one of the three models crafted by the parties for analysis.<sup>53</sup>

In addition, many parties have argued that, regardless of the nature of the end-state vision, is critical to maintain flexibility and avoid irreversible decisions in implementing the adopted policies. If anything is certain in the developing markets it is that the unexpected will occur, and the ability to address those unexpected twists and turns must be maintained if the overall effort is to be successful. Some note that robust markets are not necessarily achieved by a dictated end-state and that the end-state should be determined by what the markets are able to achieve. Others suggest that the end-state goal is useful, but that deciding too many of the details of that vision now may inhibit competition, discourage customer choice, and prove fatal to market restructuring efforts. In the same vein, it is argued that adopting timetables within which the vision would be achieved is premature and that, given the problems with the electric wholesale markets and gas reliability concerns, any chosen dates would be arbitrary.

The policy options for identifying a vision for the end-state are discussed below, followed in each case by our recommendations.

1. Choose No End-State

a. Discussion of Parties' Views

One utility argues that a uniform end-state model should be adopted statewide, a position generally supported by the ESCOs and other non-utility parties. On the other hand,

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<sup>53</sup> In analyzing the options available, the parties developed three different end-state models (April 3 Report, Section IV, pp. 15-21). Model 1 reflects the status quo and its adoption implies a different end-state and different functions being performed by each utility in the state. Model 2 assumes the utilities would leave the commodity business but remain in other retail markets. Utilities would either sell delivery services to customers and ESCOs, or only to ESCOs. Model 3 assumes utilities exit all retail functions, becoming pipes-and-wires companies selling distribution to ESCOs only.

those who believe it is premature to choose any end-state vision usually point to the problems being experienced with the ISO and the lack of sufficient electric and gas infrastructure. Some argue that no vision of the future markets should be adopted until the Commission's legal authority to achieve such a result is resolved. These parties state that solutions to these problems are at least three years away and may be as much as seven years away.<sup>54</sup> Rather than adopting an end-state vision now, what is needed, according to these parties, is a re-evaluation of the schedule and infrastructure requirements needed to achieve the goal of robust wholesale and retail competition.

Two utilities also argue that a uniform statewide vision for the end-state would violate their right to self-determine their own most advantageous end-state. One utility contends that significant progress has been made operating under the status quo and that markets will develop of their own accord if given sufficient time. These parties argue in essence that Model 1 should be adopted as the end-state vision and that little more need be or should be done at this time. Adopting this recommendation would leave in place the varied approaches that resulted from the last round of electric opinions. Under a Model 1 approach some utilities could offer customers the choices of buying everything (bundled service) from the utility or the ESCO, or buying commodity from the ESCO and transportation from the utility (Model 1a); others would not permit customers to buy bundled service from the ESCO (Model 1b--also known as the dual retailer model); and some utilities would not permit customers to separately buy delivery

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<sup>54</sup> The parties' estimates are based on the time required to solve ISO problems and to certify and construct new electric generation and gas and electric transmission facilities. A similar period (three to four years) may also be required to complete the court challenges promised by a couple of the parties to any Commission order directing the utilities to cease offering gas or electric commodity or to seek legislation that might be needed to support such an order (see discussion of legal issues infra.)

from the utility and commodity from the ESCO (Model 1c--also known as the single retailer model).

The majority of the parties believe it very important to identify some end-state vision now so that future planning may proceed. The choice of an end-state and some idea of the schedule for achieving it will have, according to these parties, a significant impact on utility rate proceedings and on the willingness of ESCOs to invest in the infrastructure needed to support the evolving market. Decisions in utility cases on matters ranging from rate design and unbundled rates to the types of services to be provided by the utilities over the next several years<sup>55</sup> will directly depend on whether an end-state vision is chosen and, if so, which one. It is further argued that unless the Commission continues to endorse retail competition development and issues some statement of its vision for the future, ESCOs will not invest further in New York and the fledging markets that do exist may collapse.<sup>56</sup>

Overall, most parties see taking no action or adopting Model 1 as unacceptable. ESCOs complain that the seemingly random and arbitrary differences in the retail access programs of the utilities<sup>57</sup> renders competition on a statewide basis

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<sup>55</sup> For example, utilities now price electric commodity to ratepayers in three different ways: fixed-rate (e.g. NYSEG), partially hedged rate (part long-term contracts and part spot market) (most utilities), or straight pass through of the market price (Niagara Mohawk SC-3A customers). The method chosen for commodity pricing in the next round of cases can have a substantial impact on the development of the market and the vision adopted here could greatly affect those decisions.

<sup>56</sup> MI contends that the number of ESCOs serving large gas customers has been steadily declining over the past several years, and it urges the Commission to monitor the situation. More generally, it appears that a great many of the more than 200 Commission registered ESCOs are not currently serving customers.

<sup>57</sup> For example, there is no uniformity among the utilities' commodity pricing (fixed, partially hedged, unhedged) or the roles utilities assume in the market (Models 1a, 1b, or 1c).

difficult to impossible. Allowing the utilities to remain in competitive markets (or failing to adopt a vision under which the utilities exit those markets) will doom any effort to create retail competition in the mass markets (i.e. the market of residential and other small-volume users). One utility joins the ESCOs arguing that we should go aggressively forward or go back, but the status quo is intolerable. Other parties seem to believe that the progress made with the existing utility programs is so slow that the benefits of competition will be denied to all but the large-use customers for decades (or perhaps permanently) unless an end-state vision other than Model 1 is adopted. Most of these parties in turn believe that one of the principal reasons progress has been so slow is the substantial incumbency advantage of the monopoly utility.

This raises the question of whether the utilities should be allowed to remain in any markets that became workably competitive.<sup>58</sup> The arguments against allowing the utilities to remain in competitive markets include most fundamentally a concern that the incumbency position of the utility coupled with "customer inertia"<sup>59</sup> could defeat the goal of developing robust retail competition. Customers, especially small-use customers, would simply not leave the utility. This competitive advantage would not allow, according to some, a fair chance for ESCOs to compete.

The parties also note regulatory difficulties that would result from allowing the utilities to compete in their formerly monopolistic markets, including: the need to prevent monopoly revenues from subsidizing the utility's competitive offerings; the difficult and controversial determination of appropriate back-out credits or unbundled rates for competitive

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<sup>58</sup> April 3 Report, pp. VI-19 to VI-24.

<sup>59</sup> The parties generally assume that some customers will feel more comfortable staying with the "trusted utility" even when it may be advantageous for them to purchase energy from an ESCO. Under the circumstances, customers are likely to favor long-term, fixed price rate plans even if those plans are not economically attractive.

services; the possibility that a utility with virtually all the customers buying most of what the wholesale market is offering in its territory would create monopsonist or oligopsonist problems, either of which could diminish greatly the potential benefits of competition; and, with the utility controlling the bottleneck services (i.e. pipes and wires), the need to maintain close regulatory scrutiny to avoid discrimination based on the identity of the customer's energy supplier.

Those favoring allowing the utility to remain in markets that become workably competitive argue that: removing the utility eliminates one competitor as a customer choice and reduces the competitiveness of the market; customers who want to be served by the utility should not be forced to accept another supplier; competition in the telecommunications industry has been successful where the incumbent supplier has remained in the market, and that model should be adopted for energy; if the economies of scope and scale result in the utilities being the lowest-cost provider, eliminating the utility from the market would cause prices to rise; eliminating a utility function could result in the work being performed out-of-state; and, finally, the Commission has no authority to remove the utilities from markets which become workably competitive.

b. Recommendations

The existing flaws in the operation of the wholesale market, the inadequacy of transmission (gas and electric), and the lack of adequate generation reserves must be solved before robust retail competition can be expected. On the electric side, more generation must be built, more aggressive action

needs to be taken to reinforce the transmission system,<sup>60</sup> and demand side market creation and numerous other issues at the ISO need to be resolved. On the gas side, constrained pipeline capacity likely eliminates the possibility of having robust competition for this element of the retail product until additional capacity is added. This in turn suggests that the Gas Policy Statement's vision of removing the utilities from the totality of the merchant function (i.e. commodity and capacity) cannot be achieved in the near term. Until some method to allow competition for this capacity becomes apparent, we recommend that the gas end-state vision not include competitive pipeline capacity.

While the foregoing observations have a direct impact on our recommendations for fostering the development of retail competition in the short term (discussed below), they do not preclude the adoption of an end-state vision. Numerous infrastructure problems in both the wholesale and retail markets<sup>61</sup> and they must be solved before the end-state can be achieved; but that does not mean that an end-state vision of the markets cannot be selected. Indeed, the failure to articulate such a vision in this proceeding would clearly impede ESCO investment, without which retail competition is more likely to fail. A guiding vision is also necessary to be able to address, in a reasonably uniform fashion, the utility programs, services,

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<sup>60</sup> MI argues that the Commission needs to devote more attention to efforts to increase New York's electric transmission and gas pipeline capacity, noting that a number of new gas-fired generating plants will come on line over the next few years, which will exacerbate existing gas and electric constraints. MI appears to be correct that more attention is needed to upgrade electric and gas transmission infrastructure. We recommend that more aggressive efforts be made in this area, if necessary, directing the franchised utilities to construct the needed facilities.

<sup>61</sup> We are using the term "infrastructure" broadly to refer to the rules and requirements for market operation such as a plan to provide uniform consumer protections, fully unbundled rates to assure a level playing field, uniform business rules, flexible billing tariffs, environmental disclosure procedures, etc.

and rates that will be established for multi-year periods for many of the utilities in the next six to twelve months. While we strongly agree that the policies adopted here must be flexible and designed to be reversible at low cost, the failure to adopt a pro-competitive vision now could have material adverse public consequences. If retail competition is not to be abandoned (and no party suggests it should be), we recommend that one of the end-states discussed herein be adopted as a guiding vision.

We do not recommend adopting Model 1 as the end-state goal. Robust competition across the state and among utility territories is unlikely to develop given the significant differences in substance and philosophical approach among the utility programs that currently exist. If each utility offers different services, if each utility is free to determine which businesses it will enter and which it will not,<sup>62</sup> and if the pricing of commodity differs from utility to utility it is hard to see how robust, statewide competition can ensue.

Moreover, development of the market for small-use customers under Model 1 conditions has been glacially slow. Many reasons have been given for this result: small to non-existent commodity margins; monopoly revenues subsidizing utility competitive commodity rates; customer inertia; the failure of ESCOs to offer attractive product combinations and/or attractive pricing plans (e.g. hedged products, caps, collars,

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<sup>62</sup> Those utilities who claim the right to determine their own course ignore the public interest obligations imposed on their corporations by the government's grant to them of a monopoly franchise. The law grants a monopoly and gives the corporations the right to charge rates that are just and reasonable to their stockholders (as well as to the ratepayers), but it does not permit them to enter into any competitive business they see fit. For example, the Commission has ordered utilities out of the appliance sale and repair business, based on its concern, among other things, that the competitive business could be subsidized with funds derived from the provision of monopoly services. These corporations, imbued with a public service obligation, have no such absolute rights.

etc.); and, perhaps the most frequently cited, the incumbency advantage of the utility that has always been the supplier for 100% of the customers.<sup>63</sup> Regardless of the reasons for the slow rate of development of the mass markets, however, most parties agree that Model 1 is not an end-state that will achieve the Commission's goals.

The arguments concerning future and ongoing ESCO investment in the state also are persuasive. Businesses will not invest if the "rules of the game" are not known. This is especially true regarding the mass market, where the margin per customer is small and the cost to acquire and serve customers is high compared to large-use customers. We are convinced that, if a long-run vision is not adopted or if Model 1 is chosen as the end-state, there will be no significant further investment by ESCOs in the state. It is also entirely plausible that some of the ESCOs now serving the state will leave. Indeed, if MI's allegations concerning gas marketers is accurate, this exodus may have already begun.

Rejecting a "do-nothing" approach and the adoption of Model 1 as an end-state brings us to one of the most pivotal and fundamental issues in the proceeding: should the utilities be allowed to remain in any market which becomes workably competitive? In our judgement, the answer to this question must be no for two basic reasons: the market-limiting power of the incumbent utility; and the constant need to exercise close regulatory scrutiny of utilities performing both competitive and monopoly activities.

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<sup>63</sup> We are not persuaded by the argument raised by a few utilities that markets have developed for large-use customers without removing the utility as a competitor, and, therefore, markets will develop under the same circumstances for small-use customers. As MI noted, large-use customers are much more sensitive to small changes in price (i.e. more price elastic) than are small-use customers. In addition, a wide range of flexible pricing plans are (gas) or will be (electric) more readily available sooner to large-use customers. These and other factors suggest that the development of the market for small-use customers will be much more difficult and will take longer.

The majority of parties in the case as well as the vast majority of jurisdictions that have considered this issue (including New York for natural gas) have concluded that robust retail competition in the energy markets is unlikely to evolve if the incumbent utility is allowed to remain a competitor. And even if this conclusion may be questioned in principle, the highly publicized recent difficulties encountered in various restructuring efforts simply increase the attractiveness to customers of the familiar, stable, safe utility. The incumbency advantage of the utilities in the mass market is probably greater now than it has ever been. In our view, it will take well more than a decade for competitors to wrest from the incumbent more than half the market (compare, e.g., the long distance telephone market), if an end-state permitting the utilities to remain in competitive markets is adopted. (Even with a vision of the utilities removed from the competitive markets, a number of years will be required before the conditions justifying the exit of the utilities from the residential market will be manifest.)

Even assuming that the slow evolution of the market over a number of decades were deemed to serve the public interest, we would still recommend an end-state vision with the utilities removed from workably competitive markets.<sup>64</sup> The close regulatory scrutiny that would be required of utilities offering both monopoly and competitive services would be substantial.<sup>65</sup> In setting rates, the Commission would have to consider the different level of risks the utilities' competitive and non-competitive services would face, and the correspondingly

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<sup>64</sup> We are using the term "workably competitive markets" to mean retail and wholesale markets, uninfluenced by the exercise of market power, where customers have a variety of supplier choices and the choice of a number of different products. Utilities should not be removed from any markets until all these conditions have been met.

<sup>65</sup> In the Gas Policy Statement (p. 4) the Commission noted that if the utilities were no longer in the merchant function, "the regulation of a competitive function should be unnecessary."

different costs of capital that each of its endeavors would engender. While prudence would likely remain the standard for monopoly service cost recovery, competitive losses on the competitive side of the utilities' business might well be deemed unrecoverable. The identification and separation of recoverable prudent costs for monopoly services and non-recoverable competitive losses for competitive services would undoubtedly create perpetual litigation. It would also be extremely difficult to set rates in a manner that precluded the use of monopoly service income to subsidize rates for competitive services and products. Finally, with the utility in control of the bottleneck service (pipes and wires) and participating in a competitive market that depended on those bottleneck services, issues of favoritism and undue discrimination by the utility in favor of customers purchasing the competitive product from the utility are bound to arise. Some parties that support allowing the utilities to remain in competitive markets argue that it is not unfair to limit shareholder opportunities to only monopoly services; this point, which we find unpersuasive, is discussed below. Some argue that allowing the utility to remain in the market provides the customer with one additional choice, but the Commission rejected this argument in the Gas Policy Statement.<sup>66</sup> Finally, some contend that if utilities have no retail services, communications with customers will be more difficult which could affect service quality, costs, and the ability to offer tailored economic development programs. We are not convinced that there are any significant public benefits that would be lost if the utilities were required to cease offering products and services that become available through a workably competitive market.

In our view, overall, if the utilities were allowed to remain in competitive markets in the end-state, rate and service regulation would become more complex, more contentious, and more difficult, and any benefits achieved by allowing the utilities to compete in these markets would be minimal. In fact, the Commission specifically noted that vertical market power

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<sup>66</sup> Gas Policy Statement, p. 5.

concerns could justify divesting energy services from a utility's offering.<sup>67</sup>

Furthermore, considering the essential character of rate regulation, it is not clear why the utilities would even want to remain in the energy commodity business. Utilities earn profits on invested capital, not expenses. Now that the utilities have sold the vast majority of their generating assets, their costs for commodity are virtually all expense rather than capital items, and there would seem to be no profit-making incentive to remain in these markets, except in connection with energy market speculation that should, in any case, be precluded.<sup>68</sup>

Finally, it is important to note that the utilities have been allowed to create holding company structures under which unregulated affiliates of the utility are permitted to compete in the energy markets. These affiliates have been

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<sup>67</sup> After concluding that it would be preferable for the utilities to divest generation, the Commission turned to energy services provided by the utilities and stated: "As to energy services, to the extent that divestiture will provide consumer benefits (lower rates, increased choice, and reduced likelihood of market power abuse), divestiture of this function is encouraged." (Case 94-E-0952, Competitive Opportunities Regarding Electric Service, Opinion No. 96-12 (issued May 20, 1996), pp.90-91).

<sup>68</sup> If, for example, the utilities' commodity rates were completely frozen regardless of the market price of the commodity, utility profits (or losses) would be generated based on the cost of its portfolio of energy supplies. As the California experience shows, however, this is an extremely risky and speculative venture; it is the type of risk an enterprise affected with a public interest should not take. If utility energy rates are tied to utility costs, however, the utility will have no incentive to speculate in the market as only its net costs will be permitted in rates. We strongly recommend that utility energy rates remain tied to energy costs and that rates not be frozen without regard to those costs. If this approach is adopted, the utilities will have no profit incentive to remain in the commodity or any other competitive field which is not characterized by large capital investments.

granted the further benefit of being able to use the utility corporate name and logo which used to be the sole province of the monopoly. Thus, for example, denying the utility the right to sell commodity does not deny its shareholders the right to profit from the commodity market through the unregulated subsidiary. These shareholders have also maintained the right to benefit from the use of the corporate name and good will. Thus, no claim of unfairness or inequitable treatment could be raised against a requirement that utilities exit any functions for which workably competitive markets develop.

Having concluded that neither doing nothing nor adopting Model 1 is recommended and that utilities should not be allowed to remain in workably competitive markets, the remaining policy options for an end-state vision are the choice of Model 2 or 3, the adoption of SP2, and/or the adoption of the Gas Policy Statement for electricity.<sup>69</sup> These options are next discussed.

## 2. Models 2 and 3 and POLR

### a. Discussion of Parties' Views

To analyze the benefits and detriments of removing the utilities from various functions that have the potential to become competitive, the parties developed and analyzed what have been called Model 2 and Model 3. Under Model 2, end-use customers would be required to purchase electric and gas commodity from ESCOs; utilities would no longer purchase capacity, energy, and ancillary services on behalf of electric customers nor upstream pipeline capacity, storage, or commodity

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<sup>69</sup> Another option presented was the adoption of certain aspects of the "telephone market model," where the obligation to serve and consumer protections imposed on the regulated utility are also imposed on all competitors. In the present energy market, competitors have no obligation to serve (i.e. they can discriminate among customers on any grounds) and are not required to provide the statutory (Home Energy Fair Practices Act [HEFPA], Public Service Law §31 et seq.) or regulatory (non-residential rules, 16 NYCRR, Part 13) consumer protections that are required of utilities.

for gas customers.<sup>70</sup> Two versions of Model 2 were considered. Under Model 2a, utilities could offer both single retailer service (customer buys a bundled product from the ESCO) and dual retailer service (customer buys energy from an ESCO and delivery from the utility). Under Model 2b, the utilities would offer only dual retailer service.<sup>71</sup>

Under Model 3, the utilities would no longer have any retail relationship with end-use customers, would no longer retain retail service capabilities, and would sell energy delivery services to ESCOs who would resell them bundled with commodity and, potentially, an array of other services.<sup>72</sup> The delivery services remain regulated, but ESCOs are free to design, package, price, and bill for all retail services.

Under both models, the utilities would provide only energy delivery and would no longer be obligated or permitted to provide energy. The parties generally believed that some entity other than a utility would fulfill the statutory mandates that all customers be served (subject to limited and defined exceptions) and that residential customers receive the consumer protections required by HEFPA.<sup>73</sup>

The parties recognized that neither of these models exists today, for utilities continue to have the obligation to serve, but they suggested that "virtual Models 2a or 2b" now

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<sup>70</sup> April 3 Report, section IV, p. 17.

<sup>71</sup> The parties assumed under this model that utilities now offering only single retailer service (such as RG&E) would be required to discontinue that service and adopt the dual retailer model.

<sup>72</sup> Many predicted the bundling of utility services (e.g. telephone, internet, gas and electricity, cable TV), energy efficiency and management services, and other services once the markets opened, but little evidence exists that these packages of services are being sold in the residential market.

<sup>73</sup> The Home Energy Fair Practices Act, Public Service Law, §31 et seq. It was also assumed that this entity would be required to follow the Commission's non-residential consumer protection rules (16 NYCRR Part 13).

exist for industrial gas customers, almost all of which now purchase gas from non-utility sources.<sup>74</sup> Niagara Mohawk states that "these large customers are ineligible for Niagara Mohawk gas supply service."<sup>75</sup> In 1995 NFGDC eliminated its tariff for gas sales to large volume customers because none were being served. While a non-residential rate is available from NFGDC today, nearly all medium- or large-sized commercial and industrial customers are now buying commodity from ESCOs. Both firm and interruptible KeySpan tariffs are available for large-use customers, but the firm rate is relatively unattractive and no large-use customers are taking the service. All of this suggests that Model 2 can work where the economics of the market favor competition.

The parties' analysis of Models 2 and 3 began with a detailed delineation of the various functions performed by the utilities, and, identification of those that could potentially become competitive (e.g. various customer care functions) and those that were unlikely to become competitive (e.g. the physical disconnection of a customer).<sup>76</sup> While some level of agreement was reached regarding the functions the utilities would continue to perform under each of the models (e.g. maintenance of the pipes and wires, service restoration activities, special service offerings such as for those on life support equipment), the enormous level of detail generated by the parties raised at least as many questions (e.g. whether gas metering should be considered potentially competitive) as it did answers. As noted by one utility, the schedule in the case did not permit an analysis of the costs associated with transferring each of the functions to an ESCO, nor was a determination possible of which of the multitude of functions could in fact become competitive and which could not. While a few parties were not satisfied by the level of detail, the close examination

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<sup>74</sup> April 3 Report, section IV, p. 19.

<sup>75</sup> Niagara Mohawk Initial Brief, p. 17.

<sup>76</sup> April 3 Report, pp. VI-4 to VI-18, and Appendix VI.

of utility functions will be valuable in the unbundling track of this proceeding.

The parties also undertook a comparative analysis of Models 2 and 3, both in the April 3 Report (pp. VI-24 to VI-33) and in their briefs (see Appendix B summary), addressing the questions of the costs and benefits of moving from Model 2 to Model 3 and whether Model 3 should be allowed if the Commission determines that Model 2 is the preferable end-state. While the parties concluded that calculating the costs and benefits of the models is problematic from a number of perspectives,<sup>77</sup> most parties believe that Model 3 offers the greatest opportunity to minimize costs. Under Model 2, the utilities would remain in a number of retail businesses including billing, metering, customer care functions, etc. Exiting the commodity market alone would not allow utilities to shed as many costs as would be the case if the utilities left all retail functions.

In addition to cost considerations, one party expressed the concern that Model 3 would not allow it to maintain a retail relationship with the distribution utility, a relationship valued by some large customers. MI asserts in this regard that large customers with monthly bills in the tens of thousands of dollars "often require a more personalized level of service for reliability and other purposes."<sup>78</sup> Others noted the risks of adopting Model 3 as the end-state before it is known whether suppliers are willing and able to perform all retail functions. On this issue, Model 2 appears attractive because it allows a transition to competitive markets on a function-by-function basis as these services become more widely offered. Some parties also noted that Model 3 might expose customers to the manipulation of delivery rates by ESCOs, who,

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<sup>77</sup> The parties noted that it would be helpful to first clearly identify each of the functions to be provided and to be abandoned by the utilities under each model. But, even if statewide cost study parameters were established and the functions clearly defined, it would still be necessary to examine the costs on an individual utility basis.

<sup>78</sup> MI Initial Brief, p. 26.

in the absence of a Commission prohibition, could mark up the cost of the delivery service they are purchasing from the utility. Staff, in contrast, argued that competition should limit the ability of the ESCOs to make large profits by marking up wholesale transmission and distribution.

RG&E urged that even if Model 2 is chosen as the end-state, utilities so wishing should be allowed to move to (or remain at) Model 3. Those favoring this approach argue that if the utility can save customers money by moving to Model 3, they should not be precluded from doing so, and that the voluntary adoption of Model 3 by one or more utilities could serve as a test of the model. Those opposing the permissive adoption of Model 3 worry that one utility voluntarily adopting the model could set a precedent to which all would be required to conform in order to achieve a standardized approach across the state. They argue as well the choice by some utilities of Model 2 and the choice by others of Model 3 would create impediments for ESCOs wanting to do business on a statewide basis. They also warned of customer confusion caused by multiple models.<sup>79</sup>

Perhaps the area that generated the greatest effort by the parties, as well as some of their strongest controversies, was the issue of the POLR. For the sake of this discussion, it is assumed that there are two basic aspects of POLR service beyond price: the obligation to serve "all customers" and the provision of consumer protections (HEFPA protections for residential customers and non-statutory protections for non-residential customers).<sup>80</sup> The end-state options considered by

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<sup>79</sup> The surveys and focus groups tend to suggest that the complexities of the models are not easily understood and that most people do not want their choices limited to non-utility suppliers.

<sup>80</sup> In discussing POLR service in Opinion No. 97-5, the Commission indicated that POLR responsibilities are threefold: to accept customers subject to consumer protection rules (e.g. HEFPA); to obtain electricity supply; and to provide programs to assist low-income customers. (Case 94-E-0952, supra, Opinion No. 97-5 (issued May 19, 1997) mimeo at pp. 10-11). Low-income programs are discussed below under public benefit programs.

the parties began with the assumption that necessary consumer protections in a competitive market may be somewhat different from the current requirements of the Public Service Law and Commission regulations. While the specifics of how the current requirements would be changed was not reached, there was broad support for continuing collaborative discussions on this topic.

There also appeared to be general support for the proposition that all utilities and ESCOs (and, in one party's view, aggregators as well) should be required to abide by the same set of consumer protection rules in the end-state. This approach has been followed by the Commission in the telephone industry, where all competitors are required to abide by the same consumer protection rules required of the utility. At the present time, however, ESCOs are not required to provide the HEFPA or non-residential consumer protections that are required of the utilities.<sup>81</sup> Most ESCOs believe that providing HEFPA protections would be quite expensive and that their imposition on ESCOs could drive a number of them out of the market.<sup>82</sup> On the other hand, it appears that most other jurisdictions have required ESCOs to provide the same level of protections to consumers as those offered by the utilities,<sup>83</sup> and, in Pennsylvania (electric) and Georgia (gas) at least, it does not appear that these requirements have adversely affected competition. Nevertheless, the ESCOs argue strongly that HEFPA should not apply to them.

Of even greater concern to the ESCOs than consumer protections, however, is the issue of the "obligation to serve." At the present time only the utilities are obliged to serve all consumers without undue discrimination, and the ESCOs vigorously argue that if they are subjected to this obligation, they will

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<sup>81</sup> There is one partial exception to this statement. In the RG&E implementation of Model 3 (single retailer), the ESCOs are required to provide some of the HEFPA protections.

<sup>82</sup> NFGDC reports that this was their experience in Pennsylvania, where a gas POLR pilot program was undertaken.

<sup>83</sup> April 3 Report, Appendix V-D.

not be able to do business in New York and the retail market will never develop.

Parties taking the contrary view respond that the obligation to serve all customers in the chosen service classification (e.g. residential, commercial, or industrial) and geographic territory has been imposed on telephone competitors in New York and has worked well. Further, the CPB notes that the obligation to serve was imposed on the gas marketers in Georgia and that robust competition for customers nonetheless ensued. In fact, the CPB argues, ESCOs have an obligation to serve all customers in their selected service categories and territories in England, California, Connecticut, Georgia, New Jersey, Ohio, Pennsylvania, Rhode Island, and Texas.<sup>84</sup> It goes on to note parallel requirements in the banking industry, where credit cannot be denied on the basis of age, sex, marital status, religion, race, color, national origin, receipt of public assistance, or disability. It must follow, the CPB alleges, that competition can flourish in those industries where essential services are offered and where they must be provided without undue discrimination. According to the CPB, the obligation to serve, at its core, is no more than a legal requirement to provide service without undue discrimination.

In the end-state, if all ESCOs are required to comply with statutory consumer protection rules and if they are required to serve all customers in the areas they choose, there will be no need to select a POLR, as all sellers would be

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<sup>84</sup> CPB Initial Brief, pp. 20-22. The CPB notes that Maryland also imposes an obligation to serve on ESCOs, but allows them to refuse service to a customer based on poor credit history. Ohio allows a "reasonable nondiscriminatory deposit" for service, but otherwise requires ESCOs to serve all customers in the class of customers served by the ESCO.

offering POLR service.<sup>85</sup> The only other end-state option the parties developed was to use a competitive bidding process to select POLRs every few years.<sup>86</sup> The POLR price, which might include both a fixed rate and a market rate offering, would be approved by the Commission, and the POLR would provide all statutory consumer protections and would have the obligation to serve. Non-POLR ESCOs would, as today, have no obligation to serve, could discriminate among customers as they saw fit, and would not have to offer the consumer protections contained in the Public Service Law. In effect, two different markets would be created.

If the parties' assumptions are correct, POLR service would be more expensive than service from non-POLR providers. However, to avoid having only the highest priced service available for the poor, for those living in areas not served by other ESCOs, and for those with poor credit histories, a funding mechanism to subsidize the cost of this last resort service was believed necessary.<sup>87</sup> Two options for approaching this issue were considered. Funds could be collected through a neutral wires charge paid by all customers--in essence, the same way the cost of utility POLR service is recovered today. A second option would be a "pay or play" approach where ESCOs would have

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<sup>85</sup> One important qualification on this statement should be noted. Before the utilities can be allowed to exit any function, the Commission must be certain that multiple suppliers are available for every geographic area in a utility's franchise territory. If the ESCOs self-identify the territory they intend to serve, there is always the possibility that few or none will be available in some areas. This may be the result of business economics (e.g. low population density) or it may reflect redlining. If the Commission decides to take this approach, the practice of redlining should be monitored.

<sup>86</sup> It is likely that more than one POLR would be needed to provide statewide geographic and service class coverage.

<sup>87</sup> Charging higher rates for essential energy services to those who have few, if any, additional choices and who may be least able to afford them was not generally believed to be just and reasonable.

the option of either providing full POLR service or contributing to a pool of funds that would help defray the cost of service of POLR-providing ESCOs. In either event, the Commission would have to determine the level of the subsidy, oversee its collection and disbursement, monitor the provision of POLR services around the state, operate and oversee periodic bidding processes, and resolve customer complaints.<sup>88</sup>

b. Recommendations

There is little doubt that Model 3, if it could be achieved, would offer the greatest potential savings for customers and provide the greatest range of competitive choices. Because the utility would maintain no retail relations under this model, the functions and associated costs that could be shed by the utility would be much greater than under Model 2. Also, because customers would have a range of competitive services, from billing and metering to commodity and customer care, that might not be competitively offered under Model 2, the options available to customers under Model 3 would be greater.

The largest drawback to Model 3, however, is the significant uncertainty over its feasibility. It is simply not clear that all of the utility's retail functions could be provided more economically by the competitive market. While competitive markets are in theory and in the long-run believed to be always more efficient, our role as defined under the Public Service Law is to assure that rates are just and reasonable even in the short run. The experience of the past few years shows that enormous, uneconomic transfers of wealth can take place in the short run, if the long-run ideology of market perfection blurs the focus on the shorter-run goal of just and reasonable rates. While we fully support open markets and believe in the long run they are the most efficient method

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<sup>88</sup> The new "POLR-ESCOs" appear similar to utilities and may require a similar level (perhaps a higher level at first) of regulatory oversight. This raises the question of whether such entities should also be required to fund DPS activities as the utilities now do (Public Service Law, §18-a).

to allocate societies' resources, the vertically integrated energy monopoly structures also contain significant efficiencies and economies and have allocated resources reasonably well in the past.<sup>89</sup> Opening all potentially competitive markets to competition, should be vigorously pursued; but until markets develop to the extent that we can be reasonably confident that a given market will be more efficient than the regulated utility and will offer benefits to all consumers, removing the utilities from that market should not be adopted as a regulatory goal.

We likewise advise substantial caution in choosing a specifically defined end-state that may take on a life of its own to the detriment of both consumers and efficient market development. As the California experience suggests, defining in detail and in advance the operations of a market that the government is trying to create carries substantial risks. Even if a market is created, it may produce prices that are not just and reasonable, as the FERC belatedly recognized has happened in California. Model 3 suffers from over-specificity, in our view, because it starts with the assumption that competitive markets will be able to perform all retailing functions, not just generation and energy supply, better than the utility. While this belief is consistent with the theory of competitive markets, there is as yet little evidence to suggest that competitors in these other retail areas will be more efficient than the existing vertically integrated monopoly. Should the theory prove correct, a Model 3 end-state should be adopted and fostered; but in our view it is premature to reach that conclusion now.

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<sup>89</sup>It is worth noting that the favorable view of the job performed by regulation has increased over the past 12-18 months. The conventional wisdom only a few years ago was that regulation was inefficient and that opening markets could only result in a decline in prices. California's reconsideration of the wisdom of retail competition and other states' putting restructuring efforts on hold suggest a resurgent appreciation of the benefits of a regulated, vertically integrated monopoly.

Nor is it clear as yet that Model 3 (single-retailer model) will induce independent ESCOs to offer all of the retailing services formerly provided by the utility, at least based on the experience of implementing that model in the RG&E territory.<sup>90</sup> At the present time, there are two independent ESCOs and one utility-affiliated ESCO serving electricity customers in the RG&E territory,<sup>91</sup> and virtually all customers who have left the utility for an ESCO are now customers of the utility affiliate--Energetix.<sup>92</sup> If the only major players in the market are the regulated utility and its affiliate, customer choice cannot be considered expansive nor competition considered robust.<sup>93</sup>

Finally, both Model 2 and Model 3 suffer from a lack of flexibility due, in part, to the extremely detailed definition of the models as designed by the parties. For example, under Model 2 the utilities would no longer purchase pipeline capacity from those areas where liquid markets exist to the utility city-gate. For a few years at least, it does not

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<sup>90</sup>At the present time, gas and electric customers in the RG&E territory who purchase commodity from an ESCO receive all retailing services from the ESCO. This is essentially a Model 3 approach.

<sup>91</sup>In addition, there are one municipal purchaser and one direct purchaser in the RG&E territory

<sup>92</sup>Specific information on ESCO market shares has been determined to be trade secret at the outset of competition because disclosure of the number of megawatts of capacity enrolled by individual ESCOs could likely cause substantial competitive injury to other ESCOs. (July 3, 1998 letter ruling of Records Access Officer Steven Blow to George Stein and Sara Schoenwetter). We of course abide by that ruling, but we suggest it be revisited.

<sup>93</sup>MI notes that in its experience with "utilities that have implemented some version of the single retailer model," the utilities have shifted numerous risks and costs to ESCOs without an increase in back-out credits or a reduction in regulated rates. If this allegation is true, it may explain why few ESCOs and customers have found the RG&E program attractive.

appear that competitive markets will be the most efficient or most cost-effective means to allocate the constrained supply of pipeline capacity. While it may be possible for that market to become competitive in the future, it is not clear now how that would be accomplished by entities other than the local distribution companies. Other examples could be drawn from the numerous "potentially competitive" functions identified by the parties,<sup>94</sup> but the point is that mandating a detailed definition of the end-state may result in a lack of flexibility to reverse course or to adopt different policies.<sup>95</sup> Accordingly, we do not recommend as the Commission's end-state vision the adoption of either Model 2 or 3 as defined in the April 3 Report.

At the same time, it does appear that a "virtual" Model 2 situation now exists for industrial or other large-use gas customers. The vast majority of these customers have migrated to ESCO service (one utility states that such customers are not even eligible for utility service), and those who have not are paying market based rates--clearly a service available from the ESCOs.<sup>96</sup> If the Commission desires to take any immediate action to remove the utilities as competitors in any market, gas service for industrial and other large-use customers is the place to do so. Legal issues remain of course and are discussed below, but the fact that most of these customers are not served by utilities now suggests that the market is workably competitive and is doing a better job of producing just and reasonable rates for this customer class than would regulation.

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<sup>94</sup>April 3 Report, pp. VI-4 to VI-18 and Appendix VI.

<sup>95</sup>For example, if the utilities divest themselves of their pipeline capacity contracts in anticipation of moving to Model 2 as defined, it may not be possible to reacquire those contracts at a reasonable cost if it becomes apparent that workably competitive markets for pipeline capacity are not yet possible. To the extent feasible, we recommend that the Commission adopt policies that can be reversed at low cost.

<sup>96</sup>Most ESCOs offer market based energy services, but few offer fixed or otherwise hedged products, especially for small-use customers for electricity supply.

Further, the fact that firm service tariffs do not exist for these customers at some utilities (and at least one may offer them no service at all) suggests that utilities can be moved out of markets in a way which yields net, short-term benefits to the consumer.

Based on the experience to date in the energy commodity markets, a Model 2 approach for both gas and electricity appears to be both feasible and potentially beneficial to customers. We accordingly recommend that a portion of the Commission's end-state vision include removing the utilities from the provision of energy commodity. (This recommendation for gas is limited purely to the commodity and does not include upstream pipeline capacity or system balancing.)

This experience in the development of the gas market raises some question regarding the role of a provider of last resort (POLR). It appears that the utilities now are not commodity providers of last resort for all industrial gas customers under all circumstances, and yet we have no reports of any customer being unable to obtain service. While there may be a theoretical need for an interim pooler<sup>97</sup> to provide service in the event of an ESCO default or bankruptcy and to cover the period before a new ESCO is chosen, it appears, at least for this class of customers, that robust competition will provide service for all who want it. If competition in other customer classes becomes sufficiently robust, there may ultimately be no need for a designated POLR.

As a number of parties have noted, the components and operation of a POLR for the mass markets as developed in this case are not sufficiently definitive that a specific approach

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<sup>97</sup>The gas market restructuring in Georgia which applies to all classes of customers includes the designation via competitive bidding of an interim pooler who agrees to provide short-term service to customers in the event of an ESCO default and until the customer can choose a new supplier. While defaults have occurred, the result has been that other marketers have bid for and purchased the accounts of the defaulting ESCO, obviating use of the pooler.

can be adopted with confidence. The two possible plans that have been explored, assuming that a POLR (rather than an interim pooler) is needed, are (1) to bid out the service to a limited number of ESCOs who would undertake the obligation to serve and provide all the consumer protections now offered by the utilities; and (2) to require all ESCOs to provide those protections and undertake the obligation to serve. Most parties advocate bidding, but strong support for the all-ESCO alternative was provided by the CPB and a few others. Aside from the question of whether a specifically designated POLR is needed in the end-state, both alternatives present serious drawbacks.

Before discussing either of these proposals, it is important to first determine why a POLR might be needed. It is usually argued that the law imposes an obligation to serve all customers and that the competitive market will not provide service to all customers, or at least will not serve them at a price that would be possible under regulation. Low-income customers or those with poor credit ratings are often cited as those most likely to be unable to obtain service at just and reasonable rates. If the competitive markets will not serve these customers or will not serve them at just and reasonable rates, a POLR may be needed that will provide service to all customers at rates regulated to ensure that they are just and reasonable.

Perhaps the greater concern is the price a poor customer would have to pay to receive service from the market. In the past, bad debt and uncollectible costs were spread via ratemaking across the entire customer base, and the price a customer had to pay was unaffected by the customers' financial status or credit history. In a competitive market where suppliers are free to discriminate at will, it is more likely that the ESCOs would attempt to recover the costs (or cover the risks) of serving a high-risk customer directly from that customer. Even if the ESCO spreads those costs over its entire customer base, that base will likely be much smaller than the existing utilities' customer base, putting upward pressure on

the ESCO's prices. In either event, some consumers may well have fewer and less attractive choices than others due to their financial circumstances.<sup>98</sup> Clearly, some provision should be made, by designating a rate-regulated POLR or otherwise, to ensure that the benefits of competition are not restricted to those in good financial standing.

As mentioned above, another possible use for a POLR is to provide short-term service to customers whose ESCO has defaulted. The service would be provided at market rates until the customer chose another supplier. Such an entity may well be required due to the inherent nature of gas and electricity supply. In both cases, the commodity continues to flow even if the ESCO leaves and stops providing supply. Some entity must be ready to purchase supply for the customer and to bill for consumption, and it would seem that only a single designated POLR (or pooler) would be able to fill this minor but still essential role.<sup>99</sup>

A final potential use of a POLR is to generate markets. The idea is that large blocks of customer accounts can be auctioned to ESCOs who agree to provide the equivalent of utility service. In this approach, designating a POLR is actually a technique for creating a market and encouraging customer migration. The difficulty here is that, if a developed

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<sup>98</sup>That the market will differentiate among customers to a much greater extent than utilities now do should be assumed. For example, residential customers with significantly different load patterns are likely to have significantly different rate options, with the most economical usage pattern receiving the lowest rate. Discrimination for rational economic reasons will allow the markets to become more efficient and should be encouraged. Discrimination based on income, however, should not be permitted for the supply of these essential services. At the present time, ESCOs are free to discriminate on this or any other basis.

<sup>99</sup>This role would be short in duration, would not need to be subject to rate regulation (rates could be limited to a market price pass through and customers could leave immediately by choosing another ESCO), and might never be used if the experience in Georgia is a guide.

market does not exist, requiring customers to buy in the market may result in significantly higher prices (due to the absence of meaningful ESCO economics of scale) or poor service (due to the lack of adequate ESCO infrastructure). We do not recommend that a POLR designation process be used for the purpose of creating a market or forcing the migration of customers. As suggested in SP2, forced migration of customers should be avoided if at all possible, and should be used only as a last resort, to allow the utilities to avoid all costs associated with providing a particular function.

Turning to the two specific POLR proposals developed by the parties, we start with the proposal to seek competitive bids for a limited number of POLRs. It should first be noted that the number of competitive auctions could be substantial. Separate bids may be required by fuel type, by customer service classification, and by geographic location. It may also be necessary in each of those areas to have more than one POLR in the event a POLR-ESCO leaves the market or becomes bankrupt. If these auctions are on a two-to-three year cycle as suggested in SP2, a huge administrative effort would be required in perpetuity. Further, if, as the parties assume, POLR service is more expensive than service offered by non-POLR ESCOs, there may be a need to establish and administer some type of funding mechanism to subsidize the cost of the statutory consumer protections for those who desire them (or cannot otherwise obtain service), and to ensure that they are provided at just and reasonable rates. Again, the administrative cost of establishing and perpetually operating such a process could be substantial.

Perhaps an even more serious flaw is the likely unattractiveness to any ESCO of such a POLR contract. Having won a two-year contract, for example, the ESCO would have to invest in the infrastructure necessary to serve all customers in the contract area. 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. Further, it appears that offering

attractive energy prices may require purchase contracts for gas, electricity, or pipeline capacity significantly longer than two or three years. If the POLR ESCO is unwilling to enter into such contracts, the POLR service bid price could be well above the non-POLR market, and mitigating that price could become very costly for all customers. Therefore, short-term contracts for POLR services may create much higher prices than would otherwise be available in the market.

Nor are we convinced that establishing two classes of ESCOs (POLR and non-POLR) and two classes of service offerings (with and without statutory protections) will aid in the development of robust markets. The creation of two separate markets reduces the level of direct competition and the number of competitors in each market. Further, to the extent that POLR service needs to be subsidized, the winners and losers in the competition between the markets will be decided on the basis of the size of the government subsidy granted--the litigation of which would create yet another regulatory morass--rather than on ordinary competitive criteria such as the quality of service. Under such circumstances, it is difficult to believe that the markets would operate efficiently, and the likelihood that the markets would provide benefits over existing service would therefore be reduced.

In addition, the use of bidding to select a designated POLR begins to sound very much like we are trying to recreate a utility. The POLR-ESCO would provide all utility consumer protections, would be obligated to serve like a utility, would have its rates and its service regulated like a utility, and would be subject to Commission oversight like a utility. (It might also be required to pay a Public Service Law, §18-a assessment like a utility.) While it might be comforting to be able forever to offer reasonable regulated rates as a guaranteed alternative to the competitive market, efficient competition is unlikely to develop under those circumstances. For example, if, thanks to subsidies or otherwise, the POLR rate is below the market price, consumers will flock to the POLR-ESCO and

competition will wither.<sup>100</sup> On the other hand, if the POLR rate is well above market prices, the cost of POLR service for those who cannot get service from non-POLR ESCOs would be more expensive. Careful regulation of the POLR rate would be an ongoing concern, and the effort to do so could be more complex than regulating the utilities' rates today. It makes little sense, in our view, to require the utilities to leave the market, if that in turn requires an elaborate administrative effort to recreate "ESCO utilities" every two or three years through a competitive bidding process.

By comparison with the above, there is much to be said for dealing with POLR needs by requiring all players in the market to offer the full gamut of consumer protections and be subject to an "obligation to serve."<sup>101</sup> This approach begins with the assumption, shared by virtually all parties, that all providers (utilities and ESCOs) should be required in the end-state to provide the same type and level of consumer protections. Most parties also believe that the existing requirements--HEFPA for residential customers and the Commission's non-residential rules for commercial and industrial customers--should be reexamined in light of competition to adapt the monopoly based rules to a competitive environment and to expand the rules where required to address competitive market

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<sup>100</sup>This appears to be happening in Pennsylvania where utility rates are now below market rates and customers are returning to the utility.

<sup>101</sup>While the ESCOs argue strenuously that these requirements are too costly, it seems to us that the burden of the obligation to serve without discrimination and the cost of providing HEFPA and other consumer protections are not as significant as argued. The obligation to serve is not absolute; customers must still pay for services if they can. For those with poor credit histories, deposits can be required to limit uncollectible expense, and the level of bad debts in the utility industries appears to be relatively low compared to other competitive endeavors. However, the actual cost of fulfilling these obligations may be better known at the conclusion of the unbundling track of this proceeding.

abuses.<sup>102</sup> If such an overhaul of the consumer protection rules is accomplished (as recommended below) and if those rules are applicable to ESCOs and utilities alike, one of the principal reasons to have a designated POLR--to provide statutorily mandated consumer protections--no longer exists. It should also be noted that requiring ESCOs to provide the same protections to consumers as are provided by the utilities is the approach taken in virtually every state that has undertaken restructuring, and we see no good reason not to require utilities and ESCOs to offer the same protections for consumers throughout the State of New York.

The "obligation to serve," under this POLR approach, would also apply to all suppliers. ESCOs would be permitted to specify the classes of customers and the geographic areas they intend to serve, and, within those bounds, the ESCOs would have to serve all customers without undue discrimination. Again, the need for a designated POLR would no longer exist; multiple periodic auctions would not be required; separate POLR prices would not have to be scrutinized or regulated; separate POLR and non-POLR markets would not be created; no Commission designation of a POLR would be required in the event of an unsuccessful auction; subsidies for POLR service from the non-POLR market would not be required; the cost of POLR service would be spread over the entire customer base as is now the case; and there

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<sup>102</sup>In a monopoly setting, there is no need to consider slamming and cramming, down payments lost when the supplier goes out of business, and unfair or fraudulent business practices (e.g. misleading customers as to the identity of the supplier). These obviously become concerns as the competitive markets develop.

would be no need to designate an "interim POLR" that would provide service in the event a designated POLR defaults.<sup>103</sup>

In the end-state, we recommend that all ESCOs be required to provide all of the general consumer protections required of utilities under the Public Service Law and be required to serve without undue discrimination all customers in the customer classes and territories chosen by each ESCO.<sup>104</sup> We do not recommend that the Commission impose these requirements, however, until such time as the parties have had an opportunity to review and propose changes to existing consumer protections and to offer a more detailed standard that would fulfill the obligation to serve.

These recommendations necessarily assume that the Commission has the authority to impose these requirements on ESCOs and to enforce them. This legal issue was not addressed by most parties in the case, and we urge them to set forth their positions and arguments during the exceptions phase. In our view, the Commission should have the authority to guarantee that

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<sup>103</sup>Once the utilities exit a market, however, some system will be required to designate a short-term supplier for customers whose supplier abruptly leaves the market until such time as the customer can designate another supplier. This "gap" supplier could be a single entity (e.g., the Georgia pooler approach) chosen via a bidding process or designated on a rotating basis, or the short-term obligation to supply could be assigned to ESCOs on a market-share basis. It is our expectation that utilities would continue to fulfill this role until they were removed from the market.

<sup>104</sup>Rather than impose the somewhat vague statutory language-- "undue or unreasonable preference or advantage" and "undue or unreasonable prejudice or disadvantage" (Public Service Law §65(3))--it might be preferable, as other states have done, to specify the grounds on which discrimination would be prohibited. For example, discrimination could be prohibited on the grounds of race, gender, employment, financial circumstances (perhaps other than the non-payment of bills for energy services), marital status, ethnicity, etc. In our view, it is extremely important to clearly establish these market rules to protect the provision of these essential services for all consumers.

essential energy services continue to be provided in a non-discriminatory way by all suppliers, whether or not the utilities fully exit the competitive markets.

3. SP2 and the Gas Policy Statement

a. Discussion of Parties' Views

Straw Proposal 2 (Appendix A) created by Staff with the input of the parties, is a broadly (though by no means universally) supported array of guiding principles, end-state visions, transition plans, and action steps. Many of the parties oppose at least some aspect of SP2 (including the Judges), but a good deal of the controversy is over timing or nuances of approach, not substance.<sup>105</sup> The Gas Policy Statement is similar in a number of ways to SP2 in its enunciation of principles and a gas market end-state vision where the utilities no longer perform a "merchant function." Because of the similarities, these documents will be discussed together.<sup>106</sup>

In SP2 as in virtually all the Commission's statements of its vision for the future, the primary goal is the provision of high-quality service at reasonable rates.<sup>107</sup> Equally uniform is the Commission's belief that the best way to achieve the primary goal is through competition.<sup>108</sup> In the telephone context, the Commission added to the concept of competition the qualifier "where feasible," suggesting a recognition that workably competitive markets may not be feasible for every

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<sup>105</sup>We will discuss in this section the principles and end-state vision in SP2 and will discuss transition plans and action steps in Section IV.

<sup>106</sup>A significant portion of the Gas Policy Statement dealt with the purchasing and selling of pipeline capacity. The changes in the markets since 1998 render most of this discussion dated, and our references to the Statement are intended to be exclusive of that topic.

<sup>107</sup>SP2 at Appendix A, p. 1; Gas Policy Statement, p. 4; Case 94-C-0095, Opinion No. 96-13, p. 3; Case 94-E-0952, Opinion No. 96-12, pp. 24-26.

<sup>108</sup>Id.

product and service.<sup>109</sup> Similarly, SP2 also confines the reliance on competitive markets to those circumstances where they will provide more choices and value to consumers.

Significant similarities among these documents are also evident with respect to the need for continuing regulation and market oversight. SP2 states that regulation should continue for monopoly functions, foster market development, ensure consumer protections, and make certain that a supplier is available for every customer. The Gas Policy Statement recognizes the need for a POLR (to guarantee a supplier for every customer), for adequate information to oversee and regulate the developing market, for sufficient and accurate information for consumers to use in making informed decisions, and for the coordination of federal and state policies. In the telephone context, the Commission noted that the regulatory framework should be designed for the transitional market (neither monopoly nor competitive) and that all providers in like circumstances should be subject to like regulation.<sup>110</sup> Opinion 96-12 likewise refers to the ongoing regulatory obligation to provide just and reasonable service for all, to continue consumer protections, to continue public benefit programs that may not be provided by the competitive markets, and to provide sufficient information for consumers to allow them to make informed decisions.

SP2 and the Gas Policy Statement both go on to provide additional specificity regarding the end-state vision. The Gas Policy Statement notes that the best way to establish a competitive market is for the utilities to "cease selling gas" and to separate the "competitive merchant function" from the

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<sup>109</sup>Case 94-C-0095, Opinion No. 96-13, p. 3.

<sup>110</sup>The Commission also said in Opinion No. 96-13 that differential regulation may be appropriate and necessary where significant market power differences exists.

monopoly distribution function.<sup>111</sup> SP2, recognizing that delivery will likely remain a monopoly function, suggests that all other functions, as they become available in workably competitive markets that provide increased choices and value to the consumer, should be provided by those markets. If such markets develop for all of the utilities' retail functions, the utility in the end-state would be purely a wholesale delivery company--Model 3. SP2 stops short, however, of endorsing Model 3 as an end-state vision to be adopted by the Commission.<sup>112</sup>

SP2 also says more pointedly that "[e]lectricity and gas utilities are expected to be out of the commodity function, i.e., buying and selling electricity and gas, for all customers."<sup>113</sup> But SP2 provides a series of criteria that would have to be met before the utilities left the commodity function. SP2 also provides that "[a] multi-stakeholder 'Competition Council' should be established to monitor the status of wholesale and retail competition, and to report to the Commission when the above criteria have been met." Finally, SP2 assumes that the preconditions can be met (we assume for both gas and electric commodity) within 48 months.

With regard to other retailing functions, SP2 expresses no "expectations," noting only that billing and electric metering markets are being opened. Should any of these or other retail functions become workably competitive in the future, the utilities may exit the market if the Commission can

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<sup>111</sup>Gas Policy Statement, p. 4, which also stopped short of a Model 3 end-state. The Commission said that other non-commodity gas retail service matters such as competitive metering, billing, and information services, could be pursued in conjunction with the electric restructuring proceedings. (Id., p. 9).

<sup>112</sup>A number of parties read SP2 as adopting Model 3 as an end-state vision and support it for that reason. While SP2 is clearly supportive of a Model 3 result, it does not express any confidence that such a result is feasible and does not endorse the adoption of Model 3 as Commission policy.

<sup>113</sup>Appendix A, p. 3 (emphasis added).

determine that the market contains a sufficient infrastructure to provide the retail services. Model 3 is achieved only if the markets develop sufficiently to be able to provide all the utilities' retail services to all customers.

Except for those who prefer Model 1, most of the criticism of SP2 concerns implementation issues (discussed under Market Transition below). A number of parties, however, challenge the SP2 assumption that commodity competition sufficient to justify the utilities leaving the market will occur in 48 months. A few argue that this period is much too long and that the market can and should be made ready in a much shorter time (12-18 months is suggested). Another party argues that the market will not be ready for retail competition for seven years and that our sole focus now should be on the creation of adequate infrastructure for the wholesale markets. One utility notes that some of the SP2 preconditions are not within the control of the parties and that any time frame chosen is likely to be arbitrary.

b. Recommendations

The statement of vision and end-state goals in SP2 and the comparable statements in the Gas Policy Statement received little criticism in the parties' briefs, and either of them could be adopted as basic guidelines. And though few parties mentioned similar vision statements in Opinion No. 96-12 (electricity) or 96-13 (telephone), those statements also could be adopted. A combination of some of the concepts, however, might produce a better result, and we would recommend the following as a statement of the goals undergirding the transition to competitive markets:

1. The provision of safe, adequate, and reliable gas and electric service at just and reasonable rates should be the primary goal, having priority above all others

This suggests that:

- Before taking any action in the competitive arena the Commission should be convinced that net benefits to

the customers will result in the short-run as well as in the long run.<sup>114</sup>

- Rates must remain just and reasonable during the transition and in the end-state.
- Consumer protections should be available on the same terms to all customers, and low-income, special needs, and public benefit programs should remain available until such time as the Commission determines they are no longer needed.

2. Where possible, all services and products should be provided by competitive markets and not by regulated utilities

This suggests that:

- Wherever reasonably possible, markets should be opened to competition and utility rates should be fully unbundled to maximize customer choice.
- It should not be a foregone conclusion that competitive markets will always be able to provide net benefits to consumers greater than those the regulated, vertically integrated monopoly can provide.
- Once workably competitive wholesale and retail markets are achieved, the utilities should exit those functions.

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<sup>114</sup>This concept may be especially controversial given that a couple of ESCOs specifically warned that it may be some time before customers will see economic benefits, even if the utilities are removed from the market quickly. It seems to us that if the market is not sufficiently developed to provide better prices and/or better service than the utilities do now, it would not yet be in the public interest to remove the utilities from that market.

3. The regulation of rates, services, and competitive market activities should be appropriate for the status of the transition (with greater scrutiny being exercised at the outset, and less as the dominant players lose the ability to exercise market power) and for the status of the service provider, (with greater scrutiny being exercised over those with greater market power)
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This suggests that:

- The degree and type of regulation undertaken may vary by customer class, for some are entering the last stages of market transition (e.g., large-use gas customers) and others have barely begun (e.g. residential electric customers).
- Cost-based rate regulation should continue to be applied to competitive utility products and services to avoid subsidizing those services with monopoly revenues.
- Scrutiny of the activities in the competitive market, especially those of the incumbent utility, is required to prevent the exercise of the incumbent's market power and to prevent undue discrimination based on the incumbent utility's control of bottleneck facilities.
- Sufficient information regarding the market must be available to the regulator to allow adequate oversight of the market.
- All providers in like circumstances (considering especially market power) should be subject to like regulation.
- Regulation should be designed to foster the development of competitive markets.

Regarding the end-state vision of the market and the role of the regulated utilities, we recommend the approach taken by SP2. In our opinion, there is sufficient evidence to believe that workably competitive energy commodity markets can be achieved and that they will provide net benefits to consumers. We recommend that the end-state vision include competitive energy commodity markets with the regulated utilities no longer

providing these services. The vision adopted, however, should not assume that similar results can be obtained for all the utility's retail functions or for gas pipeline capacity.<sup>115</sup> In our view, it is premature to conclude now that workably competitive markets can be developed except in the electric and gas commodity markets.

A further aspect of SP2 that should be mentioned is its vision that the utilities can be removed from the retail commodity business in 48 months. In our view, such a deadline is artificial and potentially misleading. First, SP2 sets forth a number of preconditions to the utilities' exit from the commodity markets,<sup>116</sup> all of which are sound but some of which are not within the control of the parties or the Commission. Second, the significant differences in maturity between the gas and electric markets means that utilities could be removed from gas markets much sooner than they could for electric markets. Third, it seems clear that markets will develop more rapidly for large customers and the preconditions for utility removal from those markets are likely to be met well before they are for the

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<sup>115</sup>The Gas Policy Statement should be adjusted to reflect the fact that it is not now clear whether workably competitive markets can develop in this area.

<sup>116</sup>While SP2 does not discuss preconditions for other potential markets, we believe similar preconditions (e.g. workably competitive markets, adequate infrastructure to serve all customers, general public acceptance, etc.) should be applied before the utility is required to leave any markets.

mass market.<sup>117</sup> Finally, in light of the different geographic markets for electricity and gas, the SP2 preconditions could be met at different times in different parts of the state.

In our view, a workably competitive retail market for gas commodity for large-use customers now exists, and it may be possible to remove the utilities from this market in substantially less than 48 months. At the other end of the spectrum, it does not appear that workably competitive wholesale markets for electricity will exist for three to four years, and workably competitive retail markets for residential and small commercial customers may not develop for a number of years thereafter. Accordingly, we do not believe it prudent to set a date certain now by which the utilities would be removed from all energy commodity markets. We do recommend, however, that, so long as customers are not disadvantaged, all reasonable efforts be made to foster the development of commodity and other potential markets, as described below.

#### IV. TRANSITION TO MARKETS

In this section we discuss the wide variety of approaches suggested by the parties for the period of transition between a fully regulated monopoly environment and a competitive one. We also review the various impediments to market

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<sup>117</sup>MI argues that it would be discriminatory for the Commission to prevent the utilities from serving large customers first and argues that the preconditions should be met for all classes of customers before the utility exits any function. But not all differential treatment is undue discrimination. Factual differences among classes, such as the two specifically noted by MI (large customers have a greater elasticity of demand, ensuring that a robust market will develop more quickly for such users; and large customers "often require a more personalized level of service for reliability and other purposes") (MI Initial Brief, p. 26) can form the basis for differential treatment. Indeed, if all differential treatment constituted undue discrimination, the Commission would be more constrained in dealing with rate design matters and might have been unable, for example, to allocate rate reductions during the late 1990s in a manner that recognized the benefits of economic development.

development identified by the parties as well as their specific suggestions for steps the Commission could take to remove them. We will discuss the timing and overall philosophy of the transition, back-out credits, hedging and related ratemaking issues, consumer protections and ESCO complaint handling, customer migration strategies, the definition of terms, and other miscellaneous issues.

We begin with the questions examined by the parties as originally set forth by the Commission and as supplemented and expanded by the Judges. Next, specific transition issues are discussed with our recommendations following each discussion.

A. Questions Examined

Once again, the questions as posed by the Commission are set forth below in bold with the Judge's embellishments shown in italics:<sup>118</sup>

**What are the obstacles to the more rapid development of a retail market, especially for residential and small-use commercial customers?**

- *What are the costs of steps that might be taken to increase customer migration and what are the expected benefits to consumers and to market development? Over what period of time should the steps be taken and who should bear the costs?*

**Are there changes to the existing industry structure that may make the development of retail markets easier?** *What would be the impact on market development of: fixed price (i.e. standard offer), variable price (i.e. wholesale market pass-through) and "market value" commodity pricing by the utility?*

**Are there ratemaking or rate design changes that may make the development of retail markets easier, and, if so, what are the projected costs and benefits?** *How does the complexity of utility rate structures and tariffs affect competitive retail markets, and what remedies are available?*

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<sup>118</sup>April 3 Report, Appendices, Appendix I.

**Can customer aggregation programs (e.g. those using affinity groups) create a foundation for retail migration? How can aggregation programs be stimulated?**

**What has been the experience in other states and other countries; what works and what doesn't? What is the impact of back-out rates, the level of stranded costs, and the level of SBC charges on the development of retail access?**

The following questions were posed by the Judges for the analysis phase:<sup>119</sup>

1. *What steps, if any, should be taken to overcome customer inertia and the incumbency benefits of utilities?*
  - *Incentives? Should ratepayer funds be used on a temporary basis to increase more quickly the number of market participants? Should incentives be provided to utilities for meeting customer migration goals?*
  - *Mandates? Should customers be required to leave the utility and choose a marketer? What should be the preconditions (e.g., a percentage already migrated, a minimum number of ESCOs providing services, etc.) to requiring such action?*
  - *If customers are required to leave the utility, how should it be accomplished? Consider other states' experience (e.g. Georgia - market percentage assignment; Texas - all non-choosing customers migrated to the utility ESCO; Pennsylvania - by auction; other?). Do the costs and benefits of the options vary with the customer class?*
  - *If customers are provided incentives to migrate to an ESCO, which incentives should be considered? Limiting the offerings of the*

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<sup>119</sup>Ruling on Scope and Process for Phase 2 (issued October 18, 2000).

*utilities (e.g. spot market price pass-through only)? Incentives funded from utility rates (e.g. one-time payments; slightly increased utility rates to render ESCO offerings more attractive)? Should different incentives be considered for different customer classes? For example, should utilities be precluded from offering individually negotiated industrial or large commercial contracts?*

- *Are there rate design changes that could facilitate market development?*
- 3.<sup>120</sup> *Should ESCO entry be facilitated by requiring inter-utility uniformity with respect to customer migration procedures, balancing (gas), tariff provisions, or other specific matters?*
  4. *Should voluntary or mandatory registration of aggregators be undertaken? What definitions should be used for ESCOs and aggregators?*
  6. *What are the costs and benefits of moving to a competitive market over time by removing the utilities from providing competitive services/products by customer class?*

The following questions were posed at the March 14, 2001 prehearing conference for consideration in the parties' policy briefs:

1. *Should commodity ratemaking mechanisms, especially regarding hedging, differ for small and large customers in the near term? For example, should greater hedging be provided for small customers and less or none for large customers?*
2. *Should the approach taken in the Gas Policy Statement on hedging (Case 97-G-0600, issued March 28, 1998) be adopted for electricity?*

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<sup>120</sup>The numbering set forth is consistent with the numbering in the October 18, 2000 ruling. The questions not set forth here appear in sections III and V of this recommended decision.

B. Transition Timing

1. Discussion of Parties' Views

As mentioned above, the parties have offered transition proposals that range from Model 1 (the evolving status quo) to a rapid transformation ("big-bang") plan that would have the utilities exit the commodity markets in 12 to 18 months. In our view, the overall concept of SP2 strikes the right balance.<sup>121</sup>

SP2 suggests a flexible transition period based on a series of preconditions that must be met before the utilities are required to exit the commodity markets. In brief, those conditions are:

1. Workably competitive wholesale markets exist.
2. ESCOs are willing and able to provide the services to the relevant market.<sup>122</sup>
3. All customers who need service are able to obtain it.
4. There is general public acceptance of restructuring and a reasonable expectation that the utility's exit from the market will yield additional benefits or savings for consumers.
5. The legal issues regarding the Commission's authority have been addressed.<sup>123</sup>

In conjunction with the preconditions, SP2 recommends the establishment of a multi-interest Competition Council "to monitor the status of wholesale and retail competition, and to report to the Commission when the [foregoing] criteria are

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<sup>121</sup>As discussed above, SP2's specific 48-month deadline for completing the transition is ill-advised and is not recommended.

<sup>122</sup>We interpret the reference to the "relevant market" to mean the gas or electric market for industrial, commercial, or residential customers.

<sup>123</sup>The legal issues are addressed in section VI.

met."<sup>124</sup> The Council would also be assigned the task of providing more detailed descriptions of those conditions.

The SP2 approach to removing utilities from competitive markets is based on assessments of when the marketplace is ready and capable of providing services and benefits to all consumers. Conversely, those seeking rapid transformation assume that the marketplace will never evolve to that state unless customers are forced to buy from ESCOs. SP2 assumes that markets will develop as the economics justifies their development and that it is unwise to force consumers into a nascent market where there is no assurance that they will benefit. Advocates of rapid transformation assume that markets can be best created by government decree and by forcing consumers to buy from the market, but even they acknowledge that consumers may not benefit immediately under such an approach.

## 2. Recommendations

The SP2 approach is correct, in our view, in rejecting a grand, government-sponsored scheme to force into being the perfect retail market. When governments try to dictate all the details of how a market should work, the results are rarely efficient and can be seriously perverse, as in California. It must be remembered that the primary goal under the Public Service Law is safe and adequate service provided at just and reasonable rates and that the creation of vibrant markets is simply a means to that end; it should not be an end in itself, especially if the approach to the market's creation will not offer consumers economic or other benefits (and may impose added costs) at the beginning. Markets should be allowed, even encouraged, to develop, but not forced into existence; and if and when they have sufficiently developed (i.e. met the SP2 preconditions), the utilities can be removed.

None of which means, of course, that the government has no role in market development. A significant amount of work remains to establish the appropriate ratemaking, consumer

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<sup>124</sup>Appendix A, p. 3.

protection, and physical (especially electric and gas transmission and distribution) infrastructure, as discussed above and in the following sections. In addition, and when the time is right, the Commission can encourage customer migration through a variety of methods (discussed below).<sup>125</sup> Once these infrastructure foundations have been laid, however, government mainly needs to get out of the way and play a flexible oversight role, imposing rules or other changes in the market only when it is clear that they are needed.

The preconditions and the Competition Council proposed in SP2 drew a number of comments and suggestions. Some believed that the preconditions were too vague and undefined and that the Council would be unable to agree on when they had been met. Another party observed that the last three conditions should apply only to the mass markets and were inappropriate for large customers. Similarly, concern was expressed that the Commission should not delegate its authority to the Council, which, if created, should play a purely advisory role. Others saw the Council as an added layer of bureaucracy that would only delay market development.

The SP2 preconditions, which garnered the support of many if not most of the parties, seem reasonably comprehensive,<sup>126</sup> although it is true that they are not well defined. It would be reasonable to adopt these preconditions tentatively and to ask the parties or the Competition Council to suggest further refinements.

We agree with those parties who believe that the Council could play a critical role in the transition, although

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<sup>125</sup>The time may well be right for larger gas customers (e.g. industrial and commercial) to be provided now with such encouragements. On the electric side, it is still too early to move forward with programs to aggressively encourage customer migration.

<sup>126</sup>The only amendment to the conditions we would recommend is adding the requirement that the retail as well as the wholesale market be workably competitive, i.e. operating without the exercise of market power.

its role should be only advisory. The Council can continue the successful collaborative efforts of the parties in this case and can report to the Commission regularly on the development of each segment of the market. In addition, the Council could be asked to make recommendations regarding the uniform set of consumer protections that should apply to all suppliers, or to address any other energy competition matters that may arise. Finally, the Council could perform these functions without the need for the creation of a formal Commission proceeding, thereby providing information and policy options more quickly and efficiently. Another possible role for the Council, if it is otherwise successful, would be to resolve or assist in resolving disputes among the utilities and the ESCOs.

We envision an advisory body of some 15 to 25 people representing all of those having an interest in the development of the market. Membership on the Council could rotate among representatives of the various interest groups. The Council could be chaired by Staff or an ALJ, or, in the spirit of collaboration, it could have a rotating chair. Opportunities to participate could be expanded through the use of subcommittees, which would likely be necessary to cover the breadth and diversity of the markets and the substantive matters on which it is asked to provide comments. The Council should decide its own operating procedures, subject to the requests made and deadlines established by the Commission, and any other conditions the Commission may deem appropriate.

C. Back-out credits, hedging,  
and related ratemaking issues

1. Discussion of Parties' Views

The April 3 Report (pp. V-3 to V-5), SP2 (Appendix A, p. 1), a number of the parties' briefs, and the restructuring experience in other states demonstrate the critical importance to market development of the rates charged for utility products and services and the utility charges a customer avoids by purchasing them elsewhere (also known as back-out credits). In Georgia, utility rates were increased by about 15% in order to

encourage migration, and the strategy worked better than expected.<sup>127</sup> In Pennsylvania, rates were set administratively, on the basis of the utilities' regulated rates. For the high-cost companies, the rates were initially above the market price, and considerable migration in those territories occurred. For the lowest-cost companies, rates were set below market costs and very little migration occurred. Now, rates are all below market costs, ESCOs are leaving, and customers are returning to the utilities. In Massachusetts, fully regulated rates are available to the residential class, defined as those who were on that service at the beginning of the program. New customers and those returning to the utility from an ESCO supplier must take a standard offer service, which consists of a flow-through of the market price.<sup>128</sup> Because market prices were above the cost of regulated service and because customers could not return to that service once they left it, little migration has occurred.

While solutions may be less clear, the problem is obvious. If a customer cannot save money by switching to an ESCO, it will not switch; and, if the customer can save money by switching back to the utility, it will (unless doing so is prohibited). Based on this analysis and the arguments of the parties, it appears that utility rates may be below market rates for two reasons: the stated utility rate (i.e. back-out credit) may not cover all of the costs for providing the service (i.e., the rate may be subsidized); or the utility has developed a supply portfolio whose hedged costs are at times less than the volatile spot market.

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<sup>127</sup>The extra funds collected were set aside to cover ESCO uncollectibles and to fund expansion of utility's gas infrastructure. For an ESCO to collect from the fund, it must submit a financial filing showing expenses and profits. To the best of our knowledge, no claims have yet been filed.

<sup>128</sup>Recently, Massachusetts has changed the standard offer service to a six-month fixed price. The utility issues a request for bids for a fixed-price supply, including in the contract the risk that quantities will vary. This risk is normally borne by the utility and its customers after the fact, but in Massachusetts it is factored into the initial rate.

Regarding the back-out credit and potential subsidy issue, the Commission has begun an expedited effort to fully allocate all corporate costs to the products and services offered by the utilities. Once rates are fully unbundled<sup>129</sup> the amount a customer saves by purchasing services from the competitive market (the price the ESCOs must beat) should fully and fairly represent the cost of providing the utility service.<sup>130</sup>

The question of hedging is more difficult and more complicated. In 1998, the Commission addressed this issue in the Statement of Policy Concerning Gas Purchasing Practices<sup>131</sup> in light of the significant volatility being experienced in the gas supply markets. The Statement (p. 3) observed that the "almost exclusive reliance on spot or monthly pricing does not attempt to manage price volatility." In contrast, the Commission stated, marketers appear to use a more diversified strategy. The utilities, however, were concerned that a more diversified purchasing strategy that would limit volatility could put them at a price disadvantage should the price of gas fall. The Commission concluded that the utilities should consider all available options and should take account, in determining their supply portfolios, of the interest in limiting the volatility of customers' bills. The Commission warned that excessive reliance on any one strategy might not be considered reasonable.

On the electric side, it appears that the utilities have physical hedges (i.e. long-term contracts from independent power producers or contracts obtained from the sale of their

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<sup>129</sup>This also assumes that cost-based ratemaking scrutiny continues to ensure that competitive utility offerings are not subsidized.

<sup>130</sup>The utilities argue that unbundling costs on anything other than a short-run incremental basis creates stranded costs that, in effect, subsidize the ESCOs. These issues are squarely presented in the unbundling track of this proceeding and will not be discussed here.

<sup>131</sup>Case 97-G-0600, supra.

plants [transition power agreements]) for a substantial portion of their supply. Some of those contracts will expire over the next few years, raising the questions of whether the utilities continue to hedge a substantial portion of their supply in the future; if so, for how long; and, if so, whether hedging should be provided for all customers or be limited to those classes for which hedged products are not yet available from the competitive market.

In the current retail market it appears that a variety of attractive hedged and other products are available to large-use gas customers, but significantly fewer such options are available to the gas mass market. For various reasons including the immaturity of the market, the same variety of attractive options are not available for either small- or large-use electricity customers. This is reflected in MI's position that there is no tremendous need for hedging for large-use gas customers, but offering hedged prices to such customers for electric service should be adopted as Commission policy. With specific regard to the transition power agreements, MI argues that all customer classes are "entitled" to the benefits associated with those agreements.

It appears that SP2 uses commodity pricing mechanisms to foster the competitive markets. For large-use electric customers it encourages the offering of a real-time rate option to increase demand responsiveness, but it does not discuss offering hedged pricing options or the "benefits"<sup>132</sup> of the utilities' transition power contracts to this class. For small-use customers, SP2 suggests that a hedging policy for electricity be adopted similar to that for gas. As the markets develop and as a variety of products, including hedged

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<sup>132</sup>The prices under these contracts are now below market, but if market prices decline sufficiently, as might result from the construction of new supply, these contracts might offer only stranded costs. If all customer classes are provided these benefits now, then it only seems reasonable that all customer classes will be responsible for any stranded costs that may appear in the future.

offerings, become available, utility hedging should be phased out and utility rates would be based solely on a pass-through of spot market prices. The theory is that the volatile spot prices will not be overly attractive to most customers, and migration to ESCOs, who could offer more stable (i.e. hedged) prices, will thereby be encouraged.<sup>133</sup>

From the customers' perspective all this seems relatively straightforward, but in viewing the options available from the perspective of fostering the development of retail markets, matters become more complex. It is generally assumed that one can avoid or limit the impact of market volatility through hedging, which, in the long run, will result in a higher but more predictable cost for the commodity. In the short run, hedges can either reduce total costs compared to the market or increase them; it is a gamble with the cost of the hedge (the bet) proportional to the risk it covers. There is no way to know in the short-run whether a hedged product will be more expensive than buying from the spot market.

In addition, if the utility's price is largely hedged through long-term contracts, it may be very difficult for ESCOs, who have a tiny fraction of the utility's purchasing power, to offer as attractive a product. If 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 the utilities. A stable market will have a difficult time forming under these circumstances, and additional problems are created by the possibility of stranding the costs of the utilities' hedges if customers leave in large numbers.<sup>134</sup>

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<sup>133</sup>In 1997, the Commission expected "that ESCOs will offer stable [electricity] prices if that is what consumers prefer." (Case 94-E-0952, supra., Opinion No. 97-5 (issued May 19, 1997), mimeo p. 12). So far, these offerings have not materialized, but it seems that many consumers might prefer such products were they available.

<sup>134</sup>The Massachusetts approach described above avoids the utility volume-related stranded cost problem by shifting the risk of a change in volume from the utility to the supplier.

In addition, the ESCOs have argued that they would prefer to compete against the spot market price plus the utility's cost to provide commodity service, rather than against a hedged price. Perhaps when rates are fully unbundled, this approach can be more successful, but to-date the ESCOs have not had broad success in competing against the spot-market price.

## 2. Recommendations

If the primary goal is just and reasonable rates (as recommended above), it is evident that hedging should continue to be used for small-use gas customers and for all electric customers. The migration of customers in these classes to market-based products has been limited, suggesting that attractive products have not yet been developed.<sup>135</sup> Further, it seems clear that the prices derived from the wholesale electric market are not at all times reasonable, and, probably as a result, attractive hedged electricity offerings are not generally available for any class.<sup>136</sup> Accordingly, until the wholesale electricity market becomes workably competitive and hedged products are widely available in the retail market, the utilities should continue to offer hedged products for all classes.

Given the spectre of stranded costs created by switching to ESCOs and then back to the utility as the market price rises and falls relative to the utility's tariff, consideration should be given to requiring a fixed contract term for hedged commodity for large-use customers. ESCOs require

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<sup>135</sup> ESCOs have argued that small-use customers are reluctant to leave the security of utility-provided service, but the experience in Georgia and in Pennsylvania (at least until recently) suggest that significant migration of small-use customers can be expected if the competitive market offers sufficiently attractive products compared to the products offered by the utility.

<sup>136</sup> This is not to say that no hedged products are available. For larger-use customers hedges can be obtained, but their cost is relatively high due to the volatility and relative unpredictability of the wholesale markets.

such terms to minimize their risks from customers "gaming" the system, and we see no reason the utilities cannot do the same.<sup>137</sup>

We also agree with MI that the benefits of the transition power contracts should be made available to all customer classes. Those classes supported the construction and operation of the utility plants, and, if there are benefits flowing from their sale, all customer classes should be entitled to them. The benefits should be provided in a competitively neutral way,<sup>138</sup> and the responsibility for the costs of the contracts should they become stranded should also be spread among all customer classes.

On the gas side, it appears that the market is offering superior products for industrial customers and perhaps for larger commercial customers, and we therefore conclude that no hedging is required for these customers.<sup>139</sup> As the gas market develops, hedging should be phased out for all commercial customers,<sup>140</sup> and ultimately for residential customers.

Therefore, we recommend that the hedging portfolio requirements of the Statement of Policy Regarding Gas Purchasing Practices be continued for gas (as described above) and be

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<sup>137</sup>Utility contract terms should be limited to perhaps a year or two to avoid locking-up all the customers in the market and thereby precluding the development of robust competition.

<sup>138</sup>The Competition Council could be asked to develop proposed implementation plans to accomplish this result.

<sup>139</sup>Due to the significant variation in customer class definitions among the utilities, a more precise delineation of which customers should be provided a hedged product and which should not will have to be determined on an individual utility basis. Recommendations in this regard could also be sought from the Competition Council.

<sup>140</sup>Again, the Competition Council could be asked to develop proposed implementation plans to accomplish this result.

adopted for electricity.<sup>141</sup> We hasten to add, however, that there should be some temporal limit to the physical and financial hedging contracts purchased by the utilities. If these contracts extend beyond the time when a workably competitive wholesale electric market comes into being, customers may be locked-in to utility contracts and market development could be stalled. And even if customers are not constrained under utility contracts, hedging well into the future creates a significant exposure to utility stranded costs. Similar results could obtain on the gas side if hedging contracts extend well beyond the point that the retail market offers a variety of attractive services to residential and other small-use customers. Again, timing can be critically important and that timing can differ significantly by customer class, depending on how the market develops. Accordingly, the utilities should be required to file for Commission approval their hedging plans by fuel and customer class, including a competitively neutral mechanism to recover the costs.

A number of parties also expressed concern over the proliferation of very long-term utility rate proposals, arguing that adopting such plans for competitive products would seriously impair the ability of the markets to develop. The long-term rate proposals appear to be based on an incentive-regulation theory under which utility prices are capped and a constant incentive is thereby created to reduce costs and

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<sup>141</sup>A few parties objected to the Gas Purchasing Policy Statement's position that a utility without a diversified gas portfolio will have to meet a heavy burden to demonstrate that its approach is reasonable. One utility argued that there was no need for such a statement because the utilities are under a legal obligation to provide such products under the Public Service Law. We are not convinced by these arguments. If a diversified purchasing portfolio is the prudent or legally required approach, the failure to adopt the approach is not prudent, and, under traditional regulatory practice, the utility would have a heavy burden to prove otherwise. The Commission's observation in the Gas Purchasing Policy Statement is simply a restatement of the law, which is appropriate to apply to both the gas and electric markets.

therefore increase profitability.<sup>142</sup> The argument has been made that because this type of approach has been used in the past for setting utility rates, cost-based regulation of what are now competitive services should be considered passé.

We are convinced that the establishment of long-term rate plans for competitive services<sup>143</sup> creates significant problems for the development of competitive markets. Because the utilities continue to control 85% to 95% of the retail commodity market, they also account for 85% to 95% of the commodity purchased in the wholesale market. This creates the potential for monopsony or oligopsony abuses, potentially for an extended period of time. Further, if the utilities purchase physical hedges for their existing customer base covering the next seven to ten years of commodity purchases, the active trading in the wholesale markets will be thin and the development of a robust wholesale market could be stunted. The development of the retail market could also be dampened if a long-term fixed price utility option were available well after a workably competitive markets came into being. In the worst case, these types of rate plans could guarantee that workably competitive markets never develop. If such markets develop nevertheless, utilities might end up with very large stranded hedging costs. We cannot envision circumstances under which it would be in the public interest to allow such extended plans. Accordingly, we recommend that the Commission adhere to its historic practice and allow multi-year rate plans for

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<sup>142</sup>The key to providing these incentives, however, is a true rate cap with no provisions to allow the utility to recoup unexpected costs or cost overruns. If these recoupment provisions are included there is only the illusion of a cap and the intended incentives are diluted or negated. It should be noted, however, that a true retail rate cap on extremely volatile wholesale commodity can be extraordinarily risky, again as shown by events in California.

<sup>143</sup>Longer-term rate plans for transmission and distribution services may well be a prudent approach, but that issue was not examined in this case.

competitive services that cover no more than three to four years.

We are also concerned that incentive ratemaking approaches, while commendable for monopoly services, could cause havoc in the competitive market. If rates are only loosely based on some level of historical costs and are capped at a negotiated or administratively-determined level, a potentially artificial (i.e. not based on a competitive market) price is established, possibly for years. If the resulting rates happened to track market costs, no harm to the market would be done; but if they did not, the ensuing competition would be between regulated and market-based prices. The resulting market would likely be inefficient. We accordingly recommend that utility rates for competitive products and services remain based on the utility's costs rather than being fixed regardless of costs under an incentive based regulatory plan.

A final issue was raised in the case concerning the utilities' ability to negotiate individual contracts with certain qualified large-use customers and the potential anti-competitive effect of such contracts (especially if they are long-term). It seems clear that these special contracts play an important role in economic development and that the discounts they provide should be continued; however, these contracts can also impede the development of competitive energy markets, without which future economic development could be severely harmed. As a reasonable solution to this problem, the utilities, first, should be allowed and encouraged to offer such contracts for electricity until a workably competitive wholesale market exists. As our best estimate of when that market will develop is three to four years in the future, new special contracts and contract renewals that include electricity commodity should not extend beyond June 30, 2005. Thereafter, the same level of benefits could be provided to these customers by the utility in a competitively neutral manner through its

transmission and distribution rates.<sup>144</sup> The economic development customers would then have the dual benefits of a competitively priced supply of commodity and a discounted price for delivery.

D. Customer Migration Strategies

During the course of this proceeding, a number of different strategies were discussed and investigated concerning the migration of customers to the competitive market. The most draconian approach is embodied in the "big bang" proposals, which would require customers to accept service from an ESCO almost immediately. At the other end of the spectrum, a laissez-faire approach would allow customer migration to evolve over time under the existing structure and without regulatory stimulus. Either of these approaches could be implemented in association with aggregation programs, which allow groups of small-use customers to combine their purchasing power to increase the competitive benefits they receive. Customers could also be provided incentives to migrate based on the rates and services which the utilities are allowed to offer. Each of these approaches is discussed below.

Forced migration of customers has taken a number of different forms. In Georgia, once customer migration had reached a certain critical level, all customers remaining with the utility were assigned to ESCOs in numbers proportional to each ESCO's market share.<sup>145</sup> A slightly less forceful method is the negative check-off approach used in Pennsylvania. There, customers were first asked if they wanted to remain with the utility and all who did not respond were assigned to ESCOs following a competitive bidding process. Massachusetts used a

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<sup>144</sup>The utility might still provide commodity thereafter, but it is assumed that the commodity rate would consist of a straight pass-through of the spot-market price.

<sup>145</sup>The customer migration level in Georgia that triggered their mandated migration was many times higher than current customer migration levels in New York.

different twist, establishing two separate categories of utility service, with fully regulated rates available only to those customers who were taking that service at the time the program began. New customers or customers returning from an ESCO are required to accept a market-based utility service. Texas offers yet another variation; there, customers not choosing an ESCO as of a certain date will all be removed from the utility to the utility's unregulated ESCO.

As a general matter, we agree with the statement in SP2 that the forced migration of customers should be disfavored and should be used only as a last resort after most customers have voluntarily migrated. It may also be advisable when the market is sufficiently developed to consider the Massachusetts approach, which makes a regulated utility rate available only to existing customers. We do not recommend, however, the forced migration of a large percentage of customers without their consent under any circumstances.

The laissez-faire approach, which has achieved some success here, will likely continue to provide only slow movement. Nevertheless, we recommend it as the best of the alternatives until workably competitive markets (especially at the wholesale level for electricity) come into existence. Once workably competitive markets do exist, we recommend that the Commission undertake more aggressive measures to foster the migration of customers to the competitive markets. This will advance considerably the time when the utilities can be removed and their competitive service costs fully eliminated from rates, something that might otherwise be a matter of decades.

Aggregation of small-use customers has also brought some meaningful success. This approach may be one of the best ways to confer the benefits of competition on small-use customers and to spur the retail market to increase its service to these customers. This migration strategy should be fostered to the greatest extent possible at the present time.

The Commission has already experimented with a number of different programs designed to provide financial incentives for consumers to migrate to the competitive market. In some

cases, those incentives offer a flat "sign-up bonus," and in others delivery or customer care charges are reduced to make purchases from ESCOs more economically attractive. Another incentive-based approach is to render utility rates less competitive by any number of means. Utility commodity charges could be increased to include utility stranded costs, or utility services could be limited to what has been termed "plain vanilla service". Under one version of this approach, the utilities' regulated and hedged rates would be moved gradually to a pure market-price pass-through. In addition, special service classifications and individually negotiated utility contracts could be grandfathered and ultimately eliminated. The theory behind these suggestions is that as the market continues to develop and as the variety of products and services available to consumers increases, the utilities should be removed from providing such services. Assuming these services are attractive to customers, they should be willing to purchase them from the competitive market.

At the appropriate time, any of these strategies, except the mass migration of a large percentage of customers against their will, might be found to be in the public interest. The proper time depends on the development of the retail market which is likely to differ by fuel type, customer type, and utility territory. For example, if most medium- and large-use gas customers have already migrated from the utilities, then the more aggressive use of incentives or the establishment of a deadline by which the utilities will leave that market should be considered. But given the immaturity of the electric wholesale and retail markets at this time, we recommend for now a laissez-faire approach to market migration combined with aggressive implementation of aggregation programs. It may be advisable to ask the Competition Council for recommendations on when it would be appropriate to use other migration strategies for each fuel, customer type, and utility.

E. Consumer Protections

In Opinion No. 97-5, the Commission established a two-tiered structure to provide consumer protections.<sup>146</sup> Utilities would continue to provide HEFPA and non-residential protections, and the ESCOs would be required to provide a more limited set of protections. Requiring all energy providers to provide the same level of protections offered by the utilities was expected to "act as a barrier to entry for many ESCOs, particularly small providers."<sup>147</sup> The Commission also decided that ESCOs should not be required to use our complaint resolution procedures established for the regulated utilities,<sup>148</sup> but should disclose a complaint resolution process that would provide customers access to the ESCO at reasonable times, be convenient to the customers' locale, and require no fee from the consumer.<sup>149</sup> Nevertheless, the Commission directed Staff to monitor complaints against ESCOs, if not attempt to resolve them.

The structure established by the Commission for imposing these and other requirements on ESCOs was an indirect

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<sup>146</sup>With RG&E adopting the single-retailer model, ESCOs in that territory must provide some of the HEFPA protections otherwise provided by the utilities. Thus, the structure is now three-fold, including the full provision of protections by utilities, partial HEFPA protections by ESCOs in the RG&E territory, and a lower level of protections from ESCOs serving elsewhere in New York.

<sup>147</sup>Case 94-E-0952, supra, Opinion No. 97-5, p. 22.

<sup>148</sup>At least in the competitive metering area, it appears that customers have recently been given the right to bring unresolved complaints to the Commission for resolution, if a satisfactory resolution with the supplier cannot be reached (Case 00-E-0165, Competitive Metering, memorandum order (ARSO) regarding petitions for rehearing (issued May 29, 2001), mimeo p. 12).

<sup>149</sup>Case 94-E-0952, supra, Opinion No. 97-5, pp. 24-25. The small claims court dispute resolution option offered by a number of ESCOs seems not to meet the Commission's requirement that the process involve no fee for its use. If the consumer is the plaintiff, a fee to bring the action is required in advance and may be recovered only if the consumer prevails.

one. The ESCOs file a minimal application with the Department, but must enter into a contract with the utility under which the ESCO is required to comply with established Uniform Business Practices and other requirements. The ESCOs are thus contractually bound to provide established protections but are not subject to more direct regulation. Should the ESCOs fail to live up to their commitments, the sole remedy available to the Commission at the moment is to suspend their right to do business in New York.

In this proceeding, it appears that a consensus has developed (and been incorporated in SP2) that all suppliers in the market should be subject to the same set of consumer protection rules and that the existing rules need to be modified both to add protections against competitive market abuses that did not arise in a monopoly setting and to delete or modify the monopoly protections that are no longer needed in a competitive environment which provides customer choice. A consensus was also reached that the Department's complaint handling procedures should be used to resolve customer/ESCO complaints.

As the parties have largely agreed, the experience of the past four years, including the almost uniform approach taken by other states,<sup>150</sup> suggest that a single set of consumer protections should be provided by the utilities and by "ESCOs that seek to market or aggregate electricity for retail sale to customers in New York."<sup>151</sup> For the reasons we set forth above, we do not believe that establishing a two- or three-tiered consumer protection structure (and thus a two- or three-tiered market) will lead to an efficient end-state. Further, customer

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<sup>150</sup>For example, Pennsylvania required ESCOs to offer the same protections to consumers as did the utilities, and the requirement did not appear to be a barrier to entry. Virtually all other states that have undertaken restructuring have adopted a similar approach.

<sup>151</sup>Opinion No. 97-5, supra, pp. 31-32. The Commission noted that customers who buy for their own use and not for resale would not be included. The issue of aggregator regulation is discussed below.

research suggests that the protections currently provided by utilities are very important to the public, and such protections can increase consumer confidence in the operation of the markets. We are also concerned that the existing structure is overly complex and misleading. It is likely that many customers currently taking service from an ESCO do not realize that they are being afforded a lower level of consumer protection than that provided by the utilities.<sup>152</sup> While the customer remains protected under the existing structure by returning to the utility, it is highly unlikely, in our view, that the majority of consumers understand these arrangements. In our opinion, we must move toward a unified system for delivering uniform consumer protections in the end-state. We recommend that the Commission request recommendations from the parties (or from the Competition Council) regarding changes that may be required to the existing consumer protection rules.

We also agree with a number of parties who argued that consumer complaints against ESCOs should be heard by a single state agency, at least during the transition. In our view, that agency should be the Department of Public Service, which has both the facilities and the expertise to handle such complaints. We believe this approach will help develop a degree of trust and confidence in the new markets, which they seem to be in need of at this point. Two possible options are available. The Commission could offer the services to the ESCOs on a voluntary basis, with the ESCO agreeing to be bound by the outcome; or the Commission could require that the ESCOs use our processes for resolving complaints, as is required for utilities. We recommend that the use of the Commission's process be mandatory and that it include all of the appeals steps offered customers of the utilities, including an ultimate appeal to the

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<sup>152</sup>This lack of understanding may be especially pronounced for customers of utility-affiliated ESCOs who use the same corporate name as the utility. The research shows that significant portions of the public could not distinguish between the name of the unregulated affiliate and the name of the regulated utility.

Commission. With this approach, those customers buying from ESCOs and those buying from utilities would both be provided a free dispute resolution service provided by an agency with the applicable resources, expertise, and technical knowledge.

Another area of consumer protections that should be addressed involves market information. Two types of information are being provided by other states involved in restructuring: reliable comparisons of utility and ESCO prices and services; and an ESCO "report card" delivered in a user-friendly format reflecting the nature and frequency of complaints against ESCOs. In our view, this information is critical if consumers are to be enabled to make informed decisions, and more work needs to be done in these areas in New York. At present, our web site connects consumers to private services that offer energy price and service comparisons. Unfortunately, they have been found to be frequently inaccurate. Further, a listing of consumer complaints by ESCO can also be found on our web site, but the information can be difficult to find, use, and interpret. We recommend that improvements in these areas be designed and implemented.<sup>153</sup>

All of which brings us to the final point, the overall structure of ESCO regulation. The existing structure, which regulates the ESCOs through the utilities, separates the Commission from the ESCOs and interposes the utilities. Some of the difficulties experienced in the development of retail markets in New York (and elsewhere) suggest that greater direct oversight of the ESCOs, especially during the market transition, may be in the public interest. In our opinion, the Commission

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<sup>153</sup>Providing up-to-date price comparisons can be problematic prices change on a daily basis. Further, a number of ESCOs appear to prefer keeping their prices confidential. Accordingly, we would recommend establishing a price and service comparison page on the web, identifying the appropriate utility price-to-compare, and posting prices and terms of ESCO service for those ESCOs willing to participate voluntarily. Should consumers find this information useful, it will provide competitive pressure for all ESCOs to participate. If they do not, the service can be discontinued.

should assume direct oversight of the ESCOs' provision of consumer protections, the resolution of consumer/ESCO complaints, and the provision of non-discriminatory service by ESCOs. Its oversight should include provision for graduated penalties, in contrast to the existing arrangements, in which the only available penalty--revocation of the authority to do business--is so extreme that enforcement is discouraged except in the most egregious circumstances. We recommend that the Commission adopt formal rules in these areas, to the extent it has authority to do so. The parties should address themselves, in their briefs on exceptions, to the scope of that authority.

F. Miscellaneous Issues

1. Definitions of Terms

SP2 reflects the general agreement of the parties that additional precision is required in defining the various players in the market. The existing definition of ESCO, for example, does not include any reference to its taking title to or reselling electricity and natural gas commodity.<sup>154</sup> Other parties have noted that distinctions should be made in the definitions between entities that buy and sell to end-users and those that operate at the wholesale level and purchase on behalf of utilities and other ESCOs. "Aggregation" likewise may need more formal definitions related to whether the aggregator is non-profit or for profit and whether it performs any billing functions (regardless of whether it accepts title to the commodity).

SP2 contains proposed definitions of a number of additional terms, to which a few of the parties suggested changes. Because a full debate on the specific wording proposed for these terms was not completed, these definitions need to be considered further. The parties in their exceptions or the Competition Council thereafter should produce recommendations for formal adoption.

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<sup>154</sup>Opinion No. 97-5, p. 2, n. 1.

## 2. Regulation of Aggregators

Some have argued that aggregators should be regulated to the same extent as ESCOs. A few suggest that certifying aggregators may help establish public confidence in their services and foster the development of aggregation programs. Others, however, oppose any type of regulation or certification for aggregators, arguing that any such requirement would create barriers to entry and limit the development of aggregation plans.

In our view, so long as aggregators do not take title to the commodity, do not bill customers, and otherwise act solely as agents for the end-users, there is no overarching need to require their registration or to impose on them all of the consumer protections required of utilities and ESCOs.<sup>155</sup> At the same time, there is merit to the argument that a voluntary certification of aggregators could help develop the consumers' confidence in the reliability of these market services. Accordingly, we recommend that the Commission establish a process for voluntary aggregator certification and consider including, among the certification requirements, a code of conduct with which aggregators agree to abide. This option will avoid barriers to aggregators who do not desire certification, while allowing those to be certified who believe they will benefit.

## 3. RG&E Single-retailer Model

As previously noted, RG&E urges that if the Commission adopts Model 2, it also make clear that RG&E need not return to Model 2 and may continue with its single-retailer (Model 3) program. We noted above that RG&E's program to date has not shown significant success, but, in view of the potential benefits of Model 3, we nevertheless believe that additional time should be provided to determine if this model can work.

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<sup>155</sup>It may be advisable at some point to establish some minimal level of consumer protections or other codes of conduct for aggregators.

Accordingly, RG&E's request should be granted at least until some significant additional experience has been gained.

4. Mark-Up on Delivery Charges

MI requests that the Commission prohibit ESCOs from marking up a utility's delivery service charges. Staff opposes the suggestion, claiming that the market should prevent any such mark-ups. We agree with Staff that a truly competitive market with a sufficient number of suppliers would preclude those suppliers from marking up delivery services; but such markets, as already noted, do not now exist (except in the case of large gas customers). In a few utility territories, the number of competitors is so small that it would be possible for ESCOs to mark up utility delivery charges without customers knowing. MI accordingly has identified a significant issue that needs to be addressed in the near-term.

In our view, the basic issue is not whether utilities should be allowed to mark up (or discount) utility delivery charges, but whether the customer is aware that the supplier is doing so. So long as the customer has full information, it can always move to another ESCO or (at least for the time being) return to the utility. Accordingly, there is no need to forbid mark ups, as MI proposes, but we recommend instead that the Commission require ESCOs to disclose all changes made to utility delivery charges for which the ESCO is billing or reselling.

V. PUBLIC BENEFIT PROGRAMS

The questions raised by the Commission in this area as expanded and modified by the Judges are first set forth below. The analyses done by the parties on these issues (April 3 Report, pp. VII-8 to VII-68) and the arguments raised in the parties' briefs are reviewed below together with our recommendations.

A. Questions Posed

The questions posed by the Commission regarding public benefit programs are set forth below in bold, with the additional questions raised by the Judges shown in italics.

**Should the gas and electric and/or energy services companies (ESCOs) continue (or begin) to fund or administer low-income, research & development, energy efficiency and related public benefit programs** *once competitive markets have developed (i.e. the transition period has been completed)?*

**If so, how should the programs be structured and should the programs be uniform statewide?** *Should existing, utility-run low-income programs be centrally administered? By whom? Should centrally administered low-income programs be run by the individual utilities?*

*How can SBC supported low-income programs best be coordinated with other low-income energy-related programs (Utility, DSS, and HEAP, etc.)?*

**How should these programs be funded and at what level?** *What are the alternatives to including the SBC in the utility bill? Could the SBC be part of the NY ISO uplift charge? Should both gas and electric customers contribute to and benefit from programs from SBC? Should the utility customer funding for SBC programs be shifted to government?*

**What has been the experience in other states and other countries; what works and what doesn't?** *Should prepaid meters be allowed? By the utility? By the non-utility POLR? By any ESCO?*

The following questions were posed for the analysis phase<sup>156</sup>:

4. *Should low-income programs be mandated for any or all service providers and for gas and electric customers?*

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<sup>156</sup>Ruling on Scope and Process for Phase 2 (issued October 18, 2000).

- *Should such programs be managed by services providers (as most utilities do today), centrally (as NYSERDA does today), or both?*
  - *Should a lifeline rate be created? For gas? For electric?*
  - *How and by whom should such low-income programs be funded? At what level?*
  - *How would the choice of Model 3 for the market end-state affect the analysis?*
5. *Should research and development continue to be funded from energy sales (or distribution sales) once a retail energy market is established?*
- *Which entities should collect the funds?*
  - *Who should set the requirements and review compliance?*
  - *How would it be determined that such funding, if mandated, was no longer needed?*
  - *How would the choice of Model 3 for the market end-state affect the analysis?*
6. *Should spending on energy efficiency and clean or renewable energy programs continue to be funded from energy sales (or distribution sales) once a retail energy market is established?*
- *Which entities should collect the funds?*
  - *Who should set the requirements and review compliance?*
  - *How would it be determined that such funding, if mandated, was no longer needed?*
  - *How would the choice of Model 3 for the market end-state affect the analysis?*

5. *Should low-income programs be mandated for all utilities, both gas and electric, during the transition period?*
  - *Should program funding be increased in light of recent market conditions? To what level?*
  - *Should a lifeline rate be developed for the transition period?*
  - *How should the public (i.e., utility, NYSERDA, and other government-based) low-income energy programs be coordinated? Are there changes to the operation of current programs that would improve the effectiveness of the programs and make them more compatible with the development of competitive energy markets?*

The following questions were posed at the March 14, 2001 prehearing conference for consideration in the parties' policy briefs:

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 Benefits Program 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 and other public benefit programs and/or to provide advice on future programs?*

B. Low-Income Programs

This Commission has always recognized that the "aid, care and support of the needy are public concerns . . . ",<sup>157</sup> and since 1989 has provided targeted low-income assistance programs for the poor through the local utilities. Because energy services are essential to the safety and well-being of all New Yorkers, it is the State's and the Commission's policy that the "continued provision of gas, electric and steam service to residential customers without unreasonable qualifications or

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<sup>157</sup>New York State Constitution, Art. 17, Sec. 1.

lengthy delays is necessary for the preservation of the health and general welfare and is in the public interest."<sup>158</sup>

In 1995, as the Commission was beginning to examine restructuring the electric industry, it reiterated its concern that adequate protections be made available for customers who are unable to afford basic electric service: "New York has a distinguished history of ensuring such protection for those who may face financial difficulties, and this will continue regardless of industry structure."<sup>159</sup> In 1996, the Commission again noted the continuing need to examine cost-effective and competitively neutral approaches to address "needs of customers who may at times face financial hardship which could jeopardize their access to electric service."<sup>160</sup> In 1997, the Commission established some of the policies that would govern the retail markets, and specifically noted that one of the roles of the provider of last resort (then, as now, the utility) was "to provide programs to assist low-income customers."<sup>161</sup> Finally, in its March 21, 2000 order instituting this proceeding, the Commission noted as one of its "established values and principles" the provision of "low-income assistance programs."<sup>162</sup>

Since the Commission instituted this proceeding a little over one year ago, significant accomplishments have been realized toward the goal of ensuring low-income access to reasonably priced energy supplies. Not all of the major gas and electric utilities offered low-income programs when this case began and thus the question was posed to the parties: "Should

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<sup>158</sup>Public Service Law, §30 (HEFPA).

<sup>159</sup>Case 94-E-0952, supra, Opinion No. 95-7 (issued June 7, 1995), p. 6 (emphasis added).

<sup>160</sup>Case 94-E-0952, supra, Opinion No. 96-12, p. 28, n. 1. The Commission also instituted a systems benefit charge (SBC) in this opinion to provide funding for low-income programs, among others.

<sup>161</sup>Case 94-E-0952, supra, Opinion No. 97-5, pp. 10-11.

<sup>162</sup>Order Instituting Proceeding, pp. 4-5.

low-income programs be mandated for all utilities, both gas and electric, during the transition period?"<sup>163</sup> During the pendency of this proceeding, low-income programs have been established at every major gas and electric utility, reflecting the Commission's answer to this question in the affirmative. In some cases, the approved low-income programs include a set discount from the utility's rate.<sup>164</sup> This answers in the affirmative another question posed to the parties concerning the appropriateness of a lifeline rate approach to fulfilling the policy of providing access to reasonably priced energy supplies for all New Yorkers. Finally, and perhaps most significantly, the Commission indicated through its approval of higher levels of SBC funding that low-income program funding should be significantly increased<sup>165</sup> in light of recent market conditions (thus answering yet another of the questions posed to the parties). While a specific policy of "universal service" has not been adopted in New York for energy services, the policies enacted by the Legislature and programs fostered by the Commission suggest that universal access to reasonably priced

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<sup>163</sup>Ruling on Scope and Process for Phase 2 (issued October 18, 2000), p. 6.

<sup>164</sup>Con Edison's program, funded at \$25 million over four years, is expected to enroll 175,000 qualified low-income customers by the fourth year of the program (Case 00-M-0095, Joint Petition of Consolidated Edison, Inc. and Northeast Utilities for Approval of a Certificate of Merger, Opinion No. 00-14 (issued November 30, 2000), p 8). KeySpan has also instituted a reduced rate for low-income customers targeting enrollment of 54,000. (Case 99-G-1469, Petition of the Brooklyn Union Gas Company and KeySpan Gas East Corp. for a Multi-year Restructuring Agreement, Order Establishing Interim Rate Plan (issued December 26, 2000), Attachment, p. 23). There are approximately 500-600,000 customers in New York currently subscribing to telephone lifeline rates.

<sup>165</sup>In its January 26, 2001 Order, the Commission approved funding for SBC low-income energy efficiency programs of approximately \$27 million per year, an increase of almost 300% over prior funding levels (\$9.8 million).

energy supplies has been established de facto as the State's policy.<sup>166</sup>

As a result of the efforts of the parties working on low-income issues in this case, even more progress has been made. Unlike most areas where no agreements were reached, a broad consensus statement was adopted regarding low-income programs. Although a variety of opinions were expressed in the briefs regarding implementation, funding, and other details, the consensus statement provides a firm foundation for establishing Commission policy and for guiding future discussions of these issues. The full text of the consensus statement is set forth below:

Movement to End-State

1. The needs of low-income customers during the movement to the end-state will continue to need to be addressed through low-income programs and other initiatives.
2. Since the needs of low-income customers are diverse, they need to be addressed through a variety of initiatives.
3. The needs of both gas and electric customers should be considered in the design of low-income programs.
4. Utility low-income programs should continue as required in existing settlement agreements.
5. Lowering utility rates so that consumers can receive lower prices and funding low-income programs through rates are competing goals that need to be continually reconciled.
6. Utility rates may fund low-income programs for the near term. In the future, the sources of funding for low-

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<sup>166</sup>These policies reflect a recognition, among others, that the societal cost of leaving the economically disadvantaged without access to energy supplies can be much greater than the cost of maintaining access for low-income customers. Electric and gas system benefits are also achieved by maintaining access for all citizens.

income programs need to be examined on an on-going basis.

7. Low-income programs, while appropriately recognizing the diversity of needs, could benefit from increased cost-effective coordination among community, government, private, utility and non-profit low-income program providers.

#### End-State

1. Even in the end-state, some low-income consumers in New York State may spend a greater portion of their income on energy costs (i.e. have a greater energy burden) than other residential consumers.
2. The needs of low-income consumers need to be addressed in the end-state.
3. The needs of both gas and electric consumers should be considered in the design of low-income programs.
4. If a Model 3 scenario is adopted in which utilities have no retail relationship with the consumer, other retail service providers and/or other non-utility entities will have to assume responsibility for the operation of low-income programs previously provided by the utilities.
5. Appropriate resources should be provided to address the needs of low-income consumers in the end-state.
6. Low-income programs, while appropriately recognizing the diversity of needs, could benefit from increased cost-effective coordination among community, government, private, utility, and non-profit low-income program providers.

We recommend that the substance of this consensus (if not its specific wording) be adopted as the low-income assistance policy of the Commission.

Given the progress made in the past year, many of the issues presented for resolution have already been resolved. Nevertheless, the parties have raised a number of questions regarding the funding, program content, and program administration of low-income programs.

1. Funding

It is important to first note that the parties agreed that competition-based approaches to providing reasonably priced service for all customers should be the highest priority. Perhaps the very best low-income program would be one that kept the cost of energy relatively low for everyone (this is not to suggest that low prices will address all low-income needs). It is ultimately expected that the competitive discipline that will be brought to the energy markets will have just such an impact.

Another market-based approach that has been successfully used to bring lower prices to low-income customers is the concept of aggregation, the pooling of the buying power of large groups of individuals. While meaningful successes have been achieved in New York, especially at the county level, the use of aggregation for low-income and other low-use customers is far from ubiquitous. Significant savings not being realized today are potentially available with the expanded implementation of this approach (which provides the additional benefit of helping further the development of retail competition for small-use customers). We therefore strongly recommend an expansion of these programs as one of the best ways to provide the benefits of competitive markets to the broad group of smaller-use customers, including the low-income population. Because these programs also provide system and market development benefits, funding to support aggregation efforts have been provided through the SBC.

A number of parties expressed concern that utility rates would be forced even higher if program funding through the utilities was increased from today's levels. Given the substantial increase in funding provided during the pendency of the case, we see no need to increase funding at this time. However, in light of the unexpected twists in market development to date, we recommend that the Commission closely monitor the

impact of future market development on low-income customers<sup>167</sup> and preserve its option to increase (or decrease) funding levels as circumstances evolve.

Another funding issue concerns low-income programs for gas customers. A gas SBC to fund such programs (as well as other energy efficiency programs) was opposed on the grounds that gas is in direct competition with oil, which does not support low-income programs, and that a gas SBC would hurt the gas industry's competitive position. It was also argued that electric customers already pay for such programs in their electric rates and should not be billed again in their gas rates. The Commission recently declined to address whether a SBC for gas was appropriate, noting that the issue was being examined here.<sup>168</sup>

The objections to the creation of a gas SBC raised by the parties in this proceeding are not convincing. While oil and gas are competitive fuels, their relative competitive positions are significantly different. Oil is available everywhere, while gas is limited to its system of pipes; gas has a monopoly franchise (for delivery) while oil dealers compete against each other in the same territory; and, perhaps most importantly, gas utilities have a POLR obligation to provide low-income programs<sup>169</sup> while oil dealers do not. Given the legal obligations of the gas utilities as regulated monopolies and the Commission's unequivocal policy requiring those utilities to

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<sup>167</sup>The impact of energy rates on low-income consumers can be best measured by the "energy burden" borne by the customer. The burden is the percent of a customer's income that is spent on energy, which can be used as a general gauge of the relative impact of a change in energy prices. Should future energy-price impacts increase the energy burden on the poor, the Commission should consider funding these programs at a higher level (See April 3 Report, p. VII-28.)

<sup>168</sup>Case 94-E-0952, supra, Order Continuing and Expanding System Benefits Charge for Public Benefit Programs (issued January 26, 2001), pp. 8-9.

<sup>169</sup>Case 94-E-0952, supra, Opinion No. 97-5, pp. 10-11.

provide low-income programs, it is difficult to conclude that the costs of those public policy programs should not be supported in gas rates.

We are also unconvinced by the equity argument. An electric and gas customer of a combination utility is paying only once for both electric and gas SBC low-income programs in its electric rates, but customers of an electric company (e.g. Con Edison) and a separate gas company (e.g. KeySpan) are paying for gas and electric low-income programs in their electric bill and again for gas low-income programs in their gas bill.<sup>170</sup> It seems to us that there is already some inequity in the way these programs are funded, and there may also be an unintentional cross subsidy of some gas utilities which are a part of a combination company.<sup>171</sup> In any event, it seems only proper that gas-related program benefits (whether bestowed by the utility or by NYSERDA from the SBC) be funded through gas rates. Accordingly, we recommend that the Commission establish a gas SBC to fund the future delivery of gas-related benefits for low-income consumers.<sup>172</sup>

Another issue that falls under the general topic of funding is the possibility of reallocating some amount of NYPA hydropower to low-income customers. A few parties believed the idea worth pursuing, but most objected. Some argued that such a reallocation would not be possible under the current law, and others noted that some group will end up paying the price for

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<sup>170</sup>The cost of KeySpan's and NFGDC's low-income programs are included within their rates, but the cost of SBC supported energy-efficiency and low-income program benefits provided to their customers are supported through Con Edison's or Niagara Mohawk's or NYSEG's rates.

<sup>171</sup>Whether a subsidy exists depends on whether the utility recovers the cost of its own programs in both gas and electric rates or only in electric rates. Both situations currently exist in New York.

<sup>172</sup>We are not recommending an increase in total SBC collections. Once gas SBC revenue levels are set, SBC collections through electric rates can be adjusted as appropriate.

the low-income program (i.e. the group that lost its NYPA allotment). We agree with the parties that the law likely precludes these efforts now; but, perhaps more importantly, the entire issue of the allocation of this extremely inexpensive power is in essence a political question. We doubt it possible to establish now a low-income program supported in part by a hydropower allocation, unless it were accomplished in the context of an overall review of NYPA's power allocations. This is well beyond the scope of the Commission's jurisdiction and we do not believe that further efforts in this area at this time would be fruitful.

Finally on the question of low-income program funding is the end-state issue<sup>173</sup> of the proper roles of the Legislature, the Commission, and the utilities. Some argue that low-income programs address social issues that should be left to the sole discretion of the Legislature. They correctly point out that general purpose funding through income taxes is a significantly less regressive method of collecting funds for such programs than funded through utility rates. Others point out, also correctly in our view, that low-income programs provide system benefits as well as societal benefits, and that the customers using the system and receiving the benefits should contribute to their cost. Some were concerned that the unique and important role the utilities play in implementing a portion of the low-income programs might be lost if the funding and operation of these programs were centralized and funded through state taxes.

The vast majority of the energy assistance afforded the low-income population is now funded through state and federal taxes. Another significant portion is provided by private charity, including contributions solicited and disbursed

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<sup>173</sup>While a few parties object to funding such programs through rates even during the transition, most parties recognized, as has the Commission, that the benefits provided by these programs cannot be provided by the competitive market and that they should be continued during the transition. Until other funding sources are created or these services are otherwise provided, it is assumed that funding during the transition will continue through utility rates.

by the utilities. The remaining portion of the assistance, which is funded through utility rates, is relatively small and supports targeted programs where needs might not otherwise be met or where the utilities' expertise and resources can best be brought to bear. Given that some benefits are provided by these programs for all utility system users and that the vast majority of low-income benefits are already being provided by the Legislature, we see no need to recommend that funding through utility rates be discontinued in the end-state. It seems to us that a fair balance among the funding sources now exists.

## 2. Program Content and Administration

Experience suggests that the needs of low-income customers are extremely diverse as are, accordingly, the programs that have been developed to meet them. Some programs use direct grants or reduced tariff rates to address energy affordability, while others provide assistance with efficient energy use or training in budget management. In addition, the numerous public and private parties who administer the programs are as diverse as the programs themselves. While these arrangements for providing low-income programs do a good job of identifying and addressing the variety of needed services, they suffer from a lack of effective coordination.

Most parties believed the broad mix of program elements was the correct approach and should be continued, but some objected to the concept of reduced tariffs or the establishment of lifeline rates. They argued that such programs simply increase rates for all other customers, and others noted that discounts do not address often needed energy efficiency or other types of assistance. It was also argued that offering such discounts to customers who were current in paying their utility bills was providing an economic benefit to people who "obviously" did not need it.

Rate discounts to qualified, income-eligible customers can be an efficient way to maintain economically distressed households on the system. Keeping them on the system provides benefits to all customers using the utility system by retaining

these customers' contribution to fixed costs and avoiding the greater costs to society (and to the utility system) that would result from a customer's separation.<sup>174</sup> Further, the argument that customers who are current on bills have no need for a lifeline discount is unpersuasive. PULP describes well the "Hobson's Choice" faced by low-income customers whose household expenses exceed their budgets. Customers who forgo purchases of food or other necessities to stay current on their energy bills are not "free riders" (i.e. being given a benefit they do not need) and are no less in need (and deserving) of assistance than those customers who choose the opposite course of action. It is true, however, that a lifeline rate alone will not address many of the needs of low-income customers. Accordingly, we recommend that lifeline rates be considered an integral component of low-income programs crafted in the future.

Although parties generally supported the need for increased program coordination, they were divided on the notion of a public benefits program council. Many parties supported the concept; however, some parties argued that its creation would add another layer of administrative complexity and cost. Others were concerned that a council would have too little (or, conversely, too much) authority, resulting in a body that either cannot function effectively or is unresponsive to local needs.

Increased coordination is especially important as the transition to competitive markets unfolds. Program changes will likely be required on an on-going basis as the energy purchasing paradigm evolves. One example of the conflict between historical program delivery and the new competitive market involves the distribution of emergency HEAP (Home Energy Assistance Program) benefits through the Office of Temporary and Disability Assistance. Emergency HEAP payments are made only to

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<sup>174</sup>It is worth noting that these system and societal benefit justifications are very similar to those that have been advanced in favor of economic development programs for financially strapped businesses. Those programs differ from low-income programs chiefly in the class of distressed customer targeted.

utilities because they alone can disconnect the customer's distribution service. This restriction is intended to comport with the requirements of the federal statute that such funds be available only to households in crisis (42 U.S.C. §8261(e)), but the effect is to create a barrier to the participation of low-income households in retail access. The interested parties should work together to develop rules that will overcome those impediments to affording low-income customer access to the benefits of competition. A coordinating council, even if limited to an advisory role, could be of significant assistance to these efforts.

In our view, a public benefits program council could increase coordination among the variety of programs, minimize administrative costs, avoid duplicative efforts, and better target the resources available to address low-income customer needs. While we acknowledge the difficulties involved in establishing such a council, the potential benefits from increased program coordination outweigh the potential costs. We recommend an approach that builds on the structure of an existing organization (the SBC Advisory Group or the LIFE Steering Committee are possible candidates)<sup>175</sup> in order to minimize additional complexity and costs. Such a group should include among its membership representatives of agencies who deliver benefits at the local level, as well as individuals with sufficient authority to see to it that its recommendations are effected.

Another issue involving the operation of these programs concerns the continuation of the utilities' role in the end-state. As a number of parties noted, the answer to this question probably depends on the final structure of the market. As long as utilities retain some retail relationship with their customers, it seems reasonable to assume that they would

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<sup>175</sup>Because the LIFE Steering Committee membership appears to be broader, we would recommend that group as the core of the council. However, the suggestion of a council was raised late in the proceeding and the parties are encouraged to put forth alternative suggestions in their exceptions briefs.

continue to provide these programs.<sup>176</sup> If all utility retail relationships with customers were eliminated (as in the single-retailer model or Model 3) and if the definition of POLR service continued to include low-income assistance, this obligation would likely fall on the POLR ESCOs.<sup>177</sup> For the foreseeable future (or at least through the end of the current SBC funding), however, it is expected that the utilities will maintain retail relationships with residential customers and will continue to provide such programs.

Another issue in the program content area involves the use of pre-paid meters in the context of low-income programs. While our survey of programs in other states and countries reveals that prepaid meters have been utilized, we conclude that their use in New York would be inappropriate as an approach to low-income issues, or for any other purpose. The goal of low-income programs is to ensure access to service for customers who may face financial difficulties, but prepaid meters perform the exact opposite function. The most basic protection that can be extended to a consumer against termination of service is adequate notice of the impending termination. New York law requires a written notice of termination, and sets the minimum time limit at 15 days (Public Service Law, §32(2)(d)). By its very nature, a prepaid meter provides no such notice. Unless there were a modification to the law, we do not see how prepaid meters could be considered for use in New York, and we strongly oppose their use in the context of low-income programs.

We return finally to the question of whether a policy of universal service should be adopted for the regulated energy market. As noted above, the Constitution, laws, and regulatory

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<sup>176</sup>This statement is equally true regarding special needs programs for the elderly, blind, and disabled and those on life support equipment.

<sup>177</sup>Much more could be done by the ESCOs today in providing low-income program services. NYSERDA solicits competitive bids to provide these services on an ongoing basis, and we would encourage the ESCOs to take greater advantage of these opportunities.

practices in New York have established de facto a universal service philosophy, and, if properly defined, a universal service policy should be formally adopted. While the goal of such a policy would be to provide access to reasonably priced electricity and gas for every resident of the State, it is immediately obvious that attaining 100% of the goal is unlikely. In our view, this is not a reason to reject the policy. Universal service in telephone has had a similar goal, but we have not yet achieved, nor are likely to ever achieve, 100% telephone penetration. Similarly, access to natural gas supplies will be limited to the existing reach of the utilities' pipelines and to those areas into which the pipelines can be economically expanded.<sup>178</sup> Electricity is no different, and both must have the limitation that service provided must be paid for. Subject to these limitations, however, we recommend that the existing de facto policy of universal service be formally adopted for gas and electricity in New York.

C. Energy Efficiency and Research & Development

Section 5 of the Public Service Law obliges the Commission to "encourage all persons and corporations subject to its jurisdiction to formulate and carry out long-range programs, individually or cooperatively, for the performance of their public service responsibilities with economy, efficiency, and care for the public safety, the preservation of environmental values and the conservation of natural resources." In Opinion No. 96-12, the Commission established a SBC in electric rates to continue the funding of public benefit programs

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<sup>178</sup>Similar to the need for infrastructure expansion previously noted, it seems that it would be in the State's best interest to expand the gas infrastructure wherever it might be economically utilized. Such expansions (in conjunction with needed reinforcements to the existing system) would inure to the benefit of all gas customers and could stimulate the economic growth of the State. Given the potential system benefits of appropriate distribution expansion, it may be worth exploring additional funding support for such efforts, either through rates (as Georgia has done) or by other means.

unlikely to be supported by the marketplace during the transition to retail competition. The Commission recently continued and expanded the SBC through June 30, 2006,<sup>179</sup> funding energy conservation, renewable energy, and research and development (R&D) programs (as well as low-income programs as noted above). There is no corresponding SBC applicable to gas rates, and, as far as we are aware, expenditures by gas utilities in energy efficiency areas are at most fairly small.<sup>180</sup>

Because the Commission has already addressed the need for the continued funding of energy efficiency and research and development programs during the transition, the efforts of the parties have focused on the appropriate funding and administration of these programs in the end-state. In contrast to areas where market solutions are never expected to fully address public benefit needs, it is expected that markets will eventually supply an adequate level of energy efficiency products and services, renewable energy options, and research and development funding. Therefore, an important part of the SBC programs will be to develop strategies both to determine the point where continued funding is no longer needed and to hasten the time when that point is reached.

A number of barriers to the provision of these services by the marketplace exist today. In the area of energy efficiency, these barriers include high initial costs of implementation, lack of information and capital, and a relatively low level of stocking, promotion and advertising of these products. In the area of research and development, barriers include performance uncertainties, immature supply and service infrastructure, and lack of market incentives to spur private investment. NYSERDA's SBC programs have been designed

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<sup>179</sup>Case 94-E-0952, supra.

<sup>180</sup>Gas utilities do fund their own research and development programs and the stand-alone gas companies (KeySpan and NFGDC) fund their own low-income programs. And, as previously noted, SBC low-income energy efficiency programs provide energy efficiency benefits to gas customers, funded through the electric SBC.

to ultimately overcome these barriers and to spur competitive solutions for their permanent removal.

There are no hard and fast rules for determining when funding remains necessary or becomes unnecessary, or at what level funding should be provided. Therefore, exit strategies should encompass situations where market barriers have been permanently lowered, as well as those where continued intervention is no longer cost-effective. It is not possible now to identify a date certain by which either of these exit conditions will occur. Therefore, it is not possible to determine whether utility rates will continue to support energy efficiency, renewable energy, and research and development programs, either in the market end-state or past the end of the currently approved funding for the SBC in 2006.

It does seem reasonable to conclude, however, that there should come a time when the funding for such programs from electric and gas rates will no longer be required. To help the Commission determine when that time may arrive, we renew our recommendation for a public benefits program council, to provide guidance, advice and recommendations concerning these programs. The council should include a balanced membership, representing a variety of viewpoints on these issues, and should be charged with following market developments in these areas.

Energy efficiency, renewable energy, and research and development program funding will not likely be required forever, and it is expected that the SBC for these purposes can, at some point, be eliminated. We recommend that the progress of these programs be closely monitored and that the programs be removed from rates as soon as it becomes clear that they are no longer needed or are no longer effective.

## VI. COMMISSION AUTHORITY AND RELATED LEGAL ISSUES

### A. Introduction

In a ruling issued January 11, 2001, we sought comment on several legal issues that had arisen during the collaborative meetings. We cited the specific questions of whether, under current law, "utilities may be directed by the Commission to

cease providing commodity to customers and whether the Commission may require customers to be switched from a utility's commodity service to that of an ESCO," but we invited comment as well on "any other legal issues related to the scope of the Commission's authority that require resolution."<sup>181</sup> We noted also that parties might wish to react, in their briefs, to the position paper on gas commodity issues that had already been submitted by the law firm of Cullen and Dykman, counsel to KeySpan. At the pre-hearing conference on March 14, we authorized reply briefs on legal issues and requested Staff to address itself, in its brief, to the concept of "realistic appraisal" insofar as that concept might apply to defining the Commission's jurisdiction to require utilities to exit markets that become workably competitive; a later e-mail to the parties memorialized those steps.

Briefs on legal issues have been submitted by Con Edison (jointly with Orange and Rockland), KeySpan (in the form of the Cullen and Dykman memo), NFGDC, Niagara Mohawk, NYSEG, RG&E, SCMC, NEM, NESPA, Amerada Hess, CPB<sup>182</sup>, PULP, the AG, and Staff. Reply briefs were submitted by Con Edison, KeySpan, NFGDC, Niagara Mohawk, NYSEG, SCMC, NESPA, CPB, PULP, and Staff.

In general, the utilities strongly question the Commission's authority to take the steps at issue without new legislation, while the ESCO and marketer organizations believe existing law provides the needed authority. Less predictably, perhaps, PULP, the AG, and Staff suggest the authority is or may be lacking, while CPB believes it exists. At this highest level of generality, the issue is a classic one of the degree to which statutes enacted in one economic context lend themselves to reinterpretation by administrative agencies and courts in light of new economic developments.

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<sup>181</sup>Case 00-M-0504, Procedural Ruling (issued January 11, 2001), p. 1.

<sup>182</sup>The filing we refer to as "CPB's Initial Brief" is captioned "Reply Memorandum of Law," presumably referring to the Cullen & Dykman memorandum.

The parties argue that general issue and many more specific ones at some length and with considerable creativity and vigor. We will not attempt to report and assess all the byways of those arguments and will confine ourselves to the principal points raised. We begin with a review of the two statutes and three cases that are most often cited, with strikingly different interpretations, by both sides. We then present highlights of the parties' arguments and set forth our own conclusions and recommendations.

B. Legal Context

1. Statutes

The obligations of gas and electric utilities in New York State to provide service to customers requesting it are imposed by Transportation Corporations Law (TCL) §12, governing non-residential customers, and by Public Service Law (PSL) §31, governing residential customers. (PSL §31 is part of the Home Energy Fair Practices Act [HEFPA, PSL Article 2, as amended], enacted in 1981; until then, TCL §12 applied to residential customers as well.)

TCL §12 provides in pertinent part as follows:

Except in the case of an application for residential utility service pursuant to article two of the public service law, upon written application of the owner or occupant of any building within one hundred feet of any main of a gas corporation or gas and electric corporation, or a line of an electric corporation or gas and electric corporation, appropriate to the service requested, and payment by him of all money due from him to the corporation, it shall supply gas or electricity as may be required for lighting such building.

PSL §31 provides in pertinent part as follows:

Every gas corporation, electric corporation or municipality shall provide residential

service upon the oral or written request of an applicant [subject to various conditions not pertinent here].

What is significant for purposes of analysis here is that neither the verb "supply" in TCL §12 nor the term "provide service" in PSL §31 is defined by the statute. It is undisputed that in 1909, when TCL §12 was first enacted,<sup>183</sup> and even in 1981, when HEFPA was enacted, both terms contemplated sale and delivery of commodity by the jurisdictional utility, since alternative arrangements were largely unknown. Alternatives are now very much in evidence, and, as noted, the parties dispute the significance of those developments for the meaning of the statutes.

## 2. Case Law

Three cases figure prominently in the parties' arguments. In Rochester Gas & Electric Corporation v. PSC, 71 NY2d 313 (1988) (RG&E), the Court of Appeals sustained the Commission's order, pursuant to newly-enacted PSL §66-d, requiring a gas corporation to transport customer-owned gas if the utility has the capacity to do so and certain other conditions are met. In rejecting RG&E's claim that the statute and the Commission's order fundamentally changed the nature of its business, which RG&E considered to be the transport and sale of its own gas, the Court said, in pertinent part, that

...plaintiff is not being compelled to offer service greater or different than authorized by its original charter. Gas corporations are charged with the duty of supplying gas for public use [citations omitted] and none of the statutes regulating plaintiff indicate that duty is to be fulfilled only by selling its own gas [citations omitted]. The transportation of customer-owned gas also results in gas being supplied to members of the public and is thus consistent

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<sup>183</sup>It was initially TCL §62.

with the general duties imposed upon gas corporations. The statute may force plaintiff to do something which, as a matter of form, differs from what it has customarily done because it no longer has title to all the gas in its pipelines. The substance of the transactions is the same, however; the company provides gas to the community, something it has always done and is obliged to do.

As will be seen, the parties offer radically different views of the meaning and import of that passage. For now, it may be noted that though the case arose in a gas context, its reasoning, whichever way understood, would apply to the merchant role of an electric corporation as well.

The second case, Energy Association of the State of New York et al. v. PSC et al., 169 Misc.2d 924, 653 NYS2d 502 (Sup. Ct. Albany Co. 1996) (Energy Association) involved a challenge to various aspects of the Commission's 1996 decision on restructuring of the electric industry.<sup>184</sup> The court there broadly sustained the Commission's powers to carry out the underlying goals of the Legislature; it declared, among other things, that:

The Public Service Law is a blueprint within which the Public Service Commission is charged with the governance of the energy resources of the State of New York within the guidelines therein set forth.

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If and when the PSC lightens regulation of generation to accommodate competition, the justiciable issue will be whether such action rationally advances the Legislature's purpose of bringing customers "just and reasonable" electric service. That is the legislative standard, to be determined in particular cases by PSC expertise, subject

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<sup>184</sup>Cases 94-E-0952 et al., Electric Competitive Opportunities Proceeding, Opinion No. 96-12 (issued May 20, 1996).

to judicial review to guard against arbitrary and capricious decisions.

In contrast to RG&E, where the very meaning of the Court's decision is understood differently by the parties, Energy Association offers simply a statement of the generally accepted theoretical relationship among a Legislature, a statute, and an administrative agency. The difference between the parties is really one of degree; they take very different views of how that theory should be applied to determine the reach of the agency's discretion in the matter at hand.

Finally, in PULP et al. v. PSC et al., (Sup. Ct. Albany Co., Index No. 5409-96, slip op. issued April 29, 1997), the court dismissed for lack of standing PULP's challenge to a Commission order holding that HEFPA did not apply to non-utility gas marketers. The court nonetheless discussed the substantive issues presented, finding that the Commission's decision was sound. It concluded that discussion as follows:

To summarize, neither the statutory or regulatory language, the legislative history, decisional law nor logic compels the conclusion urged by plaintiffs that gas marketers must be required to comply with HEFPA's provisions. The PSC's Opinion ensures that all residential consumers will continue to be covered by HEFPA's protections unless they chose to trade the Act's protections for competitive gas prices in the purchase of gas from gas marketers. Consumers may simply do nothing, and fully retain the HEFPA consumer protections in all aspects of gas service from their LDCs [local distribution companies] or local utility. The critical point is that HEFPA protections continue to be available through LDCs, giving effect to the fundamental legislative intent of ensuring service on reasonable terms [citation omitted].<sup>185</sup>

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<sup>185</sup>Slip. op. pp. 27, 29.

Here, too, the parties dispute the import of the court's statement (and some suggest it should, in any event, be disregarded as dicta, in view of the dismissal of the case on grounds of standing).

C. Arguments on the Principal Issues

1. Utilities

The utility parties deny, to varying degrees but with considerable overlap in their arguments, the Commission's authority to require them to cease providing commodity or to transfer customers from utilities to ESCOs. As already noted, we here set forth only highlights of their arguments; and at this level of generality, we attribute many of arguments to "the utilities" rather than to individual parties.<sup>186</sup> We do not thereby imply that all utility parties necessarily join in all of those arguments or that their positions are uniform.

As an initial matter, it should be noted that Con Edison challenges the premise that the legal issues are ripe for decision. It asserts that the legal decisions are likely to depend on specific facts and circumstances and that assessment of the legal issues should await greater clarity regarding the substantive direction in which it is proposed to move. NYSEG, in contrast, suggests that consideration of these issues is, if anything, overdue.<sup>187</sup>

The utilities contend, first, that their statutory obligation to offer commodity is unambiguously stated in the "supply" and "provide service" provisions of TCL §12 and PSL §31; if they do not offer commodity, they are not supplying and serving customers but simply offering them the opportunity to be supplied and served. In the event the statutes are considered ambiguous--inasmuch as "supply" and "provide service" are not

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<sup>186</sup>The most comprehensive statements of the position are in the Cullen and Dykman memo and the NYSEG initial brief.

<sup>187</sup>NYSEG's Initial Brief, pp. 3-4. (As used in this section of the recommended decision, "Initial Brief" and "Reply Brief" refer to the briefs on legal issues.)

defined terms--canons of statutory construction require interpreting the terminology as of the times the statutes were enacted. Such an interpretation would lead to the conclusion that utilities must supply commodity, since no alternative to bundled service was known or contemplated at the time. A similar conclusion, they argue, is suggested by the need to read HEFPA liberally, given its status as a remedial statute, and by the need to ascribe significance to PSL §66-d, whose enactment would have been unnecessary had the Commission already enjoyed unbundling authority.

Beyond those statutory obligations, the utilities see a common-law obligation to serve, as a quid pro quo for the grant of a franchise. KeySpan recognizes the possibility that, in the absence of the statutes, this common-law obligation could evolve into one contemplating transportation service only but suggests that outcome should not be relied on;<sup>188</sup> NYSEG believes the non-statutory duty to serve would survive repeal of the statutes and could be overcome only by specific legislation.<sup>189</sup>

The utilities see little if any authority on the part of the Commission to negate these obligations of the utilities, a step that would be implicit in any order directing them to give up the sale of commodity or requiring customers to be switched from a utility's commodity service. Nor could the Commission order customers to leave their utilities, for the added reason that the statute governs the acts of jurisdictional companies in providing utility service but not the acts of customers in purchasing it.<sup>190</sup> They stress that the Commission enjoys only those powers granted or necessarily implied by its statute and see no such authority here.<sup>191</sup> Some argue that this is not the kind of issue on which courts would defer to an agency's construction of its statute, and Niagara Mohawk asserts

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<sup>188</sup>Cullen and Dykman Memo, p. 5.

<sup>189</sup>NYSEG's Initial Brief, pp. 25-26.

<sup>190</sup>Id., pp. 36-37.

<sup>191</sup>See, especially, NYSEG's Initial Brief, pp. 27-34.

that even if the Commission had the authority in question, its exercise on the facts here presented would be unwarranted.<sup>192</sup>

In a line of argument to be described below, proponents of the Commission's authority rely to varying degrees on the three relatively recent cases cited in the previous section. The utilities dispute either the pertinence of the cases or the proponents' understanding of them. The differing interpretations of these cases can be most clearly presented in juxtaposition to each other, and the utilities' arguments accordingly will be described, together with those of the ESCOs and marketers, under the next heading.

Several utilities stress the risks of uncertainty associated with a murky legal situation. KeySpan, for example, notes its previously declared interest in exiting the merchant function, but would want to do so only "in a legal environment in which all parties are assured that the State's utilities may permanently eliminate their merchant and other retail functions without fear that they may subsequently be required to reinstate those functions in response to changes in regulatory policy or revised judicial interpretations of the existing statutory and common law framework."<sup>193</sup> It describes in some detail, as does RG&E, the risks, potential costs, and practical difficulties of re-creating a utility merchant function in response to a judicial invalidation of a Commission order directing its abolition.<sup>194</sup> KeySpan accordingly urges that the Commission, if it takes the contemplated steps without new legislation, at least delay implementation of its order to allow time for judicial review.

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<sup>192</sup>Niagara Mohawk's Reply Brief, pp. 6 et seq.

<sup>193</sup>KeySpan's Reply Brief, p. 2.

<sup>194</sup>Id., pp. 3-5; RG&E's Initial Brief, pp. 4-8.

2. Other Parties Questioning  
the Commission's Authority

Staff likewise concludes that TCL §12 and PSL §30 require utilities to supply commodity to customers requesting it and therefore preclude the Commission from taking the actions under consideration. (Staff stresses, however, contrary to some utility positions, that utilities are not obligated to offer a bundled sales and transportation service, and that the Commission is free to require the unbundling of commodity and transportation rates.) Nor does Staff see any basis for the actions in question in the "realistic appraisal" concept, under which the Commission has broad authority to interpret and apply the PSL in light of its realistic appraisal of the pertinent circumstances. In Staff's view, the parties citing "realistic appraisal" fail to analyze the specific wording of TCL §12 and PSL §31 and "rely upon broad Commission power over rates and service that is inapplicable to statutory commandments that utilities supply all customers upon demand."<sup>195</sup>

The AG takes the view that the relevant statutes can reasonably be interpreted (on the basis of both plain meaning and canons of construction) to require utilities to offer commodity; that there may also be a common-law obligation to serve; and that this might be the kind of issue on which courts decline to defer to an agency's interpretation of its enabling statute. He therefore concludes that "it is uncertain that the courts would sustain Commission determinations that utilities are not obligated to provide electricity and gas as a commodity and that retail customers may be involuntarily switched from a utility's commodity service to that of an ESCO."<sup>196</sup>

Asserting that the Commission "has no authority over the action of customers,"<sup>197</sup> PULP sees no basis on which the Commission could direct a customer to take service from any

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<sup>195</sup>Staff's Reply Brief, p. 5.

<sup>196</sup>AG's Initial Brief, p. 11.

<sup>197</sup>PULP's Initial Brief. P. 2.

particular supplier. It likewise sees no authority to direct a utility to cease providing commodity service to a customer wishing to take such service from the utility; it endorses the reasoning in the Cullen and Dkyman memo and believes it applies to electric as well as gas utilities. It adds, however, its view that an ESCO is a gas or electric corporation subject to HEFPA requirements and to Commission directives to serve customers requesting service from it.

### 3. Proponents of the Commission's Authority

In supporting the Commission's authority to take the steps under consideration (given a record showing the resulting services to be safe, adequate, just, and reasonable) the ESCOs and marketers, and CPB, object to a "static analysis" of the statutes that fails to recognize changing circumstances. They suggest the Legislature deliberately avoided defining the duty to supply, leaving the specification of that duty to the Commission's expertise, to be exercised on a rational basis through realistic appraisal of pertinent, and changing, circumstances. NESPA sees no basis for understanding "supply" and "service" as necessarily implying sale of a good rather than merely making it available,<sup>198</sup> and NEM argues that the undefined statutory obligations to "supply" and to provide "service" "must be read in the context of the overriding purpose of the statute and the resulting regulations ...[which is] to protect consumers from monopoly actions and pricing" and that the statute therefore should be read "in a manner that limits the operations of monopolies to solely monopoly functions,"<sup>199</sup> that is, delivery. SCMC regards it as "illogical to contend that the Commission may only authorize utilities under its jurisdiction to provide the type of service that was in effect at the turn of the century."<sup>200</sup> Indeed, such a stagnant approach, which would

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<sup>198</sup>NESPA's Initial Brief, pp. 12-13.

<sup>199</sup>NEM's Initial Brief, pp. 3-4.

<sup>200</sup>SCMC's Initial Brief, p. 6.

ignore the advent of competition, could lead to services that would violate the Public Service Law by not being "just and reasonable." It charges Staff with inconsistency in failing to extend to questions of service such as these the very broad view of the Commission's authority that it takes with respect to rates.

CPB, stressing the provider of last resort (POLR) aspect of the issue, recognizes that statutory clarification might be helpful but regards it as unnecessary in view of the Commission's "ample authority under its existing legislation to alter POLR service as necessary, providing the end result is safe and adequate service at just and reasonable rates even if that service is provided by entities other than the traditional utilities as long as all consumers have access to a POLR with full [HEFPA] protections."<sup>201</sup>

In support of their view, the proponents of Commission authority variously cite the court decisions noted above. They contend, for example, that the RG&E court, in stating that "the transportation of customer-owned gas also results in gas being supplied to members of the public," in effect held that "the provision of delivery service alone is sufficient to meet [a utility's] statutory obligation" and that "ownership of the commodity is not relevant."<sup>202</sup> The parties questioning the Commission's authority read the case differently, emphasizing the distinction between the court's holding that a utility may be required to deliver customer-owned gas and a holding that it has no obligation to sell its own gas to customers requesting it and noting, among other things, the court's statement that the requirement to transport customer-owned gas would not interfere with the utilities regular business of selling gas.<sup>203</sup>

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<sup>201</sup>CPB's Initial Brief, p. 5.

<sup>202</sup>SCMC's Initial Brief, p. 8; NESPA's Initial Brief, p. 5.

<sup>203</sup>E.g., NFGDC's Reply Brief, p. 7, Staff's Reply Brief, pp. 16-18.

Proponents of the Commission's authority likewise cite the Energy Association court's expansive reading of the Commission's authority to carry out the Legislature's goals of ensuring the provision of "just and reasonable" service. Referring to the passage quoted above, they point as well to the court's statements that introducing competition into a monopolistic marketplace is within the Commission's jurisdiction and that a utility's refusal to deliver a competitor's electricity, while delivering its own, would be an improper preferential use of the distribution system.<sup>204</sup> Noting that point, Staff, for example, responds that the proponents would create an improper preference of their own, by denying utilities the right to deliver their own commodity: "Ending discrimination means allowing all providers access, not denying access to one provider. Moreover, ending discrimination provides no basis for denying utility-supplied gas or electricity to customers that want to be supplied by utilities."<sup>205</sup>

Finally, CPB sees the dicta in PULP as implying that the key concern is the availability to customers of some POLR subject to HEFPA, which need not necessarily be the utility, and it stresses again the breadth of the Commission's discretion in carrying out the statutory policies.<sup>206</sup> In response, staff, for example, stresses the court's reliance on the availability of HEFPA protections through the utility as the basis for the Commission's conclusion that ESCOs and marketers need not be subject to HEFPA: "The Court's decision cuts completely against the idea that a realistic application of HEFPA to the PSL would

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<sup>204</sup>CPB's Initial Brief, p. 18; NESPA's Initial Brief, p. 6.

<sup>205</sup>Staff's Reply Brief, p. 8.

<sup>206</sup>CPB's Initial Brief, pp. 18-23. Proponents other than CPB decline to rely on PULP or to dispute Staff's reading of it; instead, they stress that its discussion comprises non-binding dicta that, even on Staff's reading, would not constrain the utilities' ability to abandon the merchant function. SCMC's Reply Brief, pp. 8-9.

allow the Commission to excuse the utilities from providing [commodity] to customers on demand.<sup>207</sup>

D. Discussion and Conclusion on  
the Principal Legal Issues

SCMC expresses surprise at Staff's distinction between the steps under consideration here<sup>208</sup> and rate setting, but the distinction is a real one and affords a good starting point for analysis. Rate setting may be the area in which the Commission enjoys the greatest degree of discretion. The statute directs that rates be "just and reasonable," and the courts have repeatedly sustained the Commission's authority to specify, through the application of its expertise to the record in particular cases, what that generally worded standard means. Generally speaking, if the Commission's decision has a reasonable basis, it will be sustained.

The Commission's broad discretion is by no means limited to rate setting, of course, and the decisions in RG&E and Energy Association demonstrate its long reach into other areas, including industry structure.<sup>209</sup> (PULP is more ambiguous in its implications for the discussion here and, as parties note, its only holding was on the issue of standing.) But to

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<sup>207</sup>Staff's Reply Brief, p. 6.

<sup>208</sup>For purposes of this discussion, we are treating the two steps--directing utilities to leave the merchant business and requiring customers to cease purchasing commodity from their utilities--as one. The issues are substantially the same, except that the latter step implicates the additional concern regarding the Commission's authority over customers, as distinct from jurisdictional corporations.

<sup>209</sup>One argument against the Commission's authority that needs to be specifically rejected is the claim that the enactment of §66-d of the Public Service Law demonstrates that the Commission would not have had the authority in question in the absence of that statute. It is not at all unusual for statutes to be enacted to confirm the Commission's authority against challenge, rather than to establish that authority; indeed, that might well be the effect of the legislation said to be needed here.

oust utilities from their century-old role of selling as well as delivering commodity is a far different matter from, say, determining that rates should be unbundled into commodity and delivery components in order to advance movement toward a competitive marketplace; and the Commission's clear authority to do the latter does not conclusively establish its ability to do the former.

For one thing, the "just and reasonable" rate standard is inherently unspecified, and it gains meaning only through a history of reasoned regulatory decisions sustained by reviewing courts. In contrast, it is undisputed that the statute when enacted contemplated that the utilities would provide the commodity as an integral and necessary part of providing service; and the question is whether the Commission can redefine that obligation--indeed, eliminate one portion of it, by forbidding utilities from providing commodity--in the exercise of its mandate to administer the policies of the Public Service Law in light of changed circumstances. Evolving rate policies do not change the historical meaning of the statute; barring utilities from providing commodity might well do so.

The preclusive action under consideration invokes an additional concern, one that suggests an important distinction between the action contemplated here and the one sustained in RG&E. As some utilities argue, ousting them from the commodity business would, in effect, deny them the right to conduct a lawful business that they are otherwise authorized to conduct.<sup>210</sup> In RG&E, the Commission in effect required utilities to offer a new service--transportation of customer-owned gas--on the premise that the service was consistent with their fundamental role as it should be exercised in the evolving marketplace and that performing the new role would not interfere with their traditional activities. That new obligation, to be sure, could be characterized as entailing an implicit prohibition against selling commodity to customers not wishing to purchase it from the utility. But the step contemplated here--forbidding a

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<sup>210</sup>See, e.g., Niagara Mohawk's Reply Brief, pp. 4-5.

utility outright from selling commodity to any customer, even one wanting to purchase it, in order to foster the development of new competitors and a more dynamic marketplace--would involve a more sweeping change in the utilities' traditional role.

None of which is to say that a decision to oust utilities from the merchant role would necessarily, or even likely, be overturned. Energy Association, very much the most pertinent here of the three cases for an expansive view of the Commission's authority, suggests that the Commission has considerable power to structure the energy marketplace and define the roles of its participants in a manner designed to achieve the overall purposes of the Public Service Law. And it is entirely possible that the courts would sustain a well reasoned Commission decision finding that effective competition could best be developed by freeing the market of the dominance of the utility merchant. But Energy Association's reach remains undefined; and we cannot say for sure that a court would use it as precedent for sustaining a determination by the Commission that the statutory goal of safe and adequate service at just and reasonable rates could best be achieved by ousting utilities from the merchant function in order to promote the development of a vibrant retail energy marketplace.

The decision thus comes down to one of how to deal with the uncertainty. CPB, as noted, recognizes that legislative clarification of the Commission's authority would be desirable, but believes we can go forward even in its absence. Conversely, several of the parties questioning the Commission's authority do not deny it outright but stress the risks of going forward in the face of uncertainty; it would not be easy or cheap to unscramble the omelet if a court later determined that the eggs should not have been used. We take that note of caution very seriously.

There is a further consideration that precludes a definitive determination now that the Commission can go ahead with the actions under consideration. In reviewing the Commission's actions, a court would necessarily consider the reasonableness of the specific steps, their effects on the

various interests at stake, and their relationship to the overall statutory goals sought to be advanced. That does not mean that consideration of these legal issues would be premature, as Con Edison suggests, as long as the contemplated actions are not precisely defined; but it does mean that a definitive judgment on the Commission's authority cannot precede a specific definition of the steps to be taken and of the rationale advanced for them.

Taking all of these considerations into account, we see a fair chance, but far from a certitude, that a Commission decision ousting utilities from the merchant function (or directing customers to purchase commodity from an entity other than the utility) would be sustained in the absence of legislation confirming the Commission's authority. That uncertainty need not deter the Commission from taking those actions if it finds a reasonable basis for them, but it strongly suggests that their effective date be deferred to allow time for judicial review. The sole exception would be to allow for the immediate effective date of a requirement that utilities cease performing the merchant function in those areas where, as a practical matter they already have done so: the provision of gas to large industrial customers. In such areas, the Commission would simply be confirming the preparation of an omelet already scrambled by the parties, and the risks of the unscrambling that might be required by an adverse court decision would be minimal.

E. Other Legal Issues Raised by the Parties

1. Assignment of POLR Functions

NYSEG raises a series of questions concerning the legal effects of any decision by the Commission to require utilities to assign their POLR responsibilities to other entities. It suggests a court might overturn any such decision as contrary to the consumer protection purposes of HEFPA; and that even if such a decision were sustained, utilities might still remain liable for failures to serve pursuant to their statutory and common-law responsibilities.

Staff similarly asserts, on the basis of PULP, that "customers have a right to receive gas (or electricity) from utilities with HEFPA protection,"<sup>211</sup> implying that the HEFPA responsibilities may not be assigned to other entities.<sup>212</sup>

CPB, in contrast, sees no need for the HEFPA protections to be provided through utilities, reading the PULP dicta as concerned about their availability, not their provider. It asserts that "a well-reasoned Commission order altering the HEFPA responsibilities of the incumbent utilities, but still providing that such protections are always available to consumers, would be well within the reasoning [in PULP]." <sup>213</sup> PULP, for its part, reiterates its view that ESCOs should be subject to POLR responsibilities and HEFPA requirements.

The posture of this issue resembles that of whether a utility may be required to exit the merchant function. An expansive view of the Commission's authority to advance the purposes of the Public Service Law might well lead to the conclusion that it could provide for a transfer of POLR responsibilities from a utility to another entity in a manner that would free the utility of any residual obligations; but there can be no certainty that courts would so hold. (It seems clear that the Commission could impose POLR responsibilities on ESCOs as a condition of service; the more difficult question is whether it could thereby relieve utilities of their statutory responsibility.) For the reasons already described, legislative

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<sup>211</sup>Staff's Initial Brief, p. 11.

<sup>212</sup>NYSEG (Reply Brief, p. 9) seems to misread Staff's position as asserting that utilities may contract out their POLR responsibilities to a third party. In the passage cited by NYSEG (Staff's Initial Brief, p. 9), Staff argues that a utility need not take title to commodity it supplies and therefore could contract out to a third party the function of obtaining it--as when it transports customer-owned gas--but that the utility nonetheless remains legally liable. NYSEG's quarrel on this point may be with CPB, whose position is next described, rather than with Staff.

<sup>213</sup>CPB's Reply Brief, p. 13.

confirmation of the Commission's authority would be preferable; and any decision to take such a step without legislative confirmation should have an effective date deferred far enough to allow for the completion of judicial review.

## 2. Rate Issues

Several overlapping matters related to rate setting are discussed by the parties and require decision or clarification.

First, Staff asserts that while the utilities are correct in arguing that they cannot refuse to supply commodity, they are wrong to maintain that they are obligated to offer "bundled service." Staff points to several references to "bundled service" in utility pleadings<sup>214</sup> and argues that the Commission is clearly empowered to require unbundling through the exercise of its rate power.

The disagreement may be illusory, the result of imprecise terminology. Staff is correct regarding the Commission's authority to order unbundled rates, and it is not clear that the utilities take a different view. In referring to "bundled service," they appear to mean only a service comprising both delivery and commodity, without implying that separate prices for those two components may not be broken out. RG&E, for example, says the most likely interpretation of the pertinent statutes is that utilities must "provide bundled retail service upon request," but later says the statutes "do not prohibit the unbundling of services, or the competitive provision of service by ESCOs, for retail customers voluntarily accepting such options. They do, however, require that a utility stand ready to provide a bundled, regulated service to any customer that may request it."<sup>215</sup> The utilities do not appear to challenge Staff's correct conclusion that the

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<sup>214</sup>Staff's Initial Brief, p. 9, citing Cullen & Dykman memo, pp. 2-3; Staff's Reply Brief, p. 19, citing the initial briefs of NYSEG and RG&E.

<sup>215</sup> RG&E's Initial Brief, pp. 2, 4.

Commission may require unbundled rates for the bundled (i.e., combined) service.

A more substantial dispute appears to have arisen between Staff and PULP regarding how an unbundled commodity rate may be set. Staff argues not only that the Commission may unbundle commodity rates but also that it may allow them to be set by the market; it sees no statutory requirement for the Commission to set commodity prices "were it to deem that market prices would be just and reasonable as a result of the operation of a workably competitive market."<sup>216</sup> Staff goes on to support that view by reference to the Commission's broad authority to determine just and reasonable rates, a process in which it need not follow any particular formula or test.

PULP responds, first, that the issue is not ripe, since the determination of just and reasonable commodity rates is unrelated to the market design and competitive policy issues under consideration here. It also regards Staff's argument as incomplete, inasmuch as it omits any suggestion of how the Commission might determine that a "workably competitive" market--the predicate for finding market-based prices to be just and reasonable--is in place. It adds that even if such a market were operating, it could not be automatically deferred to; rather, its results would simply be one more tool that the Commission could use in discharging its unavoidable statutory responsibility to determine just and reasonable rates.

The issue indeed is not ripe for decision--not, however, because it is unrelated to the questions being examined here, but because a decision could be based only on the characteristics of a specific proposal. For present purposes, it is enough to note that Staff is correct in emphasizing the great breadth of the Commission's authority with regard to rate setting, but that PULP properly sounds a cautionary note with regard to how that authority is exercised. Before deciding that market-based rates were inherently just and reasonable, the

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<sup>216</sup>Staff's Initial Brief, p. 13.

Commission would have to have found, on a rational basis, that a workably competitive market was in operation.

Finally with respect to rates, NEM relies on the Commission's ratemaking authority to contend that the Commission could set back-out rates "that provide consumers with shopping credits equal to the full costs of the gas commodity function and related competitive products, services, information and technology historically included in the utilities' fully bundled rates."<sup>217</sup> It suggests that could encourage utilities to leave the merchant function voluntarily, thereby in effect rendering moot the question of whether they could be compelled to do so.

NEM's point is correct in principle, but applying it would require, again, a determination on a rational basis that the backout rates were reasonable. Beyond that, a voluntary exodus of all of a utility's commodity customers, inspired by favorable back-out rates, might moot the question of whether a utility could cease providing commodity. NEM, however, speaks of the utility having an incentive to withdraw voluntarily from the merchant function, and that would make academic only the question of whether such a withdrawal could be compelled. A voluntary withdrawal by the utility would continue to pose the questions previously discussed regarding a utility's statutory obligations.

### 3. Other Issues Raised by NYSEG

NYSEG raises three additional points that, in its view, would warrant the Commission's attention were the Commission to decide to remove utilities from the merchant function.<sup>218</sup> First, it asserts such a step would have the effect of transferring from this Commission to the Federal Energy Regulatory Commission jurisdiction over nearly all delivery service and associated delivery facilities. Second, it argues that the Commission would have to provide for the recovery of

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<sup>217</sup>NEM's Initial Brief, p. 5.

<sup>218</sup>NYSEG's Initial Brief, pp. 42-45.

costs incurred by utilities under power purchase and related agreements that would remain binding notwithstanding the utilities' withdrawal from the provision of commodity. Finally, it warns that removing utilities from the merchant function could impair reliability by transferring to the ESCOs the role of providing to the Independent System Operator the load forecasts and related data needed for the ISO's operations.

NYSEG is right that these matters are worthy of attention. But they pose, for the most part, policy considerations (indeed, the third point presents no legal issues whatever), and to the extent legal issues are involved, they cannot (because the factual specifics are not yet known) and need not be decided now.

#### VII. CONCLUSION AND SUMMARY

For the reasons discussed above, we recommend that the Commission first adopt three overarching goals or principles to be used in guiding the development of competitive markets and as a basis for determining an appropriate end-state competitive model. Those goals are as follows:

1. The provision of safe, adequate, and reliable gas and electric service at just and reasonable rates should be the primary goal, having priority above all others.
2. Where possible all services and products should be provided by competitive markets and not by regulated utilities.
3. The regulation of rates, services, and competitive market activities should be appropriate for the status of the transition (with greater scrutiny being exercised at the outset, and less as the dominant players lose the ability to exercise market power) and for the status of the service provider (with greater scrutiny being exercised over those with greater market power).

Based on these principles, we recommend that the Commission adopt as its end-state vision of the competitive markets one in which the utilities no longer provide gas and electric commodity service and are removed from any other market

that becomes workably competitive. Before any utility is removed from any market, however, the preconditions set forth in SP2 should be met, including a determination that the wholesale and retail markets are operating without the exercise of market power. As a general matter, the utilities should not be removed from any market until multiple suppliers offering a variety of products are available for the entire customer class throughout the utility's service territory. At the present time, it appears that the only workably competitive market is the commodity market for non-residential gas customers. In that area, we recommend that the Commission move forward, removing the utilities from supplying commodity to those customers. In all other areas, movement that would be difficult to reverse should await not only market development but also confirmation, by the Legislature or the courts, of the Commission's authority to take the action contemplated.

We conclude as well that significant work remains to be done before the competitive market infrastructure is fully established. On the electric side, it appears that sufficient generation supply to ensure against the exercise of market power in the wholesale markets will not be available for three to four years, and, until it is available, we recommend allowing the markets to develop under the present structure, without the creation of further incentives for migration. We also recommend that increased attention be paid to the need for transmission and distribution infrastructure (both gas and electric), including, if necessary, ordering the franchised utilities to construct any needed facilities. We conclude further that the regulatory arrangements for protecting consumers and resolving their complaints needs to be reexamined. In particular, we recommend that all energy suppliers in New York provide the same level of consumer protections and provide energy services without undue discrimination. In order to accomplish this result, we conclude that more direct Commission oversight of ESCOs is required.

On the gas side, it appears that the pipeline infrastructure is not adequate to support opening a competitive

market for pipeline capacity at this time. Accordingly, we recommend that the vision in the Gas Policy Statement be amended by eliminating the assumption that competitive markets for pipeline capacity will be feasible in the near future.

With regard to the transition, we conclude that robust, fully competitive retail markets will develop at different times for different customer classes and for gas and electricity. Accordingly, we recommend a transition plan that first moves the utilities out of the commodity business for large customers and then for smaller and ultimately residential customers, depending on the pace of market development. Migration incentives are recommended for now, only in the gas markets, but a number of other steps can be taken to foster market development. Perhaps the most important is to fully unbundle gas and electric rates, so that customers are given the proper economic signals and ESCOs are aware of the price to compete against. In addition, we recommend that the utilities be required to offer hedged commodity prices for small-use gas customers and all electric customers until such time as the ESCOs are broadly providing this type of service to the retail markets. We further recommend that commodity ratemaking for the regulated utilities continue to be based on utility costs rather than on price-capped, incentive-based programs.

In the area of consumer protections, we recommend that a more detailed examination of existing consumer protections be undertaken to identify additions and deletions appropriate to the ongoing market transition. Once a set of rules has been adopted, they should be made mandatory for all energy providers. We also recommend that ESCOs be required to serve customers without undue discrimination in those territories and for those customer classes chosen by the ESCOs.

In the area of public benefit programs, we conclude that the law and Commission precedent have established a de facto "universal service" policy in New York, and we urge that universal service be formally adopted as Commission policy for gas and electric service. We also conclude that the current funding for low-income programs will continue to be necessary

throughout the transition and in the end-state, and that these programs be continued in the end-state, unless obviated by other funding sources or mechanisms. In contrast, it may ultimately be possible to remove energy efficiency, renewable energy, and research and development programs from utility rates. We urge the Commission to monitor existing programs and to remove them from rates once they are provided by competitive markets or become no longer cost-effective.

Finally, the Commission should reiterate its endorsement of retail competition and should move ahead with deliberate speed in fostering market development. Just and reasonable rates, however, must be maintained throughout the transition period, and the possibility that workably competitive markets will not develop for all utility functions should be borne in mind. Future regulatory policies in this area should remain as flexible as possible and, to the extent possible, policies should be designed to be reversible at relatively low cost. We are confident that a flexible oversight process that encourages competition and allows it to develop wherever the economics can support it will protect consumers during the transition, permit markets to develop freely, and will serve the public interest.

July 13, 2001  
JES/MC/JAL:ys

**CASE 00-M-0504**  
**APPENDIX A**  
**STRAW PROPOSAL 2**

**COMPETITIVE MARKETS CASE 00M0504**  
**STRAW PROPOSAL 2**  
**February 26, 2001**

*This proposal does not necessarily represent Staff's or the Department's position nor are we bound by it in any way.*

**I. Vision:**

- Ensuring the provision of safe, adequate, and reliable electric and gas service at lower overall costs to consumers is the primary goal of developing competitive markets.
- Competitive markets should be relied upon for providing all products and services that result in more choices and value for customers.
- The utility delivery function will continue to be a monopoly service. The remaining utility functions, including retailing and customer care services, will be or have potential for becoming competitively provided by non-utility companies. In the long run, and depending on how the market develops, the utility's function is expected to be delivery service.
- Regulation should continue for the remaining monopoly functions, and should facilitate the development of workably competitive markets, monitor the functioning of those markets, establish consumer protections for all consumers, and address the needs of consumers who are not served by the competitive markets. Regulatory oversight should be relaxed as markets become more competitive.

**Implementation:**

There are several steps in getting to this long-term vision.

**UNBUNDLING**

- Fully unbundling retailing services will enhance the development of competitive retail markets. The Commission immediately should institute a proceeding to address generic policy issues related to unbundling with a goal of establishing an appropriate level of uniformity in calculating back-out credits.

**MARKET PRICE PASS-THROUGH**

□ Large Customers

- Gas
  - Most large volume natural gas customers have already switched from the utility to marketers for commodity service. The large customers that still purchase bundled gas service from utilities generally pay a market-based price.
- Electric
  - Utilities should be required to offer their largest electric customers (i.e., those with interval metering) rate options reflecting the straight pass-through of hourly market

electricity prices.<sup>1</sup> In the long run, such pricing options will need to be coupled with appropriate customer outreach and education programs and further supported by market offerings to customers of load management and other price-responsive program

packages that will enable customers to better manage their operations in a market-based pricing environment.

□ Small Customers

- Gas
  - The Commission has already required gas utilities to take action to mitigate price volatility.<sup>2</sup>
- Electric
  - A purchasing practices policy statement for electric utilities should be established, similar to that already in place for gas.
  - At this time, electric utilities should manage their supply portfolios to, among other things, reduce customer exposure to price volatility. This can be phased-out as the competitive market develops.
  - Once criteria (a) and (b) listed below under Preconditions, Timing/Process, have been met, utility rates that are more reflective of a straight pass-through of market-based prices for commodity, capacity and other ancillary services should be extended to the incumbent's smaller commercial and residential customers. Such utility pricing options will need to be coupled with appropriate customer outreach and education programs.

**UTILITIES EXIT COMMODITY FUNCTION (MODEL 2) ONCE PRECONDITIONS ARE MET**

- The most direct way to establish a robust competitive market is for utilities to cease buying and selling commodity (see the Commission's November 1998 Natural Gas Policy Statement wherein the Commission envisioned gas utilities exiting the merchant function in three to seven years). Electric and Gas utilities are expected to be out of the commodity function, i.e., buying and selling electricity and gas, for all customers. Before the complete exit, however, the Commission needs to be assured that the preconditions identified below have been met. These criteria may be satisfied at different times for gas and electricity and for large and small customers.

**PRECONDITIONS, TIMING, AND PROCESS**

- **Preconditions** - Before utilities exit the merchant function the Commission needs to be assured that the following criteria have been met:
- (a) "Workably competitive wholesale markets" exist;
  - (b) New York State registered ESCOs/marketers are collectively able and willing to provide reliable service to the appropriate market;
  - (c) Mechanisms are in place to provide access to electric and gas service to all consumers who need service but are unable to secure it in the competitive markets (see POLR and Low-Income sections below);
  - (d) There is general public acceptance of energy market restructuring and a reasonable expectation that greater levels of customer migration to competitive providers will create

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<sup>1</sup> See Case 00-E-2054, In the Matter of a Status Report on the Demand/Supply Component of the Department's Electric price and Reliability Task Force Including Recommendations for Specific Utility Actions on the Demand-Side, Order Requiring Filings and Reports on Utility Demand Response programs (issued December 20, 2000).

<sup>2</sup> See Case 97-G-0600, In the Matter of the Commission's Request for Gas Distribution Companies to Reduce Gas Cost Volatility and Provide Alternative Pricing Mechanisms, Statement of Policy Regarding Gas Purchasing Practices (issued April 28, 1998).

additional opportunities for all customers to save and to benefits; and  
(e) Potential legal impediments are addressed.

- **Timing/Process** - The timing for utilities to exit the commodity function will depend on how well the above conditions are satisfied. A multi-stakeholder “Competition Council” should be established to monitor the status of wholesale and retail competition, and to report to the Commission when the above criteria have been met. The specific measures to determine that these criteria have been met will be established with input from all parties. The following framework is suggested:
- within three months after an order in this proceeding - parties decide on metrics for determining when the above preconditions (a) - (e) have been achieved;
  - twelve months after an order in this proceeding - review the status of the wholesale market to ensure that specific criteria are met;
  - twenty-four months after an order in this proceeding - review the status of retail issues [pre-conditions (b), (c) and (d), above] to ensure that specific criteria are met;
  - twenty-five to forty-eight months after an order in this proceeding (assuming that the 12 and 24 month reviews were successful) conduct a coordinated statewide outreach campaign educating customers that the utility is exiting the commodity business, coordinated outreach could be conducted sooner to educate consumers on other emerging competitive issues, depending on the need;
  - Forty-eight months after an order in this proceeding - utilities are expected to exit the commodity business.

### **UTILITIES EXITING RETAIL FUNCTIONS (MODEL3)**

- The opening of some retail functions (billing and electric metering) to competitive markets is currently in progress. Before the utilities cease providing retailing functions (Model 3), however, the Commission must be assured that competing ESCOs/marketers have the infrastructure to provide the retail services. This issue should be revisited within the next few years to assess the ability of the marketplace to provide these services. However, individual utilities should not be precluded from voluntarily seeking to exit the retail function sooner, as long as there is a showing that the marketplace is ready and capable of providing these services (some of the yard sticks to gauge whether the marketplace is ready might include percentage of customer/load migration experienced to date, number of ESCO/marketer choices available to serve customers, customer satisfaction with ESCOs/marketers, collective ESCO/marketer infrastructure in place to handle retail functions for millions of consumers).

### **II. Consumer Protections:**

- Development and implementation, including enforcement, of modified consumer protection rules appropriate to meeting the needs of consumers in a competitive marketplace is essential for the well-being of all New Yorkers. Changes may be needed to HEFPA and Non-Residential rules, and the modified rules should be aligned with other existing statutory requirements.
- All service providers in New York are expected to abide by a standard basic level of consumer protection rules. The parties should develop these standard rules. Specific areas to be considered include disclosure requirements, service quality standards, fair trade practices (e.g., anti-slamming, anti-redlining), and complaint resolution. More consumer protections

may be needed during the transition phase (e.g., limitations on prepayments, marketing codes of conduct). Experience would allow for the refinement and modification of those protections, to achieve an appropriate balance between the strengthening of consumer trust that they create, and the costs they impose on marketplace participants. Once there is a vibrant competitive retail market, some of the protections may be relaxed.

- The Commission should investigate and resolve customer complaints against ESCOs. This could be accomplished through alternative dispute resolution and other mediation techniques.

### **III. Customer Migration Strategy:**

- Ideally, full customer migration to competitors should happen voluntarily. This has occurred for large gas customers and may in fact occur for large electric customers. Voluntary migration should and will be strongly promoted through customer education and customer choice.
- ESCO/marketer price mechanisms and value-added services should give consumers new options over current utility offerings. In addition, utility price signals (e.g., utility recovery of some stranded costs via commodity charges) could also help facilitate customer migration.

### **IV. Provider of Last Resort:**

- The POLR entity or entities will have the responsibility of satisfying “obligation to serve” and attendant consumer protections. As long as the utilities provide commodity service to some classes of customers, they will continue to be the POLR for commodity service to customers in those classes. During the transition, however, utilities should be encouraged to outsource POLR functions (i.e. implement POLR pilots). Once the utilities fully exit the commodity function, other entities will discharge this responsibility. The POLR entity could be different for electric and gas industries and different by customer group, and should be approved by the Commission. The utilities may also bid for providing POLR service. The preferred approach is the one where one or more entities provide POLR service on a regional or statewide basis, with the “obligation to serve” not imposed on all ESCOs. It is expected that in the end-state, the POLR will serve “transient or gap” customers only, and not necessarily have a large customer base.
- A pre-requisite for establishing the new POLR entity or entities is the continuity of the obligation to serve. Reliability must be ensured. The solution must address the term of obligation and what will happen if one or more entities are unable to fulfill POLR obligations during, or at the end of, the term.
- With regard to POLR pricing to consumers, price offerings could include both fixed and variable prices as options. The variable price could be formula-based, approved by the Commission.
- Assuming all ESCOs do not have the obligation to serve, a competitive process involving issuance of an RFP should be used to select the POLR entities. The term should be at least a one-year period with possible provision for extensions to two or three years. Bidders should be able to bid across utility territories, by fuel type and/or service class, to allow serving multiple areas or the entire state. Evaluation of RFPs must consider the technical and financial competence of the bidders and terms of the proposed service offerings. Renewable energy sources could also be considered in the selection process. A process is needed to

provide guidance on how, if at all, the terms could be changed during the term. If suitable bidders are not found, the PSC can designate an entity (a governmental body, NYPA, incumbent utility, etc.) as the POLR or solicit a qualified bidder under negotiated terms. An interim POLR could be designated by the PSC in case of default.

- POLR oversight is expected to involve pricing, service quality, consumer protections, economic viability and a process for back up in the event of POLR failure. This will require the collection of data regarding complaints and other compliance measures. It will also involve a process for monitoring and problem resolution, as well as provision for enforcement and disqualification as conditions and qualifications may change over time. Some limited number of service standards (addressing reliability, safety etc.) should be developed that qualifying bidders would be subject to. A publicly available report card on POLR performance is recommended and should be periodically issued by the Commission. POLR oversight role should be expanded to include other stakeholders besides the PSC (e.g., consumer groups and other representatives of the community) on a voluntary basis in an advisory role, working with Department staff, subject to the Commission's decision making authority.

#### **V. Low Income Programs:**

- The energy burden on low-income customers should not be worsened as a result of the development of competitive markets. The continuing needs of low-income customers both in the end-state and during the transition to the end-state must be addressed through low-income programs and other initiatives. Appropriate funding resources should be assured to address the needs of low-income consumers.
- Market-based solutions, where possible, should be developed to address the needs of low-income customers.
- In the long run, the financial support needed to assist low-income customers should be derived from broad-based public funding. For the transitional period, however, surcharges on bottleneck functions (e.g., pipes and wires) would be a reasonable alternative mechanism for achieving these benefits, the loss of which would not be in the public interest. Such cost recovery mechanisms are reasonable because low income programs help to at least partially avoid collection related and working capital costs on unpaid bills that are borne by all customers, as well as collateral costs to government social service agencies.
- A basic level of reasonably affordable service must be maintained for low-income customers. Coordinated program initiatives that include programs implemented by utilities as well as alternative providers should be developed. The sources of program funding should be considered in program design and implementation. Some of the components to be considered part of a coordinated statewide low-income program could include the following:
  - Targeted energy efficiency and weatherization measures - to reduce usage and overall energy costs for payment-troubled low-income consumers and address the concern that low-income households tend to live in poorly maintained housing stock.
  - Energy education and budget counseling programs - to help customers manage energy affordability problems.
  - Forgiveness of arrears linked to improved prospective payment behavior - to improve revenues from low-income customers.
  - A “lifeline” discounted rate (without distorting economic price signals) - to reduce energy burden. Such a discount should be applied to delivery rates, in order to maintain customer

entitlement whether the customer stays with the utility for sales service or migrates to a competitive supplier.

- Market-based solutions, such as aggregation programs - that allow low-income customers an opportunity to enjoy the benefits of a competitive market, as well as providing a savings to counties, municipalities, or other entities that seek to aggregate low income customer load.
- Reducing overall energy rates to achieve lower consumer prices and funding low-income programs through energy delivery rates are competing goals that need to be continually reconciled. The future sources of funding for low-income programs need to be examined on an on-going basis.

#### **VI. Public Benefit Programs:**

- A competitive market may not necessarily provide all energy efficiency, renewables and R&D programs that are in the public interest because demand for these activities in a competitive market is driven by the benefits derived by the purchaser rather than the benefits to society as a whole. These programs provide important environmental benefits that are difficult to obtain through markets. Ideally, the financial support needed for these programs should be derived from broad-based public funding.
- Energy Efficiency/Renewables/R&D programs (fuel-neutral) could be funded from a competitively neutral Public Benefits Charge assessed on all electric delivery rate customers until the market meets the societal needs that the programs are designed to address or broad based funding approaches can be implemented..
- Such energy efficiency/renewables/ R&D programs could be implemented by a single entity to be designated by the Commission (e.g., New York State Energy Research and Development Authority) as program administrator.
- A multi-stakeholder forum could be established to assist with defining needs and objectives, setting fund requirements, reviewing compliance and other standards for participation, as well as periodically assessing whether the market is meeting the societal needs that the program is designed to address.
- The Public Service Commission will administer a process that will aid in its determination of the amount and oversight of the collection of the funds as part of its regulation of the T&D companies.
- Gas customers should continue to fund utility-based R&D as per existing Commission orders.<sup>3</sup>

#### **VII. Aggregation:**

- We expect that clarity and commonality in language will facilitate the transition to competition. As a first step, we offer the following definitions. Once consensus is reached on definitions, the parties should develop necessary business practices and list requirements for new entities.

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<sup>3</sup> Case 99-G-1369, Petition of New York Gas Group for Permission to Establish a Voluntary State Funding Mechanism to Support Medium and Long Term Gas Research and Development (R&D) Programs, Untitled Order (issued February 14, 2000)..

**Aggregator** means any person or firm joining two or more customers into a single purchasing unit to negotiate the purchase of electricity and/or natural gas from ESCO/marketers. Aggregators may not sell or take title to electricity or natural gas. ESCO/marketers are not aggregators.

**Broker** means a firm that acts as an agent or “middle man” in the sale and purchase of electricity or natural gas in the wholesale market, but never owns the electricity or gas.

**ESCO** means an entity that can perform energy and customer service functions in any competitive environment, including buying and reselling of electricity and natural gas and assistance in the efficiency of its use. [modifications from the PSC definition]

**Marketer** means an entity that can perform energy and customer service functions in any competitive environment, including buying and reselling of electricity and natural gas and assistance in the efficiency of its use.

**Registered Aggregator** means any non-profit, public interest organization, governmental entity or private firm that provides one or more of the following: conducts outreach and education to small use customers; acts as procurement agent for targeted end-users, negotiating pricing, terms and conditions with ESCO/marketers and offers the package to the customers; renders bills on behalf of the ESCO/marketer; and maintains on-going customer service relationships with the aggregated customers. Registration with the PSC is voluntary. The PSC Web site will list registered aggregators.

**Restricted ESCO/marketer** means a firm or governmental entity that takes title to electricity or natural gas on behalf of two or more service end points (defined customers or for its own use), which are defined when registering with the Department of Public Service such that others are precluded from joining or participating. Restricted ESCO/marketers are not listed on the PSC Web site.

**Sales Agents** means a separate person or firm that matches buyers and retail sellers of electricity or gas, playing no role beyond customer acquisition.

- We expect the marketplace will provide consumer information about ESCO offerings and performance of ESCOs and aggregators in an unbiased manner. Access to information on ESCO/marketer offerings also will continue to be provided on the PSC Web Site.

#### **VIII. Additional Transition Measures:**

- Uniformity in ESCO, customer, utility business interaction practices should continue to be pursued, i.e., continue to improve the UBP.
- Any economic development or flex rates offered by incumbent utilities to large customers in the future should be competitively neutral, should cover the incumbent’s marginal cost plus a contribution to fixed costs and preferably should be administered as discounts to standard delivery service rates.

**CASE 00-M-0504**

**APPENDIX B**

**SUMMARY OF PARTIES' POLICY BRIEFS**

(This summary is intended for the convenience of non-party readers who may wish to know, in general terms, the positions taken by the parties in their briefs. The number of parties and the nature of the issues would make it cumbersome at best to describe every party's position in the body of the recommended decision. It sets forth in general terms highlights of the points made in the briefs, organized around the section headings the Judges asked parties to follow. Every effort has been made to present the parties' positions faithfully, but the omission of details or loss of nuance -- both inevitable in summary such as this -- may have inadvertently caused a point in the summary to be untrue to the brief. For that reason, and because the summary is not and cannot be complete, this document should not be seen as a substitute for the briefs themselves, which interested readers are advised to consult.)

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Summary of Parties' Policy Briefs

("r" refers to comments made in Reply Briefs)

**ASSOCIATION FOR ENERGY AFFORDABILITY AND PACE ENERGY PROJECT (AEA/PACE)**

II. Vision

- While recognizing that clear policy statements are required, AEA/PACE note that the Commission must beware of establishing hard and fast policies that may not ultimately prove fruitful. They urge that the Commission maintain a level of flexibility in policy making and note that imposing a rigid path towards a defined market model may not take full account of hurdles in that path and the creative solutions that may be needed to overcome them. They argue that a robust market is not necessarily achieved by a dictated end-state and the appropriate course may very likely be to follow what the markets are capable of delivering rather than attempting to coerce markets into a particular mold.
- AEA/PACE argue that all gas and electric providers should comply with the uniform set of basic consumer protections that reflect the needs of those customers least likely to have access to the benefits of gas and electric retail choice.

III. Market Transition

- Noting their agreement with Straw Proposal 2 that ideally customer migration should be voluntary, AEA/PACE note the barriers to full customer migration for small use customers and believe voluntary migration of such customers unlikely to occur within the 48-month period contemplated by this Straw Proposal.
- AEA/PACE support the adoption of a competitive process for POLR responsibilities, noting that competition in the "POLR market" could have a beneficial impact on the "ESCO market". They note in particular the successful program for the Philadelphia Electric Company and urge that that program be investigated for possible adoption in New York.
- AEA/PACE urge that the competitive POLR approach be used as a market-based mechanism to advance renewable energy in the State.

- AEA/PACE urge the continued promotion of residential and small use customer aggregation policies supported by community education and participation programs to ensure that residential customers understand the choices they have available as well as the benefits of large scale aggregation programs. In this area, the parties stress the importance of outreach and education.

#### IV. Public Benefit Programs

- AEA/PACE support the extra-market public benefit programs set forth in Straw Proposal 2. With regard to low-income programs, they support the continuation of energy efficiency and weatherization, energy education and budget counseling, the development of a competitively neutral lifeline discounted rate, and aggregations and community-based programs.
- AEA/PACE express the belief that the mechanisms in place for the existing system benefit charge should be continued in the end-state and should be expanded to natural gas utilities to provide funding for energy efficiency and environmental programs.
- In response to the suggestion that a public benefit programs council be created, AEA/PACE note the existence of the SBC Advisory Council and urge that that structure be used for energy efficiency, research, and related programs.
- With regard to low-income programs, AEA/PACE support the creation of a statewide multi-interest low-income advisory council to facilitate the coordination of low-income programs and to ensure their consistency throughout the state.

**THE ATTORNEY GENERAL OF THE STATE OF NEW YORK (Attorney General)**  
(no initial brief was filed)

#### I. Process

r The Attorney General notes that given the complexity of issues, the number of parties, and the multiplicity of views and interests, the collaborative framework has, for the most part, met the challenges presented in an effective manner. The Attorney General notes however that there is still no firm foundation upon which to determine what the end-state of competition should look like. Traditional

regulatory procedures in the Attorney General's view might prove necessary or appropriate in the future.

## II. Vision

r The Attorney General notes that a vision of the ultimate goal is useful in overseeing the transition from monopoly to competition, but premature decisions about the details of the future market could actually inhibit competition, discourage customer choice and prove fatal to market restructuring efforts.

r The Attorney General agrees that the preconditions set forth in the Straw Proposal are the minimum to be met before significant changes are made to the present regulatory framework. It notes that none of these preconditions has been satisfied and it is thus premature to select from among the proposed long-run models.

r The Attorney General argues that customers should not be forced to switch to an ESCO, "at least not until ESCOs are offering prices and service that are deemed by customers to be good substitutes for those of the incumbent utilities, until ESCOs are willing and able to serve all customers, and until it is clear that "regulatory and statutory protections which currently apply to utility residential customers also apply to ESCO customers."

r The Attorney General disagrees with those who argue that ESCOs that do not have an obligation to serve should offer fewer consumer protections than those the utilities now provide. It further notes that experience demonstrates the need for continued and perhaps increased consumer protections in a competitive market. It notes that the market has already lead to abuses by ESCOs, citing two different Assurances of Discontinuance based on enforcement taken by the Attorney General. The Attorney General also notes that customers continue to need the protection of the obligation to serve in the event ESCOs are unable or unwilling to do so, citing one ESCO which abruptly left the gas market and another which went bankrupt.

r The Attorney General also notes that the failure to provide an adequate level of consumer protections will lead to consumer confusion and dissatisfaction, which will undermine the goals of promoting and encouraging a competitively vibrant retail market.

III. Market Transition

r The Attorney General disagrees with those who oppose mandatory utility hedging strategies to stabilize the price of electricity and natural gas. Noting the experience in California, where hedging was not permitted, the Attorney General argues that the utilities should use hedges as a prudent business practice for all customers, large and small. Some greater level of hedging might be appropriate for small customers, as those customers are less able to reduce demand through efficiency measures or to bargain with commodity providers for lower prices.

IV. Public Benefit Programs

r The Attorney General supports the continuation and expansion of effective low-income programs and has endorsed funding for NYSERDA programs through the System Benefit Charge.

**BROOKLYN UNION GAS COMPANY D/B/A KEYSpan ENERGY DELIVERY  
NEW YORK AND KEYSpan GAS EAST CORPORATION D/B/A KEYSpan  
ENERGY DELIVERY LONG ISLAND (KEYSPAN)**

I. Process

- KeySpan argues that it may be better to proceed to briefs on exceptions rather than to continue collaborative efforts, although the company notes that it would be willing to continue to work in the collaborative process.
- KeySpan identifies five areas where it perceives some significant problems with the process.
- KeySpan begins by indicating that the parties had only a little initial direction and that more specific focused and narrow questions from the Commission would have streamlined the process. They further contend that the rules of the process were unclear and were inconsistently applied, that the process should have resulted in development of a complete record, and that, as the case progressed, the entire process began to deteriorate. KeySpan appears to object in particular to private meetings held by Staff on the Straw Proposals; to a study submitted by CPB indicating that corporate affiliates of the utilities with similar names are likely to confuse the public (which report was not subject to cross-examination); and to the failure to address first the legal impediments to

transition, which KeySpan contends resulted in the parties' efforts being based on a purely hypothetical view of the regulatory environment. KeySpan states "in retrospect, KeySpan would be chary of participating in Phase I and Phase II of this case or in other collaborative proceedings generally absent further clarity on how the information resulting from those phases and/or proceedings would be used."

- KeySpan contends that a proper prioritization of issues would have led to the examination of legal impediments at the very outset of the case. It sees these issues as fundamental and the parties efforts at collaboration potentially utterly futile because these issues were not addressed at the outset. It argues that if the parties had "been asked to or allowed to address the legal issues initially", the work in the case would have been more productive.
- KeySpan contends that the case has suffered in some concrete ways from inconsistencies with Commission orders or other ongoing proceedings. According to KeySpan, this lead to confusion and inertia. It sees a significant "disconnect" between the delay in market development underlying the Straw Proposals and the Commission's repeated insistence on expeditious unbundling based on embedded and forward-looking costs.
- KeySpan's fourth concern is that "there has been no consistent scope to this case." It notes that Phase I of the case which largely devoted to gathering the facts, a focus which completely shifted in Phase II to analyzing those facts. It also notes that additional questions were raised by the presiding officers as the case progressed, including questions that were raised immediately prior to briefing. KeySpan provides as examples the question posed to the parties for their initial briefs concerning the adoption of the telephone model for obligation to serve and consumer protection issues which KeySpan says was "seemingly rejected in Straw Proposal 2 but reappears in the questions for the initial briefs." It further notes that a more consistent scope could have led to wider participation, claiming that there has been little participation in the case by marketers who are actually selling commodity in New York.
- KeySpan also contends that the "mere acknowledgment" of the significant changes in market conditions since the beginning of the case in May 2000 was not sufficient and that these "underlying conditions" should have been recognized and the parties asked to address how they changed or what impact they

would have had on the parties' work. It contends that these issues "loom unacknowledged."

r KeySpan contends that the parties' views have not materially changed in the "years since this proceeding was initially contemplated, arguing that research on this case began on July 30, 1999 and that nearly two years have elapsed since then". It further argues that policy discussions in numerous collaborative proceedings have been ongoing for the past seven years. It therefore concludes that it is time for the Commission to break the current log jam and to establish a clearly defined and accelerated timetable for competition.

r KeySpan reiterates its concern about the potential uses to which the Phase I and Phase II report will be put and urges that the recommended decision delineate that the report is not a consensus document, does not constitute an evidentiary record, and contains unverified background material.

r KeySpan reiterates its objection to addressing the legal issues toward the end of the process because, it alleges, doing so ignored the Commission directive that legal issues be analyzed, that it created a situation where the legal analysis did not inform the report and that it caused the parties to engage in time consuming hypothetical discussions.

r KeySpan reiterates its objection to Staff's confidential meetings with some of the parties regarding the Straw Proposal. KeySpan asserts that it and others should have been provided with the same opportunity.

r KeySpan reiterates its view that Straw Proposal 2 does not reflect a majority view and urges that the RD reject that characterization.

## II. Vision

- KeySpan embraces the Commission's vision of the future of the gas market and supports implementation of the single retailer model in this proceeding.
- KeySpan urges adoption of a specific end-state model for all New York utilities and for all customer classifications rather than making a more general and global policy statement concerning the evolving markets. In particular, KeySpan

contends that being partially regulated and partially competitive during the transition period is unacceptable for the following reasons:

- Marketers will find it increasingly difficult to compete against utility sales rates that reflect commodity prices at cost.
  - Customer inertia will remain as long as the utility continues in the merchant function.
  - ESCOs will be less likely to participate in regions where the utility remains a choice.
  - Marketers will continue to cherry-pick, leaving the utility with a customer base comprised of the least desirable customers.
  - Remaining half in and half out drives up the utility's cost of doing business, increases customers' exposure to stranded costs, and results in the duplication of costs within the industry.
  - Both short- and long-term planning becomes impossible for utilities and marketers and the utility's ability to maintain system reliability may be hampered.
  - If the utility remains a choice, marketers will be reluctant to sign up for additional pipeline capacity.
- After more than a dozen orders and years of collaboration, according to KeySpan, the Commission should take more detailed and action-oriented steps. A specific end-state and implementation plan to reach it should therefore be recommended to the Commission.
  - KeySpan urges the adoption of the single retailer plan because:
    - It is the most effective means to establish a competitive market.
    - Adopting a single retailer model eliminates KeySpan's concerns regarding its status as partly regulated and partly competitive.

- Adopting a single retailer model is the most efficient means of moving customers to competition, and defining the market in that way would alleviate customer's confusion. (KeySpan notes, notwithstanding other alleged infirmities, that the public involvement process reflected overall customer confusion regarding the transition to markets).
- KeySpan urged that the Commission either complete the transition to Model 3 (utilities removed from all retail functions) in "no more than 12-18 months" from the conclusion of this proceeding; **or** conclude its efforts to develop a retail mass market without attempting any further expansion of competition. In the latter option (which the company opposes), the Commission would fully regulate small-volume-use residential and commercial customers and would eliminate competition for these classes.
- Reregulating a portion of the market, according to KeySpan, would allow the utilities to return to their obligations of building or buying sufficient capacity and commodity assets to discharge their POLR obligations in a cost-effective manner.
- The Straw Proposal is not sufficient to implement the Commission's vision of a competitive retail energy market because it is not materially different from the policy statement already adopted by the Commission and does not reflect, according to KeySpan, the experiences of the last three years. KeySpan contends that the Straw Proposal merely reiterates the conditions the Commission has already set forth for developing competitive markets. It criticizes the Straw Proposal for not providing any recommendations for implementing the preconditions to the utilities exiting the merchant function, not providing any action items for encouraging ESCOs and marketers to serve New York customers, not describing any mechanism to provide service to customers not served by the competitive market, not providing recommendations for securing public acceptance of competitive markets, and not resolving any issues related to establishing a non-utility POLR. According to KeySpan, the transition period must contain concrete milestones to reach the end-state of a truly competitive market.
- KeySpan supports adopting the policy statement's vision for the electric industry in New York.

- The companies oppose allowing utilities to remain in competitive markets, noting that the most inefficient, ineffective, and expensive position for the utilities to be in is half-regulated and half-competitive.
  - KeySpan notes that if the utility merchant function is eliminated, the Commission and the public at large would then be required to accept the results of the competitive market and would no longer be able to regulate the price of commodity. If the Commission is willing to agree that free market competition produces the most efficient pricing, then the consequences of that decision would have to be accepted.
  - KeySpan supports the adoption of the telephone model for the energy markets in the end-state. They would support an obligation-to-serve requirement for market participants in areas they designate to serve and a requirement that such participants provide a uniform set of consumer protections.
- r     KeySpan notes that a "significant number of parties" support Model 3 but that many of the parties appear to view Model 3 as desirable but not attainable. KeySpan's conclusions are based on the proposal that preconditions be met before utilities exit the retail functions, noting that "it is apparent" that the preconditions required virtually insure that they cannot be met. It argues that two of the preconditions cannot be met while utilities continue to maintain the current infrastructure used to serve the mass market, noting that customer inertia will alone "ensure that public acceptance of market restructuring will never be attained while the utilities continue to participate."
- r     KeySpan urges the Commission to take affirmative steps as expeditiously as possible including: adoption of Model 3 on a statewide basis; rate incentives to encourage customer switching; customer assignment for those who do not switch; requiring ESCOs to accept the POLR responsibilities; establishment of appropriate procedures for capacity planning and procurement; and adoption of transition charges to fund restructuring.
- r     KeySpan strongly disagrees that the best approach is to allow the status quo to continue, as two of the utilities favor. Unless an end-state model is adopted, allowing utilities to completely exit all retail functions, customers will not realize the financial benefits of competition. Furthermore, KeySpan opposes the suggestion that different models might be accepted across the state, arguing that there must be a uniform goal. For the ESCOs

to achieve economies of scale needed to serve the mass markets, KeySpan argues, utility systems must be open to competition in a relatively uniform fashion.

### III. Market Transition

- KeySpan believes that if there is to be competitive retail access in New York, the transition must be sure and swift and be completed in no more than 12 to 18 months.
- KeySpan argues that there should be no contingencies, and that the utilities' exit from the merchant function should not be based on benchmarks, as set forth in Straw Proposal 2. If the Commission finds that market benchmarks are necessary, they must be objective and clear cut rather than the "vague, multiple condition criteria suggested in the Straw Proposal."
- KeySpan sets forth the following positions regarding the Commission's ultimate determinations:
  - The single retailer model should be adopted and implemented statewide.
  - The Commission should approve rate "incentives" such as those previously proposed by KeySpan, followed by mandatory customer assignment where necessary.
  - All ESCOs and marketers on the system should be POLRs.
  - Capacity planning and procurement decisions should be made by utilities so long as they are responsible for maintaining the integrity of the distribution system.
  - The transition to the single retailer model should be accomplished over a period of no more than 18 months from the Commission's order in this proceeding, and specific and enforceable milestone should be established within that time.
  - The cost of this transition should be funded by a surcharge on customers bills.
- The Commission must plan the transition allowing time to pursue statutory changes with the Legislature or to seek judicial review of its authority. KeySpan indicates that it

might be compelled to oppose a Commission order to exit the merchant function that did not also relieve the company of the legal obligation to provide commodity service.

- r KeySpan contends that there is "significant support" for establishing a swift and certain transition to the single retailer model, citing the position of CPB, NESPA, RG&E, "small marketers", NEMA, and 1st Rochdale.
- r KeySpan objects to the MI position that Model 2 should be adopted, arguing that to do so will not allow the benefits of Model 3 to flow to all interested parties in the market.
- r KeySpan notes its disagreement with Staff, which KeySpan claims embraces the Commission's vision but eschews the only practical means of achieving it. "Staff cannot bring itself to support mandatory migration of customers"; "Staff declines to recommend steps that might persuade customers from purchasing commodity from the utility"; "[Staff] favors utilities offering hedging mechanisms . . . rather than allowing accurate price signals to be passed on to consumers"; " [Staff] . . . also does not acknowledge or address the cost of a prolonged transition."
- r KeySpan disagrees with the Staff statement that we need not now reach a final conclusion on the structure of POLR service, arguing that that decision must be made now if the transition is to move forward.
- r KeySpan questions whether now is the right time for back-out credits that will begin the accumulation of stranded costs, noting that the timing is especially questionable given Staff's position that the transition may take some years.
- r According to KeySpan, a failure to adopt the NESPA "big bang" approach will result in the end of the Commission's vision of competition in the energy industries.
- r KeySpan argues that its unregulated affiliate would be unfairly punished and disadvantaged were the Commission to adopt the CPB proposal that utility-affiliated ESCOs be required to provide HEFPA protections. KeySpan argues that adopting this proposal would not protect consumers, and it would prefer an emphasis on customer education rather than expanding the applicability of HEFPA.

#### IV. Public Benefit Programs

- KeySpan believes that the needs of low-income customers will continue to exist once the competitive markets have been developed and that those needs must be met. All service providers should be subject to consistent requirements with regard to low-income programs, according to KeySpan.
- KeySpan urges that funding for such programs be through a universal fund or tax revenues, which will spread the cost of the program over the general public. It opposes the imposition of an SBC charge on gas sales, arguing that some of its customers would be hit twice for an SBC charge (both gas and electric customers) and that adding such a charge on gas service would hurt the competitive position of gas compared to other competing fuels.
- KeySpan favors a coordinating council and partnership with the local utilities to provide a statewide prospective to public benefit programs but opposes shifting control to NYSERDA. It would oppose any such council that eliminated the involvement of the local utilities in the creation and implementation of low-income programs during the transition. It also notes opposition to a shift in control from the utilities to NYSERDA for gas R&D programs.
- KeySpan believes that low-income programs should not be diluted by eliminating direct support to customers and relying solely on conservation and weatherization programs, which directly benefit property owners and not necessary customers.

r KeySpan reiterates its opposition to an SBC on gas corporations, adding its objection to surcharges on bottleneck functions during the transition as well as interim funding through wires and pipes charges.

#### V. Public Input and Outreach

- KeySpan notes its involvement with the public input and involvement committee but nevertheless concludes that the process followed was exclusionary and so flawed as to render the results invalid.
- KeySpan points to a number of matters that allegedly support its position:

- The PIIC Committee did not operate as a whole but rather operated in subgroups.
- The process followed did not allow full and fair participation using as an example that the company had only two days to review a version of a moderator's guide and alleges it therefore had no opportunity to comment on the substantial changes.
- KeySpan and other parties were excluded from business leader forums, residential consumer leaders round tables, the survey of upstate municipal officials and the low-income forum on energy survey. It complains that Staff alone conducted the business leader forums, that CPB alone conducted the survey of upstate municipal officials and that such efforts were conducted outside the collaborative process.
- With respect to all of the research performed, KeySpan indicates that it is concerned about the scope, focus and objectivity of the research instruments and the emphasis that should be placed on the results. It concludes that the results of the public involvement process are unreliable and should be rejected.
- According to KeySpan, the design of the telephone survey was biased making it a defective tool. Its allegation of bias is limited to a series of six questions (three electric and three gas) that were designed to discover the extent of the public's ability to distinguish between the regulated utility and the unregulated utility-affiliate utilizing the same corporate names.
- KeySpan contends that the design of the moderators' guide and the conduct of the focus groups invalidate those results.
- According to KeySpan, "both the process PIIC followed and the substance of the PIIC's outreach efforts are so full of errors, omissions and bias as to vitiate the results produced." Thus, KeySpan urges that none of the surveys or focus group reports be relied on or included in either the recommended decision or the ultimate decision issued in this proceeding.

**CONSOLIDATED EDISON'S COMPANY OF NEW YORK, INC. AND  
ORANGE AND ROCKLAND UTILITIES, Inc. (Con Edison)**

I. Process

- The process provided a valuable forum for the exchange of ideas and information but did not ultimately lend itself to resolving the numerous and complex matters at issue.
- Based on the statement by the ALJ that the phase I and II report is not an evidentiary record, the companies conclude that there is no record in this proceeding that would provide a basis for the Commission to mandate fundamental changes in the utilities' role in competitive markets. They urge that actions that would effect a change in the utilities' role in developing competitive markets be conducted in the context of utility-specific proceedings.

II. Vision

- Con Edison believes that the current approaches to developing retail choice should be continued for the next several years, arguing that the current pace of retail choice is reasonable.
- Noting that there are issues that arise only due to continued utility participation in competitive areas, the companies argue that the transition of the markets has not reached the point where the utilities should be required to exit any particular functions.
- Quoting the Commission's comment that: "It would not be in the public interest to be overly ambitious about the implementation of retail access, resulting in unrealistic commitments to consumers," the companies note that over 400,000 customers across the state have participated in retail choice programs and further indicate that those programs are growing significantly. They further note that the utilities' continuing role as providers of retail services does not appear to be an obstacle to customers considering alternative suppliers.
- Con Edison believes that proceeding at the reasonable pace that has been established in New York has allowed the markets to develop here while avoiding the major missteps that have been seen in other situations, especially California.

- Con Edison argues that the market for choice should be allowed to evolve, not be forced. Rather than trying to force migration, the companies believe it would be more important for the Commission to continue to focus on service reliability and the availability of customer choice than to pursue a particular end-state of industry restructuring that differs markedly from the existing framework.
- Before major retail market transformations are considered, Con Edison urges that stability in the wholesale markets be achieved. It notes on the electric side a number of material issues still pending with the ISO and the construction of needed generating plants; and on the gas side it notes unresolved long-term reliability issues regarding pipeline capacity. Noting that a resolution of these issues is likely to be three or more years away, the companies argue that it is premature to consider new retail models that exclude utilities as retail service providers. They also point out the need to maintain flexibility during the transition while avoiding irreversible decisions.
- Con Edison notes the risk of requiring utilities to undertake costly and possibly irreversible changes in infrastructure in pursuit of objectives that may not be obtainable and notes that the adoption of a generic mandate may eliminate the flexibility under existing programs.
- Con Edison urges that consumer benefits be clearly shown before utilities stop providing services. It questions whether material cost savings can be achieved with regard to the utilities' current provision of products and services. It further notes that to the extent that these services can be provided competitively, customers are already seeing benefits under the existing program.
- Con Edison also raises the question of the practicality of adopting the bidding program for POLR services, stating ". . . it is hard to understand how a program removing utilities from retail services for a one-year period could justify a utility's dismantling retail infrastructure if, after the one-year period has expired, the utility could be required to step back into the POLR role".
- With regard to adopting the gas policy statement for electricity, Con Edison argues that the adoption of such a vision at this time is not warranted and that, in fact, the Commission should rescind or at least suspend the exit-the-

merchant-function vision set forth in the gas policy statement.

- Con Edison also opposes the establishment of artificial targets for implementing any of the long-term changes that may be found appropriate, especially where the preconditions for such changes are not solely within the control of the Commission or the parties. Rather than consider such material changes now, the companies urge deferral for about five years of consideration of new end-states. This period is chosen based on the estimated time needed to address wholesale and electric and long-term gas reliability issues.
  
- r The Commission should adhere to the existing framework for at least the next several years rather than proposing any fundamental changes in the utility's role at this time.
  
- r Con Edison contends that the parties supporting near term departures did not adequately address important issues, including the identity and role of a new POLR, responsibility for customer care functions, or a demonstration that the adoption of any model would improve on the existing framework. It notes that no attempt was made to explain how or why a competitive market excluding the utility would produce lower prices than one in which the utility participates. The utility notes the observation by Staff and others that many large gas customers have already chosen competitive suppliers, emphasizing that this market development has been made without eliminating the utility as a choice. Con Edison also states no one has alleged that the ESCOs can develop the infrastructure necessary to provide customer service and other retail functions at a lower cost than the utilities.
  
- r Acknowledging the challenges of being partly in and partly out of the competitive market, Con Edison notes that managing the further development of the markets under the current framework is a better choice than a precipitous move to Model 3 with its attendant risks, costs, and uncertainties.
  
- r Con Edison opposes CPB's proposals regarding utilities with similarly named affiliates, specifically noting the proposal to subject affiliated ESCOs to consumer protections to which other ESCOs may not be subject. Con Edison's position is based on its claim that there is no adequate basis in the record for adopting the CPB position.

III. Market Transition

- Con Edison believes that the criteria set forth in Straw Proposal 2 are basically sound but it opposes the provision in Straw Proposal 2 that the utilities should exit the commodity function within 48 months. It characterizes the transition as an "uncharted marathon" and argues that little value would be created in the Commission again resetting a finish line.
- No date should be set now for implementing such a mandate because the criteria established in Straw Proposal 2 are in material ways outside the control of the Commission, the utilities, and most of the other players.
- Con Edison agrees that some market transition issues such as unbundling and commodity pricing should be addressed in an ongoing manner but contends that other market transition issues, such as the establishment of a POLR, are relevant only in the context of a new end-state, consideration of which should be deferred.
- Con Edison appears to oppose the creation of a multi-stakeholder competition council, arguing that there is neither a need nor a clearly defined function that the council would be able to undertake.
- Con Edison argues that pricing commodity service is a complex matter that must carefully balance reasonably priced utility service with avoiding subsidies and not prejudicing customers' purchasing decisions in favor of the utility. It urges that the current debate focus on utility commodity pricing issues, recognizing market conditions specific to each utility's territory.
- Con Edison observes that the Straw Proposal 2 suggestion that POLR service offer multiple pricing options subject to Commission approval is simply another way of offering consumers a regulated commodity service, which tends to defeat the argument that it is necessary to remove the utilities from the merchant function.
- Con Edison also notes that Straw Proposal 1 discusses rate options which contemplate the flow-through of spot market prices. If the suggestion is that the market will not be considered competitive until providers offer multiple pricing options including hedged prices to small customers, it should be stated that way.

IV. Public Benefit Programs

- Con Edison argues that there is no better evidence that we are not ready to consider a new service model that excludes the utilities from providing retail services than the fact that we are no closer today than we were in 1997 to defining who will be the POLR if utilities exit the merchant function and what services including consumer protections would be provided by the POLR as compared to non-POLR ESCOs. It notes that ideally a POLR should not be needed for all persons to obtain utility services in a competitive market.
- With regard to bidding out of POLR services and the removal of the utilities from that function, Con Edison notes that the infrastructures built by the utilities to discharge their current responsibilities once dismantled could not be reassembled quickly, easily or without substantial costs and reliability consequences. On the other hand, they also note that if utilities maintain the infrastructure necessary to step back in, they will not shed costs, which is one of the prime purposes of requiring the utilities to exit in the first place.
- Con Edison argues that low-income assistance should not be resolved by regulation and that funding for other public benefit programs should naturally decrease with market development. It notes that the long-run goal in restructuring the markets is to achieve lower costs, and if this goal is achieved, all customers, including low-income customers, will benefit.
- Con Edison acknowledges that low-income assistance may be considered in the regulatory arena, but argues that such assistance is more appropriately resolved by social services agencies and the Legislature.
- With regard to the lifeline program, Con Edison notes that, unlike telephone, energy services are covered by public assistance benefits in New York. Therefore, it argues that there are public policy reasons for telephone lifeline rates that do not exist with regard to energy services.
- Appropriate regulatory approaches to low-income issues, according to Con Edison, would include the support and furtherance of aggregation programs.
- With regard to research and development expenditures, Con Edison notes that sustainable new technologies may not be

developed if public funding is used for such purposes because the work may not be performed with a commercial goal. In fact it argues that R&D subsidies may have a chilling effect on the development of commercial technologies.

- Assuming reasonable guidelines and that the transition period will not be of indeterminate length, Con Edison does not disagree that the systems benefits charge is an appropriate funding mechanism to fulfill public policy goals. It notes that utilities should be allowed to provide those programs where the utilities can effectively implement them.
- With regard to the suggested public benefit program council, Con Edison notes that such statewide coordination has added value to these programs in the past, but that the concept of coordination is vague. It indicates its willingness to consider a council that would have an advisory and informational structure and suggests that it might assume the current functions of the SBC advisory council. It emphasizes, however, that such a council should not have the authority to mandate the implementation of programs or to assume responsibility for the operation of any programs.

## V. Public Input and Outreach

- Con Edison notes that the quantitative research shows that while significant knowledge of the restructuring effort has been imparted to a majority of the population, continuing education efforts throughout the state are still a primary task to which attention should be paid. It also notes that this research indicates that customers value the regulated utility safety-net and do not now want the utility eliminated as a market choice.

## **CONSOLIDATED EDISON SOLUTIONS (Con Edison Solutions)**

### II. Vision

- Con Edison Solutions urges the partial adoption of Model 2 (utilities exiting the commodity function) for larger customers (those with demands greater than 1000 kW) but believes that the utility should continue to offer commodity service to smaller customers. It notes the impediments to the development of robust markets created by the continued participation of the utility in those markets due to customers' perceptions that the utility is a safe haven regulated by the PSC.

- This party argues that it would be premature to expand Model 2 to smaller customers until issues regarding HEFPA or other appropriate consumer protections are resolved. It urges continued collaboration on these issues and suggests one option is to solicit bids from all participants on the cost to provide these protections.
- It opposes the option of requiring all ESCOs to provide POLR protections because it believes that such protections would create enormous administrative and financial burdens that would deter ESCOs from participating in New York and could raise the cost of electricity for small consumers.

### III. Market Transition

- With reference to the five preconditions set forth in the Straw Proposal, Con Edison Solutions notes that items C and D are related to the mass market (i.e. residential and other small customers) and are not necessary preconditions to moving to Model 2 for large customers. It believes that the reduced number of preconditions associated with large customers would allow an evaluation of whether the remaining conditions had been met within a 12-month period. It suggests that following that evaluation, a 6-month outreach campaign be undertaken, notifying the largest customers (i.e. those with demands greater than 1000 kW) that the utilities would stop providing commodity. An evaluation of that program would be undertaken approximately 18 months later (36 months after the order in this proceeding) and, if the experience proved successful, utilities could then exit the commodity function for the remaining large customers (i.e. those with demands between 100 and 1000 kW).

### **CONSUMER PROTECTION BOARD (CPB)**

- CPB recommends that a market structure be established with utilities exiting both commodity and retail functions (Model 3) and under which all ESCOs would provide all consumer protections including obligation to serve.
- CPB endorses a specific focus on consumer benefits and urges that changes be made only when those benefits are evident.

## I. Process

- The process followed in this proceeding has resulted in a large accumulation of valuable research and information and has resulted in the Phase I and II report, which is "a comprehensive compilation of facts and analyses of policy options regarding a wide range of issues and views." It notes that the positions of all interested parties are in fact a part of that record.
- The presiding officers ". . . correctly permitted neither large groups to overwhelm the concerns raised by smaller groups, nor allowed smaller groups to offer unsupported proposals or concerns."
- Regarding the Straw Proposals that were discussed, CPB notes that Straw Proposal 2 contains the recommendations of the majority but not all of the parties.
- CPB does not favor continuing collaboration in this phase of the proceeding but notes the likely need for further collaboration in future phases implementing the Commission's vision.

## II. Vision

- CPB generally endorses the vision for the energy markets set forth in Straw Proposal 2 except that it is concerned that the anticipated relaxation of regulatory oversight may not be in the public interest. It notes that the scale and focus of such regulatory relaxation may be less extensive in some areas but more extensive in others, especially regarding consumer protections. In this regard, it cites to recent ESCO practices that are not currently subject to regulation (e.g. prepayment plans and unilateral contract modifications).
- Noting that the Commission intends to monitor the market's development and take corrective actions as required, CPB argues that recent experience and numerous other factors support its recommendation that the obligation to serve be imposed on all ESCOs. In support of its position, CPB cites various Commission statements in the telecommunications area.
- CPB endorses the adoption of Model 3, in which the utilities cease providing retail functions (both commodity sales and other retail services). CPB argues that Model 3 offers the best opportunities to secure consumer benefits, citing a

similar determination by the Commission in the gas policy statement. It also cites the Commission's requirement that utilities develop single-bill systems because consumers prefer to have only a single business relationship.

- CPB opposes the suggestions in Straw Proposal 2 that obligation-to-serve and attendant consumer protections be required only of POLR providers and not of all ESCOs in the market. CPB asserts a number of difficulties in the Straw Proposal approach:
  - If all but POLR ESCOs have lower standards of consumer protections and are not required to serve all consumers, the likely outcome is an increase of the number of ESCOs serving niche markets rather than the general body of customers.
  - Consumers have a strong preference for maintaining essential consumer protections as currently provided only by utilities under HEFPA.
  - While the number of POLR ESCOs under PSC oversight would be fewer if the Straw Proposal were adopted, the difficulties of implementing that Model overwhelm the difficulty of imposing an obligation to serve and consumer protections on all ESCOs.
  - The annual or biennial POLR bidding process by utility territory (or subterritory) and by customer class would be administratively complex.
  - Establishing a mechanism to help fund the higher cost of the POLR ESCO provider would also create significant administrative difficulties.
  - The Straw Proposal does not increase customer choice to all customers because those customers who cannot obtain an ESCO to provide service would have no choice but to return to the POLR ESCO.
  - Requiring the POLR ESCO to submit bids that include both fixed and variable prices as options would add additional complexity to the bidding process.
  - Straw Proposal 2 understates the importance and complexity of other issues, such as the need to address situations in which no POLR bids are received, as well as circumstances where entities

designated as POLRs ultimately default. It notes that if the utilities are no longer in the business, it may not be possible to assign POLR responsibilities to any entity.

- For natural gas, an ESCO lacking available pipeline capacity could be precluded from being assigned as a POLR.
- The POLR ESCO price established through the regulatory process would become the price to beat for all ESCOs, and ESCOs have consistently explained that regulated commodity prices are inconsistent with a level playing field.
- Under the Straw Proposal it was envisioned that an interim POLR would be needed to provide service for the period following an ESCO failure and before customers select new ESCOs. CPB argues that its approach eliminates the need for such an interim POLR.
- CPB believes existing consumer protection rules should be reviewed to identify any changes required by the evolving multi-provider environment.
- CPB urges the adoption of a single approach on a statewide basis for New York, noting the Straw Proposal is not clear on this point.
- CPB notes that the POLR solution recommended in the Straw Proposal has never been implemented successfully, but the CPB proposal to require ESCOs to offer consumer protections, including the obligation to serve has been implemented in a number of states and in England.
- CPB notes that under New York and Federal banking law as well as in New York's competitive telephone service market, all providers are required to comply with fundamental consumer protection rules and all providers have the obligation to serve throughout the service territories and customer classes they identify.
- CPB believes that based on the comprehensive information developed in this proceeding the Commission is well equipped to choose a specific Model for the end-state for New York State's energy markets and should not rely on a more generalized approach. Certain knowledge of the market

structure is essential for ESCOs to plan and develop infrastructure and capabilities and that knowledge can only come with the adoption of a specific Model for the market's end-state.

- CPB endorses the adoption of the concepts that underlie the gas policy statement for use in the electric market.
- CPB opposes allowing utilities to remain in markets that become competitive, noting the powerful incentive to shift competitive costs to regulated operations and thereby skew the playing field and impede the development of the competitive market. It cites the Commission's conclusion requiring gas utilities to exit competitive markets as support for its position.
- CPB raises concerns over customer confusion caused by similarly-named but unregulated utility-affiliated ESCOs. Citing to the survey data collected in this case, CPB asserts that New York consumers do not generally recognize that similarly named utility-affiliates are not regulated utilities and that such customers are therefore unlikely to be aware that in purchasing from such unregulated ESCOs they do not benefit from full consumer protections.
- CPB also contends that the practice of utility holding companies (such as KeySpan) establishing many different affiliates with related names further adds to the customer confusion and can raise important concerns about otherwise private customer information. It again notes that its proposed end-state obviates many of the problems by requiring all ESCOs to provide all consumer protections and to be subject to an obligation to serve.
- CPB argues that the use of the same corporate name for both regulated and unregulated providers of energy services could provide an unfair advantage to the utility-affiliate over its ESCO competitors. It recommends that the hearing officers review existing market data regarding the market share of ESCOs operating in each utility's service territory. (CPB notes that this information has been held to be a trade secret under the Public Officers Law.)
- CPB endorses the adoption of the telephone market model for obligation to serve and consumer protections.

III. Market Transition

- CPB generally supports the market transition proposal set forth in Straw Proposal 2.
- CPB strongly supports requiring electric utilities to take actions necessary to reduce exposure of all customers to price volatility. It argues that the current wholesale electric market in New York is operating under conditions that can create the "perfect storm" under which the electricity prices increase substantially. It notes that the Commission has recently established explicit incentives for Consolidated Edison to provide just such protection.
- CPB endorses the Straw Proposal 2 suggestions that utilities exit both commodity functions and retail functions, noting, however, that they should not do so until all of the preconditions outlined in the Straw Proposal are met.
- CPB opposes the customer migration strategy suggested in Straw Proposal 2 regarding the use of stranded costs in the commodity charge to encourage migration. CPB believes it unfair for customers choosing to remain with the utility to be "punished" by assigning to them costs stranded by migrating customers.
- CPB urges that policies regarding aggregators be established in the transition to competition, an area not covered in Straw Proposal 2. It suggests that any entity performing previously regulated functions should be regulated by the Commission and should be subject to some level of mandatory consumer protections. It points to other states which have taken a more active role in establishing the market infrastructure for aggregators.
- Regarding rate design, CPB recommends no generic policy be adopted in this proceeding. It notes contested positions from the distributed generation case (Case 00-E-0005, Costs, Benefits and Rates Regarding Distributed Generation), as well as the lack of discussion in Straw Proposal 2.
- CPB supports the consensus view that customer-ESCO complaints must be addressed by some state agency, either the Public Service Commission or the Consumer Protection Board.
- CPB urges the adoption or the creation of a customer satisfaction report card for all ESCOs and utilities, noting

that at least four states currently post ESCO complaints on their website.

- CPB also endorses the establishment of some price-to-compare index prepared by an independent source such as a government or consumer watchdog that would provide consumers with accurate and understandable price comparisons.
- CPB believes large users of energy have the incentive and ability to hedge prices but that small customers do not. It accordingly supports commodity hedging for small customers.
- CPB supports adoption of the gas policy statement position on hedging for the electric market.

#### IV. Public Benefit Programs

- CPB generally supports the Straw Proposal 2 discussion of the public benefit programs.
- CPB notes that one of the most effective ways to encourage market-based solutions to assist low-income consumers is to adopt its end-state model, including the obligation to serve and attendant consumer protections from all ESCOs.
- CPB endorses the suggestion that the use of NYPA residential hydropower should be further explored. It notes that this issue was not explored in this proceeding and that additional work should be undertaken.
- CPB endorses the creation of a public benefit programs council similar to the competition council described in the Straw Proposal, noting that the committee could be the successor to the current system benefits charge advisory group that works with NYSERDA.

#### V. Public Input and Outreach

- CPB believes that the public input and outreach in this case has been extensive, gathering vast amounts of information regarding energy competition compiled from sources throughout the world. It goes on to note that "the facts and analysis contained in the report and Appendices will likely be a valuable source of information for New York policy-making throughout the transition to a vibrant and competitive retail energy market."

- CPB stresses that public education will be essential to a smooth transition to competition and to the ultimate implementation of any end-state vision.

## **DYNEGY MARKETING AND TRADE (DYNEGY)**

### II. Vision

- The company joins the Active Marketers in generally supporting the adoption of the policy guidelines as set forth in Straw Proposal 2. It concludes that Straw Proposal 2 constitutes the most reasonable approach to addressing and resolving the critical issues under review in a creative and comprehensive fashion.
- Without the existence of a blueprint clearly defining a policy to be followed, market participants will not be likely to deploy sufficient assets to generate vibrant competition.
- DYNEGY nevertheless favors a number of modifications to the Straw Proposal. It argues that a workably competitive wholesale market already exists but acknowledges that consumers should not be thrown into that market unless there are products available that can protect them from potential volatility.
- DYNEGY suggests that the definitions of "ESCO" and "marketer" in Straw Proposal 2 are unclear and proposes instead the following definition: "ESCO means an entity that markets and sells energy, in the form of natural gas or electricity, directly to end-use customers for their own consumption, and may also provide other energy related services, including providing assistance in the efficiency of energy use." The purpose of the suggested definition is to distinguish a wholesale and retail market of participants.

r DYNEGY notes that this collaborative was very ambitious. While a consensus was not reached, the ability of Staff to develop a proposal that has general support from at least one representative of each party sector exceeds virtually everyone's expectations. Dynegy urges the Commission to take this mandate and use the Straw Proposal as the basis for moving forward.

III. Market Transition

- Commodity ratemaking mechanisms should be appropriate to customer classes. The balancing point between exposing customers to market volatility and protecting them from volatility is different for each class of customers because the products offered to different customer classes can vary significantly. The need for the utility to provide price protection to residential electric customers is much greater than the need to provide similar protection for larger-use customers.
  - DYNEGY suggests as an implementation strategy that a variety of market participants be invited to bid to offer a range of fixed-price energy and capacity products from which customers could then choose. At the end of the fixed price contract, customers would be exposed to market products. It notes that this approach could be tailored appropriately for each class and for each commodity. It also notes that during the fixed price period, the customers' bills should include a comparison to market prices so that customers could begin to appreciate the difference between buying from the market and buying a fixed or otherwise hedged product.
  - DYNEGY supports the adoption of an electricity pricing policy on hedging similar to that in the gas policy statement. It notes that the policy has worked well for gas utilities and sees a need for a similar policy for electric utilities to provide needed direction and price protection for customers.
  - DYNEGY concludes that ESCOs have not entered the residential market to a degree sufficient to justify completely turning this customer class over to the marketplace. It completely supports a step-by-step approach and agrees with the proposition that multiple products should be available to customers before utilities are removed from the marketplace.
- r DYNEGY agrees with Staff that the hedging of commodity should be used in the near term to provide price stability, but it opposes any long-term hedging by the utilities.
- r DYNEGY supports setting a date certain for providing retail marketers the commitment they need to invest in New York, with hedging allowed up to the point of that transition.
- r DYNEGY notes that if hedging is not allowed, then customer acceptance of the transition to the competitive markets may be the one Straw Proposal precondition that cannot be met.

- r DYNEGY warns that evaluating and further defining the preconditions in the Straw Proposal via a collaborative process could bog down the implementation of the end-state in needless arguments over theoretical esoterica. It urges that the Commission carefully control whatever process may be used while allowing all parties the opportunity to provide input.
- r DYNEGY repeats the suggestion that utilities could issue RFPs for marketers to stream commodity directly to utility customers, thereby beginning the process of downsizing the utilities' trading operations in anticipation of exiting the merchant function. It suggests that this may be a useful transition step between utilities as the dominant sellers of commodity and marketers providing all services except delivery.

## **1st ROCHDALE**

### I. Process

- 1st Rochdale believes that the process was helpful in delineating key issues and providing the basis for proposals such as the Straw Proposal and the plans outlined by NESPA. It nevertheless opposes using a similar process as suggested by the proposed creation of the competition council.

### II. Vision

- 1st Rochdale urges that the vision outlined in Straw Proposal 2 be adopted, arguing against any implication that in the end-state utilities would have any role in meeting customer needs other than providing delivery service.
- Model 3 is supported by 1st Rochdale, which urges that it be implemented as early as possible to avoid the duplication of billing and customer care functions and costs during the transition and to avoid customer confusion. The longer utilities remain in retailing functions, according to 1st Rochdale, the more difficult it will be for ESCOs to achieve a sufficient customer base that would allow them to achieve economies of scale.
- 1st Rochdale supports adopting for electricity the concepts underlying the gas policy statement. It objects, however, to the "three to seven years" set forth in the gas policy statement as too vague and as leading to a potentially

protracted transition. It prefers the four-year transition specified in Straw Proposal 2 as a sufficient time to establish a base of retail competition activity and to enable ESCOs to develop the needed infrastructure.

- Utilities should not be allowed to remain in markets that are competitive, because the continued presence of the utility will preclude truly effective competition from developing.
- If utilities were allowed to remain in markets that are competitive, there would clearly be ratemaking consequences associated with cross-subsidization and it would be impossible to identify competitive costs with sufficient precision to produce a level playing field. In addition, a utility's competitive functions would require a different cost of capital than would its monopoly services, causing further ratemaking concerns.
- 1st Rochdale supports the imposition on all service providers of the obligation to serve as well as uniform consumer protections.

r 1st Rochdale contends that the expectation of the substantial consumer benefits from competition is well founded, contrary to the arguments of a few parties. 1st Rochdale points to the experience in Pennsylvania, where it contends that the Pennsylvania PUC estimates savings from electric deregulation of approximately \$3 billion. It asserts that Pennsylvania's electric rates have been significantly reduced compared to the national average, going from 15% above the national average to 4.4% below the national average.

r 1st Rochdale disputes, as misplaced and inapposite to New York, NYSEG's and Con Edison's efforts to invoke the California deregulation debacle.

r 1st Rochdale opposes the "maintain the status quo" approach to allowing markets to develop, noting that only 4% of Con Edison's customer base has migrated over three years, suggesting that 100% migration would not be achieved until the year 2073. Dragging out the transition for such a period would not be in the best interest of the state's economy or the public. Such an approach perpetuates the existing uncertainty, making it difficult for ESCOs to attract customers, significantly increases costs imposed on ratepayers, and makes it difficult or impossible to undertake short-term and long-term planning.

- r 1st Rochdale contends that Niagara Mohawk's argument that duplicate costs would be associated with the adoption of Model 3 is wrong. 1st Rochdale contends that it is the failure to adopt Model 3 that would cause the duplication of costs, i.e., adoption of Model 2 would not allow the utilities to eliminate customer service costs and would make it difficult for ESCOs to achieve the economies of scale needed to provide those costs themselves.
- r 1st Rochdale also challenges Niagara Mohawk's claim that its transmission and distribution services face competition from self-generators and that the utilities' costs for transmission and distribution should not be artificially increased. 1st Rochdale argues that there should be no artificial barriers to distributed generation either in utility tariffs or in policies regarding customer care functions. Citing to the Commission's 1998 determination that requiring the utilities to exit the supply function will produce more choices for customers rather than less, 1st Rochdale opposes the arguments raised by some of the utilities that to exclude the utility from competitive markets would deny customers a significant option. 1st Rochdale argues in effect that not excluding the utility would deny customers a significant number of options.
- r 1st Rochdale strongly supports an end-state with all ESCOs subject to an obligation to serve, as it says is required in most other states with significant energy retail competition programs. 1st Rochdale argues that a uniform approach eliminates customer confusion, discrimination, and redlining and would provide a level playing field. 1st Rochdale also supports the uniform application of consumer protections, noting that the rules may need to be modified to better reflect a competitive marketplace, in which consumers can readily switch suppliers, rather than the traditional monopoly situation.

### III. Market Transition

- 1st Rochdale believes the market transition process outlined in Straw Proposal 2 should be adopted with the following modifications:
  - 1st Rochdale suggests that the straight pass-through of market prices for electricity need not be phased-in, pointing to the process used at Con Edison, where ESCOs can compete against the actual market price while the benefits of hedges are

flowed through a separate monthly adjustment clause. 1st Rochdale urges that this mechanism be implemented within the first year for all utilities.

- 1st Rochdale agrees that a time certain for utilities to exit the merchant function is essential, and would adopt the 48-month deadline contained in the Straw Proposal as a fundamental policy assumption, not to be based on the specified preconditions as set forth in Straw Proposal 2. It expresses several concerns about those preconditions. First, assigning the determination of whether the preconditions have been met to a competition council could lead to protracted disputes. Furthermore, in determining whether workably competitive wholesale markets exist, the focus must be on the fundamental operations of the market, not on lower and stable prices. The precondition of general public acceptance cannot be met until widespread customer migration has occurred, but widespread customer migration cannot occur until there is general public acceptance. Finally, the suggested precondition that potential legal impediments be addressed should not be interpreted as requiring that they be addressed definitively, because, in 1st Rochdale's opinion, the Commission clearly has the authority to require that a utility exit the commodity supply function.
- 1st Rochdale opposes the Straw Proposal 2 recommendation that the question of whether the utilities should be moved to a single retailer or Model 3 structure should be revisited in a few years to assess whether the marketplace is able to provide those services. According to 1st Rochdale, this delay is unwarranted because ESCOs will necessarily assume substantial billing and customer care function in conjunction with the commodity supply. Model 3 should be implemented as early as possible according to 1st Rochdale, because each year of delay in completing the transition to Model 3 imposes \$130,000,000 in duplicative costs on the general body of ratepayers.
- 1st Rochdale agrees with the Straw Proposal that there should be a standard set of consumer protection rules applicable to all customers within a service class and reflecting a competitive market rather than a traditional monopoly.
- Concerning migration strategy, 1st Rochdale supports voluntary migration but believes it improbable. In order to ensure that customers move to ESCOs at a reasonable pace throughout the

transition rather than remaining with the utilities to the end of the transition, 1st Rochdale suggests that stranded costs be recovered through commodity charges and that smaller customers be offered monetary incentives for switching. It alleges that such incentives will be cost effective because the faster customers migrate, the more quickly the utility can shed duplicate functions and costs.

- 1st Rochdale supports the Straw Proposal POLR recommendations but would avoid, to the extent feasible, having the utilities serve as the POLR during the transition period. Rather, the POLR function should be bid out to ESCOs, who would provide the service during that period as agents of the utility. This would provide a means of phasing the utility out of retailing functions and could be a key element in developing end-state markets. Contrary to the Straw Proposal, 1st Rochdale believes utilities should not be permitted to bid for providing POLR service.
  - 1st Rochdale urges that efforts to moderate utility commodity charges, including hedging, should be designed in a way that does not impede the development of retail competition.
- r 1st Rochdale opposes the objections raised by a few utilities to the use of embedded costs or long-run avoided costs for back out credits for competitive functions. 1st Rochdale argues that amounts backed out of bundled rates for such functions must realistically reflect the cost of providing such services. It states that the unbundling of utility charges on the basis of a bottom-up analysis is an essential element of the transition process and should be implemented as soon as possible.
- r Noting Staff's concern over long-term, fixed-price utility services, 1st Rochdale concludes that competitive markets would be completely extinguished were a long-term, fixed-price plan such as the NYSEG Price Protection Plan allowed to take effect. 1st Rochdale argues that steps must be taken now to insure that utility customers are given pricing signals that reflect the market cost of energy.

#### IV. Public Benefit Programs

- 1st Rochdale supports the principle that the energy burden on low-income customers should not be worsened as a result of the development of competitive markets and supports the Straw Proposal recommendations regarding public benefit programs,

including those involving energy efficiency renewables and research and development.

- 1st Rochdale opposes any consideration of the reallocation of low-cost NYPA residential power, characterizing such action as the transfer of funds from one group of customers to another without any ongoing benefits.
- 1st Rochdale supports the creation of a public benefits program council to coordinate and provide advice on low-income and other public benefit programs. (It supports this council because it would be an advisory body, though it opposes the proposed competition council, which would be making substantive decisions.)

#### V. Public Input and Outreach

- 1st Rochdale recommends that the successful public input and outreach programs in other states should be studied and replicated and that all public input and outreach efforts should be continued and expanded as retail competition moves forward.

#### **JOINT BRIEF OF THE SMALL CUSTOMER MARKETER COALITION, AMERADA HESS CORPORATION, TXU ENERGY SERVICES AND SMARTENERGY, INC. (ACTIVE MARKETERS)**

- Active Marketers urge a Commission statement reaffirming the commitment to the development of competitive energy markets and undertaking to eliminate barriers to competition while providing guidance to utilities and marketers in this case.

#### I. Process

- Active Marketers urge recognition of the benefits of the collaborative process and ask that the Commission order continued collaboration on a number of issues that arise out of this proceeding. They note that, with very few exceptions, no other jurisdiction has undertaken a consensus-based solution to these difficult issues and, while the process has been unwieldy at times, the process is far superior to the traditional, litigation-based approach. They also note that if utilities and marketers are to become trade allies, the collaborative process offers a laboratory for learning on how to make that relationship work.

- "The collaborative process has been extremely useful in elucidating positions of the parties, refining issues of concern, as well as creating potential solutions which after adoption by the Commission could be implemented in a reasonably efficient manner."

## II. Vision

- Active Marketers urge the adoption of the policy guidelines set forth in Straw Proposal 2 as the most reasonable approach to addressing and resolving the critical issues under review. They believe that Straw Proposal 2 addresses the issues in a creative and comprehensive fashion, articulating a clear vision of the future, identifying with some specificity concrete steps needed to achieve the end-state, explaining the ultimate role of the utilities during the transition and in the end-state, and providing a framework for creating a viable POLR model.
- Active Marketers urge the adoption of a regulatory blueprint, without which capital investment, infrastructure creation, and marketer business plans will not go forward.
- The fundamental provisions of Straw Proposal 2 are those that declare that the best way to establish a robust competitive market is for utilities to cease buying and selling commodity, and those that provide definitive criteria and related timetables for the utilities to exit the merchant function, including the specific timetable of 48 months.
- Active Marketers believe that the provision of safe, adequate and reliable utility service must be maintained during the transition but note that the development of economic savings will best be achieved only when the utility is required to exit the market. They recognize that the transformation of the current economic model will take time and that the resulting benefits will necessarily take longer to achieve.
- Active Marketers note that the model or more generalized standard chosen for the end-state is not as important as building in the flexibility to change or adapt the model or standard in response to rapid changes in the market. Nevertheless, Active Marketers urge the formal adoption of model 2 and ultimately model 3. They contend that the preconditions, benchmarks and timetables contained in Straw Proposal 2 are comprehensive yet flexible enough to form a basis for achieving this vision.

- Active Marketers strongly support the adoption of the gas policy statement for electricity.
- Active Marketers do not believe utilities should be allowed to remain in markets that become competitive, noting that utility companies are free to create deregulated marketing affiliates to compete. They note that the role of the Commission as "Steward of Competition" is critical in insuring that no competitive benefit inures to such affiliates by virtue of their relationship to the utility.
- Active Marketers believe that HEFPA and the nonresidential rules, perhaps modified to reflect a competitive rather than a monopoly market, should apply to all marketers. Consumer confidence that they will be served and protected is critical to the development of the market.
- Active Marketers oppose any requirement that the obligation to serve be applied to all marketers, as in the telephone market model. They prefer a single POLR approach, noting the difficulties of imposing an obligation to serve all customers on a wide variety of competitors, especially with regard to service to large customers.
- Given the high migration rate of large customers in the gas market, Active Marketers suggest that this market would be the ideal testing ground for a POLR concept, where both a designation process and pricing could be developed.

r Active Marketers characterize Straw Proposal 2 as a realistic compromise in the "maelstrom of opposing "views." The Straw Proposal acknowledges the need for a clear and definitive plan but also notes important preconditions before utilities should be required to exit competitive markets.

r Active Marketers note that the utilities will not be removed from merchant function unless and until the Commission is assured that the wholesale marketplace and the associated utility/marketer/regulatory infrastructures, can provide adequate, safe and reasonably priced service. It argues that this reality cannot be overlooked in any merchant function exit implementation plan.

r Allowing utilities to remain in competitive markets would constitute the worst of all worlds, for both the consumer and the competitive market participants. They raise the

following the arguments against allowing utilities to remain in competitive markets:

- Because utility profits are earned on capital investments, utilities can remain profitable and sell power at their wholesale cost with no markup.
- Utilities have already divested themselves of their generating assets and there is little sense in allowing the utilities to provide commodity service for an indefinite period.
- Utilities benefit significantly by their dominant market presence, and those benefits ensure that the competitive playing field is not level. When that advantage is added to the costing advantage inherent in utility rates, the utility's presence in the competitive market will entirely thwart competition and undermine the Commission's goal of market-based competitive services.
- A utility should be allowed to compete with other suppliers when the utility owns and controls the bottleneck asset, i.e. the distribution facilities. Active Marketers argue that it is for precisely this reason that FERC ordered the pipelines out of the merchant business and implemented strict codes of conduct with respect to their dealings with affiliates.
- While Active Marketers agree that a standard level of consumer protection should be applicable to all service providers in New York, they oppose CPB's suggestion that all ESCOs have the obligation to serve. In Active Marketers' view, such a requirement would be destructive of existing markets, create unnecessary barriers to entry for the small use customer markets, and seriously reduce the quality of service to consumers.
- Active Marketers acknowledge CPB's observation that the POLR solution recommended in the Straw Proposals has never been implemented successfully, but notes that the concept is new and has never been tried before.
- Active Marketers point to the natural gas market for industrial and commercial customers, where they allege 90% of the customers are choosing alternate suppliers and no obligation to serve has been imposed on any of the marketers.

To impose such an obligation after that market has developed over 15 years could have a significant negative impact.

- Active Marketers note the importance of having a single POLR to accept the responsibility for serving customers that are otherwise abandoned in the market. If there is no one party with this role and responsibility, no one will be there to serve these customers.

### III. Market Transition

- Active Marketers support the implementation recommendations contained in Straw Proposal 2, believing they would provide an orderly path to a vibrant and robust market.
- Active Marketers strongly support the Model 2 approach, arguing that as long as marketers must compete with regulated monopolies, significant market penetration will be difficult to achieve.
- Active Marketers support the Straw Proposal 2 criteria that must be met before utilities would be allowed or required to exit the merchant function.
- Active Marketers note that competitors cannot be expected to continue to pour resources into the State without a fair assessment of when the Model 2 end-state can become a reality. They therefore support the timetable in the Straw Proposal.
- Active marketers strongly support the competition council, believing that it is a critical underpinning of a successful transition process. They also suggest that this council undertake the coordination and review activities suggested for the public benefits council arguing that public benefit programs are as important to market development as are the other economic and competition issues that were proposed for the competition council.
- Active Marketers support the approach taken in Straw Proposal 2 to the Model 3 potential end-state, noting that there are likely to be services beyond commodity that may be provided by competitors in a more economic manner or in a manner which provides greater value to consumers. They support an effort to make any retail functions competitive so long as doing so provides benefits to consumers.

- Active Marketers say they are concerned about additional efforts by the utilities to entirely insulate customers from price signals of the competitive marketplace arguing that if all utilities were required to sign long-term purchase contracts with fixed prices for a substantial portion of their load, competition would never become a reality. They urge that balance and moderation be applied to the issue of price moderation and that this concern not be used to shield customers from facing market realities.
  - Active Marketers argue that allowing increased hedging opportunities or discriminatory hedging opportunities among customer classes is providing the utilities with competitive tools, contrary to the effort to nurture competitive markets. They note that the stimulus to the growth of competition in the gas industry was the ability of industrials to buy gas in the spot market at prices below those contained in utility long-term contracts. When utilities sought permission to offer flexible prices or streaming of gas, those efforts were disapproved by the Commission, and Active Marketers urge the Commission to continue that policy. Active Marketers again note that if the utilities want to compete, they are free to do so through unregulated marketing affiliates. In reflecting on the hedging gas policy statement issued in 1998, Active Marketers note that the Commission expressed its preference that hedging services be offered through competitive business but nevertheless required some hedging by the utilities in order to provide stabilized bills in the interim. They emphasize that such hedging was not to be offered to non-core and interruptible customers because those customers had other options available in the market. They suggest that temporary mitigation measures might be appropriate so long as no long-term policy decisions are made that will allow the utilities to utilize these competitive tools indefinitely.
- r Active Marketers strongly support the need for the competition council, noting that such a panel, representing all interested parties, would be more efficient and quicker to respond to the rapidly changing markets than would policy decisions made in the context of the old regulatory model. According to active marketers, the competition council will become the vehicle of change for the Commission, serving to alert it to events in other states or on the federal level as well as providing a forum for the discussion of market evolution on a real-time basis in New York. The council would advise the Commission of the effectiveness of its policy initiatives, of the progress of market development in each of the utility territories, of concerns regarding the exercise of undue market power, and

of any other matters bearing on the development of energy competition. According to active marketers, the competition council is vital to the success of the competitive ideas contained in Straw Proposal 2.

- r Regarding the NYSEG plan, Active Marketers agree with many of the infrastructure improvement recommendations raised by NYSEG but argue that those good ideas have led NYSEG to a misguided proposal. Active Marketers argue that the actions suggested by NYSEG should be undertaken in concert with fostering retail competition, not to its exclusion. "Putting competition on hold for seven years as proposed by NYSEG will only serve to detract from the development of a workable competitive market."

#### IV. Public Benefit Programs

- Active Marketers are convinced of the necessity of properly designing and delivering these programs if competition is allowed and encouraged to flourish.
- They believe that Straw Proposal 2 needs more discussion and development with regard to its assertion that the energy burden on low-income customers should not be worsened as a result of the development of competition. They recognize that consumer assistance programs funded by wires and pipes surcharges are part of the answer but say that encouraging marketers to adopt forgiveness of arrears programs is not appropriate.
- Active Marketers believe programs related to energy efficiency, renewables, and R&D will be addressed by the marketplace.

#### **MULTIPLE INTERVENORS (MI)**

##### I. Process

- The parties worked collaboratively over the past year identifying, analyzing, discussing and debating the major policy issues as reflected by the Phase I and II report in this proceeding. A substantial amount of background information and analyses of many of the policy issues addressed herein are contained in that report.

- "Given the importance and the complexity of the issues being addressed, and the diversity of interest being represented by the numerous active parties, the collaborative process probably worked as well as reasonably could be expected in this proceeding."
- MI notes that a collaborative will not usually result in a consensus in proceedings as large and diverse as the current one, and typically requires a greater investment of time and resources by the intervenor parties than does litigation.
- MI notes that this process differed from prior collaboratives in that the parties succeeded in "working productively and without animosity on framing and analyzing the relevant issues and trying to understand the interests, concerns, and positions of the other parties."
- Given the current state of the retail and wholesale industries and the fact that many utilities have already filed proposed long term rate plans, MI opposes further delays in resolving the policy issues in this proceeding.
- MI believes that the content of the Phase I and Phase II Report should be treated as background information only, not as evidence, a consensus, or even a complete analysis.

## II. Vision

- In commenting on Straw Proposal 2, MI endorses the concept that competitive markets should be relied on to provide all products and services that result in more choices and value for consumers, but notes that markets for essential products and services that are not substantially competitive should continue to be regulated by the Commission. It adds that whether competition exists should depend not on whether competition in a product or service is allowed to exist but on whether there are multiple providers of the service competing actively in the relevant market.
- MI states that the electric markets are not substantially competitive because very few willing sellers are competing actively to serve very few willing buyers. It also notes remaining problems with respect to the wholesale market.
- In commenting on the proposal that the utility-delivery function remain a monopoly service, MI notes that there are potentially competitive alternatives to the utility-delivery

function (such as self-generation or distributed generation). MI makes the point that there may well be substitutes available to the current transmission and distribution system for electricity.

- MI supports the adoption of model 2 in the long run, arguing that utilities should retain some retailing and customer care functions for the delivery service for customers who want them. MI notes that large customers generally prefer to maintain separate contractual relationships with the utilities and the ESCOs.
- MI recommends that Model 2 be chosen, but that the Commission retain flexibility as to how and when that model is implemented.
- MI notes that there is much uncertainty as to the future of competitive retail energy markets in New York as well as significant inconsistency among the gas and electric service territories. Unless certain fundamental questions are answered, the uncertainties will remain, and the parties will continue to fight over the most basic retail access issues.
- MI posits that any end-state is at least "several years away" and that the Commission should therefore refrain from finally resolving implementation issues in the absence of information on future markets. MI recommends that the Commission maintain the flexibility to modify how and when the end-state actually is implemented.
- With certain exceptions, MI supports the adoption of the gas policy statement principles for the electricity market. MI posits two caveats:
  - Wholesale and retail gas markets are considerably more mature than electric markets, and the speed of transition therefore will be different.
  - In the electric industry all customer classes should be entitled to share in the benefits of the transition power agreements (hedges) acquired by the utilities from the auction of generating plants.
- While supporting the utilities' exit from the commodity business, MI notes that having utilities exit other aspects of their services may not be beneficial.

- MI notes that there are several problems with permitting regulated utilities to remain in markets that become competitive.
  - It is not clear why a utility would want to compete itself so long as it had an unregulated subsidiary that could compete in the market.
  - Cross-subsidies between the competitive and monopoly activities of the utility would have to be constantly monitored at a significant regulatory cost.
  - If utilities are required to exit newly competitive markets, MI notes that a number of considerations, such as the speed of exit, the desires of the customers, the level of competition, etc., should be resolved on a case-by-case basis.
- MI does not endorse the adoption of the "telephone market model" and urges instead that the Commission examine issues such as obligation to serve and consumer protections in relation to the "fledgling energy markets" and without undue reliance on the telephone experience.
- MI notes that the number of ESCOs actively competing to sell gas supplies in the State seems to be declining in all or most service territories and urges an examination of this situation by the Commission.
- MI objects to the concept of limiting hedging in the electric market for small customers, arguing that the hedging instruments currently available to large customers are limited and often unattractive. It urges that until the wholesale market stabilizes, all customers should have the option of being hedged by the utility and those customers that take advantage of the hedging option should pay all prudently incurred costs.
- MI argues that the amount of customer migration will likely remain limited until utilities exit the commodity business. It posits that the pool of customers in the market "will increase considerably" when the utilities are required to exit. The result will be a more rapid development of a competitive market.
- MI objects to having the utility exit competitive markets over time and by customer class as discriminatory and highly

inequitable. It argues that if the utility exits for all customer classes, substantial savings in the form of reduced stranded costs would be achieved.

- Utilities should not be permitted to exit the merchant function if to do so would result in cost increases to customers.
- It is important that the preconditions to utilities exiting, as set forth in Straw Proposal 2, be general in nature. They should be satisfied for all customer classes before the utilities exit the merchant function.
- MI sees no need for the proposed competition council arguing that the Commission alone should determine what preconditions are needed and when they are satisfied. Further, the Commission's determination should be based on input from all parties. MI also notes that the competition council would be certain to result in the expenditure of considerable resources.
- According to MI, large customers do not favor the single retailer model, for they wish to retain contractual relationships with both the regulated utility and the energy provider. MI also claims that its experience with that model indicates that utilities manage to shift risks and costs to ESCOs, without a decrease in the utilities' rates. It also notes there has been no demonstration that the single retailer model will benefit the competitive retail markets or reduce costs to customers.
- MI does not oppose the opening of selected retail functions to competition, but it urges that that step be taken well before any decision is made to require or permit a utility to exit.
- MI warns that if the consumer protection rules that are ultimately implemented are unreasonably burdensome, they may cause ESCOs to leave or not to enter the New York market.
- MI urges the adoption of a rule prohibiting ESCOs from marking up transmission and distribution charges provided by a regulated utility. MI says that customers should pay for that service in accordance with the utility's tariff regardless of who bills for the service.
- MI does not object to the Straw Proposal provision suggesting the Commission investigate and resolve customer complaints

against ESCOs so long as it does not result in precluding a customer from seeking redress through other avenues.

- Customers should not be forced to migrate to ESCOs until wholesale and retail energy markets are substantially competitive and provide economic benefits to customers.
- If rates were fully unbundled and cost-based, MI would see no need for artificial price signals or other incentives to jump start the market.
- MI believes that the obligation to serve should not be imposed on all ESCOs and that utilities should not be allowed to bid in the POLR auctions.
- MI objects to the suggestion in Straw Proposal 2 that the Commission could designate another governmental body as the POLR if suitable bidders were not found, noting a lack of jurisdiction.
- MI recommends that POLR entity contracts be multi-year in duration.
- MI characterizes the POLR oversight described in Straw Proposal 2 as active regulation and notes that its costs will be reflected in the bid submitted to provide POLR service.
- MI opposes the suggestion that economic development and flex rates offered by incumbent utilities in the future should be competitively neutral and not include the provision of commodity. Until utilities completely exit the merchant function, MI argues, there still may be a compelling need for the utility to offer economic development or flexible rates that include commodity.
- MI urges the Commission to revisit its guidelines for flexible rate contracts established in 1994 in light of the changing market conditions, which, it argues, render obsolete the use of utilities' marginal costs when the utility is in fact purchasing from the market. MI also argues that the one-cent-per-kWh contribution currently required should be considerably lower.
- MI opposes offering the protection of hedges only to smaller customers and believes all classes should have electric rate hedging available.

- MI cautions about permitting utilities to enter into large long-term electricity purchase agreements and offering customers the option of fully hedged pricing without any exposure to market volatility. While some hedging is clearly appropriate, such offerings will make the utilities' exit from the commodity business all that much more difficult to achieve. The hedging available as an option to customers should depend on the status of the wholesale electricity market and the products available from other suppliers.
- MI supports the adoption for electricity of the gas policy statement position on hedging, at least in the short term.
- MI urges that as the markets develop, existing interclass and intraclass subsidies be eliminated.
- MI asserts that the Commission needs to devote more attention to efforts to increase New York's electric transmission and gas pipeline capacity, noting the plans to add additional gas-fired electric generation capability over the next few years.
- MI urges the Commission to recognize that large customers will migrate in much higher percentages than small customers in initial phases of the market and that this result is neither unfair nor inequitable.

### III. Market Transition

r MI reiterates its argument that utilities should not be permitted or directed to cease providing commodity service to large customers in advance of other customers. It raises first legal issues as to whether the utilities can be required to exit for any class of customers and adds that singling out large customers may run afoul of the anti-discrimination and anti-preference requirements in the Public Service Law. It nevertheless notes one of the primary differences between large customers and other customers is that large customers are more price-elastic and will therefore migrate to ESCOs in the event there are economic benefits to doing so, and points out that most large customers purchase gas supplies from ESCOs.

r MI sees no rational basis for singling out large customers to be moved to market suppliers in advance of other customers. According to MI, there is little or no benefit to be derived from forcing very few large customers to migrate if most have migrated voluntarily. It notes that

such minimal incremental migration would not affect materially the level of utility costs avoided and that forcing large customers into a market where prices are higher could have a disastrous effect on both those companies and the state and local economies.

r MI argues that there are three primary advantages to having the utilities exit: expanding the pool of customers available to ESCOs would cause more ESCOs to seek to conduct business in New York; having utilities exit certain functions would permit all of the utilities costs in those areas to be avoided; and requiring utilities to exit would level the competitive playing field, thereby eliminating potentially unfair competitive advantages possessed by the utilities. MI argues that none of these advantages can be realized if the utilities exit functions only with respect to large customers.

r MI argues that consumer protection issues that need to be resolved before migration is mandated apply equally to large customers. It concludes that those issues must be resolved for every class before any classes are moved to the market.

r MI notes that while the gas market may be quite mature for large customers, the electric market remains in its infancy, and large customers therefore should not be forced to purchase from ESCOs.

r MI also argues that all POLR-related issues for all customer classes should be resolved before any customers are forced to migrate.

r MI argues that if the market is not adequately mature for all customers, then no customer should be forced into it. According to MI, the utility should not be required to exit until such time as the market is mature for all customer classes and forced migration of remaining customers does not result in the occurrence of even higher energy costs.

r MI argues that utilities should not cease to offer hedged commodity pricing to large customers in advance of all other customers. It notes initially that a distinction should be made between existing and potential hedged instruments, referring to existing instruments as those resulting from utility auctions of generation assets. To the extent those instruments are at prices below existing market levels, MI argues that it would be "grossly

inequitable" to preclude large customers from benefiting from those instruments.

r With regard to potential future hedged instruments, MI cautions if such instruments are acquired in large quantities by utilities for long periods, they are likely to make it more difficult to move utilities out of the merchant function. MI contends that there is a lack of active retail competition and a limited availability of attractive hedging instruments from ESCOs and that therefore hedged commodity pricing from utilities is still needed even for the largest customers. It contends that if the wholesale market is immature then all customers, not just small-use customers, should have the option of reasonably stable prices.

#### IV. Public Benefit Programs

- MI objects to the statement in Straw Proposal 2 that the energy burden on low-income customers should not be worsened as the result of the development of competitive markets. MI notes that all customers' rates have increased since the beginning of the development of the competitive markets.
- MI argues that low-income assistance programs are within the unique providence of the Legislature and should for be paid only out of the general fund. It further notes the Commission's recent approval of a systems benefit charge on utility bills to fund a low-income energy efficiency and other programs and strongly urges that no additional programs be implemented.
- MI urges that the Commission refrain at this time from addressing issues of SBC funding beyond the current funding date of July 1, 2006.
- MI opposes the creation of a public benefit programs council.

r MI reiterates its position that energy prices should not be increased to fund additional low-income or public benefit programs.

r MI notes that the presumption that R&D will not be funded in a competitive market is wholly without support, noting that most R&D expenditures are made by companies conducting business in competitive markets.

r MI argues that there has been no showing that additional expenditures on low-income and/or public benefit programs are either necessary or would be beneficial.

## V. Public Input and Outreach

- MI comments that the customer surveys and focus groups conducted in this proceeding specifically excluded large customers and the results may not be reflective of the interests of the industrial class. MI also notes that the results, like the entire report, should not constitute evidence.

## **NATIONAL ENERGY MARKETERS ASSOCIATION (NEM)**

### II. Vision

- National Energy Marketers Association argues that the piecemeal resolution of fundamental issues surrounding the exit of utilities from the merchant function and the separation of the natural monopoly functions should be done expeditiously and with a firm date by which the transition will be completed. It argues that the longer it takes to implement the Commission's ultimate vision, the more expensive it will be to all participants.
- NEM expresses its support for the complete unbundling of the utilities' costs and indicates that until that is completed customers should be given credits equal to the current monopoly prices to shop for competitive services.
- NEM argues that utilities should be removed from the provision of competitive services and provides a lengthy list of services that "can be opened immediately to competition."
- NEM opposes the imposition or the obligation to serve on ESCOs and marketers as the Commission has required in the telephone industry. It suggests that the utility obligation to serve be converted to an obligation to connect and deliver.

### III. Market Transition

- NEM asserts that incumbent utilities have existing relationships with large customers that prevent effective competition and suggests that the market will provide hedged

pricing services for all customers. It contends that regulatory certainty, in the form of a specified date by which the utilities will exit competitive functions, is required to permit competitive suppliers to offer fixed price or otherwise hedged offerings to customers.

- With regard to hedging, NEM notes that the Commission recognized that gas marketers were already making substantial use of strategies that mitigate price volatility. It also suggests that a hedging requirement might well be appropriate regarding the provider of last resort (POLR) function.

#### IV. Public Benefit Programs

- NEM opposes any subsidization of low-income rates, suggesting instead that aggregation programs can be utilized to address the needs of low-income customers.

#### VI. Conclusion

- NEM urges the Commission to adopt an industry end-state model that defines the role of the utility as limited to natural monopoly functions and that permits all other competitive product and services to be provided by the market. It adds that such a model should be implemented expeditiously and by a date certain to provide ESCOs and marketers with investment certainty.

### **NATIONAL FUEL GAS DISTRIBUTION CORPORATION (NFG)**

#### I. Process

- NFG notes at the outset that there is no affirmative and clear definition of a collaborative process and that the parties did not reach consensus on the issues raised in the Commission's instituting order. In its view, further collaboration is not likely to significantly advance any consensus among the parties, and it opposes the suggestion raised at the prehearing conference that collaboration rather than briefs on exceptions follow a recommended decision. It urges that briefs on exceptions be scheduled and filed with the Commission.

## II. Vision

- NFG indicates its long-term support for a "pure pipes" model but notes as a practical matter that there are legal and political and public acceptance obstacles as well as supply and capacity issues that should be addressed and resolved prior to implementing any final state. Accordingly, it urges the adoption of a generalized standard rather than a specific model to allow greater flexibility during implementation.
  - While it expresses its reservation with regard to certain aspects (reliability and capacity matters) of the gas policy statement, NFG believes that adopting a generalized standard similar to that statement could be extremely useful as a vehicle for inducing change.
  - NFG argues that utilities should be allowed to remain in markets that become competitive because to do otherwise would be an anti-competitive boon to marketers and a limitation on the choice of customers. It also notes that the very question of whether to allow utilities to remain in a market that becomes competitive suggests that the utilities' participation was not an impediment to the development of competition.
  - NFG argues that only short-run avoided costs should be used in unbundling rates because the utility is both legally and as a practical matter limited with regard to its ability to exit the market. Assuming that all costs are avoidable in the long run is contrary to the utilities' continuing obligation to provide service.
  - NFG opposes adoption of the telephone market model (imposing the obligation to serve on all ESCOs and marketers) based on its experience in Pennsylvania, where when similar obligations were placed on marketers and all of the marketers stopped participating and left the program.
- r The most productive outcome would be for the Commission to identify a workable model and adopt it in a short time or to maintain the status quo.
- r NFG concludes that the best evidence supports the adoption of Model 1 with continuation of incremental change, perhaps with an eye to Model 2 or 3 as the eventual end-state. It seeks the certainty of a Commission directive that accepts the current state of competition as part of the evolution toward a future end-state, with an end-state policy to be adopted in the future.

III. Market Transition

- In response to the question concerning hedging, NFG indicates that the market should provide a solution to the existing price volatility. Utility commodity pricing should not depend on the type of customers, for the result will inevitably be that some customers will benefit while others will not. It adds that it will be offering a fixed priced option to its commodity customers for the 2001-2002 heating season.
  
- r NFG argues that while the Straw Proposal appears to be procompetitive, in reality it would maintain the status quo for the indefinite future. It contends that the preconditions for the utilities exiting the commodity or other commodity functions could not be met for an indefinite time. The Straw Proposal's preconditions would force all stakeholders to remain in the current state of regulatory limbo for an indefinite period.
  
- r NFG argues that the "big bang" approach of moving to Model 3 is a recipe for California-style disaster, and the proposals to proceed in that manner overlook the views of retail customers who are largely satisfied with the present structure. NFG suggests that the better approach is to continue the process incrementally.
  
- r NFG contends that the adoption of Model 1, continuing the process of incremental change, would help to ease the uncertainty that is affecting long term reliability planning.
  
- r NFG argues that the "big bang" approach would drive up total costs and retail rates, especially with regard to the price incentive or bonus suggested by some. It urges rejection at least of the proposed bonus for marketers to enhance migration.
  
- r NFG largely supports the proposal to redefine ESCOs to make clear the retail/wholesale distinction but also believes that a definition for wholesale marketers should be adopted as follows: "an entity that markets and sells energy, in the form of natural gas or electricity to retail/ESCO/marketers and/or other wholesale marketers."
  
- r NFG argues that wholesale marketers play a critical role in the maintenance of system reliability and argues that the details that bind a wholesale marketer's capacity and associated gas supply to a utility service territory, particularly when a retail marketer fails, need to be

developed as part of determining that a market is competitive.

- r NFG supports CPB's call for further analysis to determine whether aggregators should be subject to the same consumer protections required of ESCOs. NFG argues that the registration of aggregators should be mandatory in order to maintain their accountability. It suggests an ESCO that failed to provide consumer protections might close shop and reinvent itself as an unregistered aggregator no longer accountable for its business practices.

#### IV. Public Benefit Programs

- NFG argues that telephone lifeline rates were established because inducing more individuals to connect to the telephone network would promote a robust economy. This universal service theory is not applicable to the natural gas industry, where numerous fuels are in competition with natural gas. In the absence of an economic justification for establishing such a lifeline rate, NFG opposes it.
- NFG also opposes the establishment of any type of system benefit charge to fund gas customer low-income programs on the theory that such programs are best implemented by the utilities who are closer to the customers. It notes, however, that funding for such programs remains a difficult issue.
- NFG supports the concept of a public benefit programs council so long as such a council would operate only in an advisory role.

#### VI. Conclusion

- NFG concludes that consensus has not been reached on the major policy issues and that an RD and exceptions process should be followed. It urges adoption of a generalized standard for restructuring due to the significant benefits that flexibility will provide. It urges a conclusion that the utilities should remain merchants in the competitive markets for all classes and argues that low-income programs should remain a utility function under the primary management of the utility at this time.

**NEW YORK ENERGY SERVICE PROVIDERS ASSOCIATION (NESPA)**

I. Process

- NESPA notes that discussions concerning opening the retail market have been ongoing for at least eight years and that many recent decisions have been made in individual utility cases, resulting in an ad hoc approach. It urges that the Commission use this proceeding to articulate a reasonably specific pro-competitive vision for the retail market.
- NESPA sees the importance of the Phase I and II reports in the value of the process that produced them rather than in the reports themselves. NESPA urges that in going forward, the reports be laid aside and that the Commission's focus be on Staff's Straw Proposals which NESPA believes were enormously helpful.

II. Vision

- NESPA provides its own detailed vision of the end-state, which it believes is substantially identical to that set forth in the Straw Proposal with some additional matters to fill in what it sees as gaps in those proposals.
- NESPA favors removing the utilities from the merchant function (which it defines as all retail functions) or the adoption of Model 3 but urges that the transition be swift to minimize total costs. In support of this position it notes that the regulated utilities provide regulated bottleneck services and are the incumbent monopoly providers with a substantial advantage in market share.
- The utilities should be required to exit the merchant function as soon as the structure of the POLR is resolved.
- NESPA urges haste because the present structure is expensive, dysfunctional, and serves no purpose. It contends that the present state of the market (Model 1) is not in the public interest.
- NESPA urges the Commission to take structural steps addressing such issues as unbundling, business rules, price incentives, advertising, educational campaigns, and, finally, a date certain by which the utilities would exit.

- NESPA speculates the most robust competition would be in the area of customer service, not price.
- The fundamental flaw in the Straw Proposal is the absence of concrete steps and a practical transition plan for achieving its vision.
- NESPA argues that effective competition will reduce overall cost to consumers in the future, but warns that those reduced costs will not be achieved now and the effects of entrepreneurial innovation will not all be felt at this time. Instantaneous reductions in overall retail prices is not a reasonable expectation and should not be a precondition to the creation of effective markets.
- NESPA notes in particular a ploy pursuant to which incumbent utilities would offer long term rate deals that, while attractive on their face, just happened to foreclose competition.
- NESPA prefers the adoption of a generalized standard rather than a specific model for the end-state, but notes that the generalized standard should not mean a standard lacking all specificity. It urges the Commission to be as specific as possible now with respect to the transition, to guide the next round of utility filings.
- NESPA supports the concepts underlying the gas policy statement and believes they should be adopted for electricity, but it notes that that policy statement has failed to spur meaningful competition for most gas market segments. It attributes that failure to a lack of sufficient guidance on transition issues.
- NESPA urges the rejection of a more passive, "let-the-market-develop-naturally" approach to competition.
- As a general matter NESPA believes utilities should not be permitted to remain in competitive markets.
- NESPA urges that the question of customer care be addressed soon and suggests that a clear definition of the various parties' roles in the market must be determined before the Commission can properly unbundle rates.
- NESPA prefers a model in which POLR obligations are only applied to a few. It opposes the use of the telephone industry model, where obligation to serve is imposed on all.

- NESPA suggests as a practical matter that a rational ESCO seeking to serve the residential mass market would in fact take "all comers". NESPA also speculates that the rational ESCO would serve all customers on a nondiscriminatory basis and would treat all similarly situated customers alike. It suggests that in the final analysis the only unserved customer base will turn out to be either very small or non-existent.

### III. Market Transition

- NESPA notes significant differences between the gas and electric markets and differences in the wholesale markets. It adds that the pace and shape of the transition to competitive gas retail market must be heavily effected by the gas reliability process. It also says the presence of cooking-only gas customers may require special programs and further notes that the Commission has not moved ahead with regard to competitive metering in the gas markets.
- NESPA contends that a material shortcoming in the discussions regarding the structure of the retail market has been the lack of informed public conversation on the general topic of customer care.
- NESPA opposes what it calls the creeping incrementalist approach to transition and urges the adoption of a scheduled date certain for exiting the utilities, providing a "big bang" for competitors.
- On a date certain unbundling and price incentives should go into effect sufficient to assure migrating customers of at least a ten percent savings for all who switch.
- NESPA proposes a three-stage program. Phase I would resolve a number of important issues such as unbundling, customer care, developing a POLR model, etc. Phase II, which would commence in April 2002, would feature coordinated customer education, advertising, and preparation by market participants. Phase III would start January 1, 2003, when unbundled price incentives and the POLR program would go into effect and the utilities would exit the commodity business.
- NESPA notes that the most daunting barrier to market development as long as the utility remains is the extraordinary cost of customer acquisition.

- NESPA urges that, in carrying out the transition to competition, regulated utilities be provided incentives, through earnings or recovery of transition costs, tied to their cooperation and success in exiting the retail function.
- NESPA notes that the transition plan for the larger customer classes could be faster than that set forth above for the residential class, with the Phase III "big bang" happening for industrial customers on June 1, 2002.
- NESPA believes the transition strategy set forth in the Straw Proposal is too timid and unlikely to be successful.
- NESPA urges that the question of customer care be addressed and reflected in the unbundling proceeding.
- POLR service is intended as a short term service, and the pricing of that service should not be attractive relative to what is available in other markets.
- NESPA opposes the creation of a competition council, arguing that it will add a layer of bureaucracy and a potential hurdle to be cleared before the decision to move ahead with the utilities' exit can be made.
- NESPA believes that the extended timetable set forth in the Straw Proposal for transition to markets is too modest and will lead to unreasonable delays in the introduction of competition.
- NESPA believes that small and large customers should be differentiated with regard to hedging protection provided by the incumbent utilities, but only to the point of the "big bang," after which the utilities would be offering no retail services.
- NESPA opposes the adoption of the gas policy statement on hedging. Under its transition plan, that issue might be moot in approximately 12-18 months.
- NESPA urges focusing on the development of the POLR model during the first phase of the transition and urges the Commission to establish specific deadlines for that work to be completed.

r NESPA reiterates its support of Straw Proposal 2, noting that the crucial point in that proposal is that it is a plan that holds out the assurance of action, an assurance

absolutely necessary to encourage ESCO investment and market development.

r NESPA indicates that the argument over the status quo versus moving forward is "a debate over getting there at all". NESPA sees the status quo as a static or shrinking market dominated by utilities and their affiliates and therefore urges the endorsement of the Straw Proposal's end-state vision and an emphatic rejection of the idea that nothing much needs to be done to achieve that end-state.

#### IV. Public Benefit Programs

- NESPA endorses the low-income section of the Straw Proposal and strongly believes that low-income support should be increased.
- NESPA suggests that POLR service should not be designed to address the needs of people with low incomes but that a separate additional program should be designed and implemented for that purpose.

#### **NEW YORK STATE ELECTRIC & GAS CORPORATION (NYSEG)**

- NYSEG claims that it has a distinguished record of supporting the transition to competition and has been a leader in implementing retail access.
- It contends that retail competition requires a viable and liquid wholesale market. It contends that the wholesale electric market has developed poorly resulting in customers facing substantially higher prices. It suggests that recent experience underscores the need to reevaluate the schedule and infrastructure requirements necessary to achieve the state's goal of robust wholesale and retail competition.
- NYSEG summarizes the various findings and recommendations in its report entitled, "New York State's Electric Energy Crisis and New York State Electric & Gas Corporation's comprehensive solution" (April 2001 public policy paper). It argues among other matters:
  - The Article X licensing process has become a morass and the plant certifications have been bogged down in litigation.

- The complete dependence on natural gas as the fuel for all new generation exacerbates New York's energy problems, and there is no regulatory or governmental policy to foster fuel diversity.
- While electric transmission investment may help, that help will be far into the future due to the extensive siting proceedings provided under Public Service Law Article 7.
- Specific plans must be implemented now to expand electric transmission and natural gas infrastructure, and while those efforts are underway customers need to be protected in an immature and volatile wholesale electric market.
- It is critical that consumers in the fragile upstate economy be protected from excessive market risks during this uncertain transition.
- Hasty action by the Commission unsupported by a strong framework will only create markets with perverse incentives and will adversely affect the long-term economic vitality of New York.
- The public input research performed in the proceeding suggests the majority of consumers want the local utility to remain an option.
- NYSEG urges that the Commission refrain from any further efforts to define an end-state in this proceeding and from directing the utilities to exit the merchant function.

#### I. Process

- NYSEG expresses its serious concerns about the process and contends that the basic collaborative approach seriously broke down.
- NYSEG states its concerns about the evidentiary weight that would be accorded the Phase I Phase II report and argues that the value of the entire process is questionable if it does not rest on a solid legal and evidentiary foundation.

- NYSEG argues that the legal issues should not have been delayed to the end of the proceeding and that that delay was especially damaging.
  
- r NYSEG contends that Staff pulled "the wool over the eyes of the parties" and "engaged in questionable negotiation tactics" because it allegedly did not reveal that its true position was in fact the Straw Proposal circulated in an attempt to garner broad based support. According to NYSEG, Staff placed a shroud on its once hypothetical Straw Proposal allegedly with the intent to mislead the parties.
  
- r NYSEG contends that Staff, in addition to the "bad faith" it showed, incorrectly characterized the Straw Proposal as supported by a substantial majority of the parties.
  
- r NYSEG's alleges that the Straw Proposal ignores the infirmities in the wholesale electric market and assumes that the problems will be corrected by implementing the Straw Proposal.

## II. Vision

- NYSEG urges the Commission not to adopt any specific end-state model or more generalized standard until the electric wholesale market is functioning properly and all gas and electric liability issues have been resolved.
  
- Utility restructuring should be evolutionary, not revolutionary. NYSEG cites the telecommunications and wholesale gas industries, which have matured over a two-decade period, as examples of an evolutionary approach.
  
- NYSEG urges the Commission to continue considering a great number of issues necessary to establish the appropriate regulatory and other infrastructure required for competitive markets, including matters concerning the operation of the ISO, reliability, electronic data interchange, competitive metering, billing, demand side issues, and the provision of ISO information and data to the Department.
  
- NYSEG opposes adoption of the gas policy statement for the electric market, arguing that the gas policy statement itself is wrong. It also argues that requiring the utility to exit the commodity market would eliminate one supplier for consumers, thereby contradicting the state's policy of increasing consumer choice.

- NYSEG argues that utilities should be allowed to remain in markets that become competitive. It notes the public research performed in the case showing that the majority of customers would prefer to retain the option of having the utility as a supplier.
  - NYSEG suggests that the telephone market model, imposing the obligation to serve and uniform customer protections on all competitive providers, should be considered by the Commission. NYSEG argues that all competitors should be subject to a set of similar requirements regarding both the obligation to serve and consumer protections. Such an approach would insure that consumers would not be subject to discrimination, would enjoy the same fundamental protections and would be able to shop in the markets without having to sacrifice these protections. NYSEG again points to the customer research undertaken in the case, which indicates that most customers believe the consumer protections currently provided are extremely desirable.
  - NYSEG argues that large customers should have a greater choice of commodity ratemaking mechanisms than are currently available, including a choice of sophisticated and individualized pricing options. It argues in essence that any hedging performed by the utilities should apply equally to large customers.
  - NYSEG opposes the adoption of the policies on hedging in the gas policy statement, arguing that such a mandate is not needed because the utilities already have that obligation under statute. It also argues that a hedging strategy should not be extended to the electric industry because it may adversely affect consumers, apparently notwithstanding the statutory obligation. NYSEG opposes particularly the warning in the gas policy statement that the utility would have a heavy burden to demonstrating that its approach was reasonable if it did not have a diversified supply portfolio. It finally argues that the gas and electric industries are different and policies in one should not be applied to the other.
- r NYSEG argues strenuously that, contrary to the allegations of DYNEGY, workably competitive wholesale markets do not exist and that the supply situation in those markets will worsen before it improves.
- r NYSEG discusses in some detail the NYSEG report issued after the Phase I/Phase II reports were completed in this case.

- r NYSEG agrees that customers will need protection from volatility, stressing that that such protection will be needed well past 2003.
- r If the Commission decides to establish an end-state model, NYSEG would oppose adopting a generic statewide model, as some parties favor. Its position is based on its belief that each utility should have the ability to move to an end-state that is most advantageous to its own customers and that the choice of an end-state must be made on a utility-specific basis.
- r NYSEG argues that before the Commission can establish any end-state, the legal issues surrounding the Commission's jurisdiction must be definitely determined.
- r NYSEG opposes CPB's arguments that the Model 3 end-state should be chosen in part because it would allay some of CPB's concerns regarding the use of corporate names by both regulated utilities and unregulated ESCOs. NYSEG argues that because it has been accorded the right to use the NYSEG name for all subsidiaries, the consequences of its having that right should not be considered in any way in this case.

### III. Market Transition

- r NYSEG alleges that Staff failed to account for market-based back-out plans, underestimated the importance of hedging, and generally misunderstood the concept of hedging in its initial brief. NYSEG argues that Staff ignored the procompetitive benefits of a market-rate back-out plan as opposed to a fixed-rate back-out plan such as the market-based plan NYSEG has recently adopted.
- r NYSEG opposes Staff's endorsement of rapidly increasing the exposure of industrial customers at spot market prices while calling for residential customers to face such prices more gradually. According to NYSEG, the California experience should be enough to dissuade any reasonable person from exposing any customers to spot market prices in the face of a poorly developed wholesale electric market.
- r According to NYSEG, Staff failed to appreciate that hedging prices often become market prices, and its distinction between hedged prices and market prices is artificial. NYSEG notes that no reasonable entity would manage an electric supply portfolio absent hedging. NYSEG also notes

that hedging instruments add liquidity to competitive markets and allow smaller market players to participate, thereby leading to greater competition.

r NYSEG opposes the recommendations of a number of parties to set a date certain by which utilities would exit the commodity market. It contends it is premature and potentially an abdication of the PSC's statutory duties for the Commission to adopt such proposals and to establish a date certain for the new retail energy market paradigm.

r NYSEG opposes the adoption of recommendations from this proceeding in pending rate cases. The adoption of such recommendations into pending cases might force NYSEG to reconsider the proposals it has made in those pending cases.

r NYSEG opposes the proposal to establish pricing incentives, customer sign-up bonuses or other subsidies to create market activity as contrary to Commission policy.

r NYSEG opposes the concept that utilities and ESCOs should become trade allies, noting that competitors in any industry are the antithesis of allies.

r NYSEG opposes the suggestion that the utilities be provided an incentive to carry out the transition to competition, arguing that the proposal is a blatant attempt to hold hostage the utilities' earnings and their ability to recover transition costs until the utilities are forced to surrender and agree to exit the merchant function.

#### IV. Public Benefit Programs

- NYSEG opposes any further consideration of the possibility of using NYPA residential hydropower benefits to support low-income programs, arguing that the hydropower allocations are specifically governed by federal and state law and that under long-term contracts, NYSEG is not permitted to provide NYPA hydropower to a subgroup of its rural and/or domestic customers.
- Assuming that the public benefits program council met specified conditions, NYSEG would not object to its creation. The conditions are that the council must be bipartisan; it must be charged with identifying best practices and providing knowledgeable guidance to human service providers; it must be prohibited from securing or allocating funds; it must

recognize the unique geographic regions; and special needs within those regions; and it must address the real and fundamental infrastructure needs facing New York.

- r NYSEG objects to a public benefit programs council that would be coordinated by NYSEERDA, arguing that it would constitute a duplication of the SBC Advisory Council efforts. Its lack of objection to the creation of such a council for low-income issues is conditioned on the council's functioning as an independent oversight body prohibited from securing or allocating funds.
  
- r NYSEG opposes the proposal to establish a mandatory gas benefits charge, arguing that the adoption of such a proposed rulemaking must first be noticed under the provisions of the State Administrative Procedure Act. It suggests instead that PACE consider implementing an SBC on Long Island rather than increasing the burden of upstate customers through a gas benefits charge.

#### V. Public Input and Outreach

- NYSEG believes that the public input and outreach efforts in the case provide the Commission with all the quantitative and qualitative information that it needs to fully analyze the public view of the developing competitive electric and gas markets and its expectations of them.
  
  - NYSEG argues that Staff has failed to acknowledge the results of the public involvement effort in the production of its Straw Proposal because it does not indicate that customers overwhelmingly want the utility to continue as a choice and do not want to be forced to switch suppliers.
- r NYSEG opposes KeySpan's view that the public input and outreach efforts were so full of errors, omissions and bias as to vitiate the results produced. It notes that KeySpan was an active participant in the committee, that the committee selected the contractor through a bid process, that the contractor has very sound credentials and has gained an excellent reputation in its prior work, and that KeySpan as well as all of the other parties had numerous opportunities to suggest survey questions provide direction, and comment on drafts. NYSEG argues that simply because the study did not produce data supporting KeySpan's position is not reason to ignore the results. It notes finally that the results show that customers overwhelmingly want the utility to continue as a retail choice.

**NEW YORK STATE RESEARCH AND DEVELOPMENT AUTHORITY (NYSERDA)**

II. Vision

- NYSERDA supports Straw Proposal 2 as submitted to the parties by Staff.

IV. Public Benefit Programs

- NYSERDA takes no position on whether NYPA residential hydropower benefits might be used for a lifeline rate or other low-income program but suggests that the issue could be taken up by the coordinating council as discussed below.
- NYSERDA supports continuation of the System Benefits Charge Advisory Committee but also strongly endorses a coordinated process for delivering energy-related services to the low-income sector. It proposes the creation of an initial Statewide Coordinating Council comprising state organizations as well as other interests involved with low-income energy issues. It suggests that such a council could achieve a balance between maintaining local program flexibility on the one hand and achieving statewide consistency and coordination on the other.

**NIAGARA MOHAWK POWER CORPORATION (NM)**

I. Process

- Niagara Mohawk believes that the collaborative process worked well in describing possible competitive models and identifying many of the issues that require examination before adoption of any vision other than the status quo. It notes that all parties have a deeper understanding of one another's positions on many matters than they did at the beginning of this case.
- As for difficulties with the process, Niagara Mohawk notes three distinct changes in direction: assessing the vision and movement questions, addressing legal issues, and examining two Straw Proposals. It asserts the schedule was sufficiently ambitious to disrupt the work flow in some cases. In particular, it says that a detailed assessment of the costs of adopting the various models was not possible.

- NM contends that the Straw Proposals could have been presented earlier in the case and notes it is unclear how the Phase I/Phase II report will be utilized.
- NM argues that the process should have begun with an analysis of legal impediments before discussing broader policy issues.
- It also notes concerns with the process by which customer research was generated and again suggests that the ambitious schedule may have led to some deficiencies.

## II. Vision

- Niagara Mohawk urges that neither a more generalized standard nor a specific end-state model be adopted as a result of this proceeding. It argues for a utility's right to decide for itself whether it wishes to provide commodity or other retailing functions and contends that no statutory support exists for the mandatory adoption of either Model 2 or Model 3. It also notes that flexibility is essential in order to give due regard to the unique situations of each utility's business and service territory.
- NM notes that no ESCO or group of ESCOs on either the gas or electric side has expressed a willingness to assume the commodity or retail functions for all customers.
- NM favors issuance of a series of statements drawing boundaries as to how utilities and ESCOs can do business, and it urges that such statements be sufficiently flexible to permit utilities to implement different models.
- NM argues that a key objective for any vision should be to avoid irreparable harm to market participants, customers or utilities in the event that the preconditions necessary to implement it do not materialize. "Flexibility, in this case, is the key to wise decision-making."
- Niagara Mohawk opposes the adoption for electricity of the gas policy statement, arguing that a formal reassessment of that statement should be undertaken. It notes that large gas customers already receive commodity supply from marketers and states that ". . . these large customers are ineligible for Niagara Mohawk supply service. . ." It believes it premature to conclude that it would be wise for utility to exit the commodity market for small gas customers.

- NM has no objection to utilities ceasing to provide commodity service to large electric customers. It strongly believes, however, that conditions are not now met, and may never be met, for small customers to be forced off utility commodity service.
- NM argues that utilities should be allowed to remain in markets that become competitive, noting that charges of utility anticompetitive behavior have neither been made nor can be made given their regulated status. It argues that the presence of an additional supplier, the utility, is procompetitive.
- NM has no objection to exiting commodity service for large customers in the near term and is willing to further consider the question for small customers subject to the preconditions in Straw Proposal 2. It notes that the costs of proceeding in such a step-wise manner should be relatively small but cautions that small customers clearly want the utility to be an available supplier.
- NM disagrees with any attempt to eliminate utility-customer relationships and lists the following reasons:
  - Establishing the ESCO as a middleman between the utility and the customer will impede effective communications.
  - Safety and reliability objectives are best addressed when the utility works directly with the customer.
  - Maintaining a direct retail relationship avoids the expense of duplicating systems and service capability by the ESCOs.
  - Delivery services are intended for the benefit of customers and not as a function out-sourced to utilities by ESCOs.
  - A model forcing utilities out of retailing functions could put the distribution company at an unfair disadvantage with regard to responding to competition, such as from self-generation.
  - Utilities are best able to tailor economic development programs when they work directly with customers.

- Niagara Mohawk agrees with the preconditions to movement to Model 2 set forth in Straw Proposal 2 but argues that they should also be preconditions for any movement to Model 3. It argues that Straw Proposal 2 should not endorse Model 3 as a long-term vision at this time and urges that Model 2 be adopted as the vision for large customers, leaving open the question of small customers.
  - The company appears to oppose the multi-interest competition council, arguing instead for the Commission to continue to monitor markets and seek party input when appropriate to establish a utility exit from the markets.
  - Again stressing flexibility, NM notes that competition will advance at different times for each commodity, for each customer service, and within each utility territory.
  - NM believes that a baseline level of consumer protection should be required of all commodity providers, irrespective of their status as POLR.
  - In the end-state, according to Niagara Mohawk, greater Commission oversight of commodity POLR providers through reports and audits would be preferable to establishing special consumer protections that only POLRs would be required to offer. It suggests that if the utilities are removed from commodity or other functions then it may be necessary for all commodity providers to bear the obligation to serve.
- r NM states that it would be premature to make any decision regarding an end-state or transition state before all costs and benefits to persons and entities, including, but not limited to, utilities, ESCOs, ratepayers, taxpayers, and communities, had been examined. It therefore urges that no decision be made on any of these issues.
- r No date certain should be specified for any movement to any model end-state because, according to NM, there is too much uncertainty regarding costs, too much uncertainty regarding benefits, and too much uncertainty regarding all of the preconditions set forth in the Straw Proposal.
- r NM contends that no competition council should be created at this time. If such a council is created, it should serve in strictly an advisory role.
- r Because commodity pricing is complicated and involves consideration of many factors including the market

conditions within the subject utility service territory, issues of rate design for unbundled commodity pricing should not be addressed in this proceeding.

- r Because numerous issues require resolution in connection with POLR, NM argues it is premature to decide upon a POLR model now. It further argues that it is unrealistic to assume that the utility, once removed from the POLR function, can be expected to resume those responsibilities; and if those responsibilities are to be kept by the utilities, it is costly and inefficient to establish some non-utility entity as a POLR.
- r NM argues that utilities should not be required to contract out their merchant functions but notes that it is not opposed to utilities voluntarily taking such action.
- r NM argues that no incentives or artificial credits should be used to induce migration, and it opposes the use of lump-sum incentive payments or artificially high back out credits.

### III. Market Transition

- Regarding hedging, Niagara Mohawk notes that nearly all of its large gas customers and most of its large electric customers currently are exposed to market prices for commodity. Although it might be reasonable to reduce or eliminate hedging for other large customers, there may also be circumstances when hedged or partially hedged services to such customers might be appropriate.
- Hedged supplies play an important role in serving small and residential customers, for whom there are limited market opportunities, at least for the near term. In any event, NM argues, all reasonably incurred costs to provide hedges should be recoverable.
- NM notes that ESCOs cannot be required to offer any of the hedged products and that there is no guarantee that ESCOs will offer hedged prices. In the absence of a regulated POLR required to offer hedged prices, NM believes it difficult to imagine any cessation of utility POLR responsibilities to small customers.
- NM believes that the fundamental principle set forth in the gas purchasing policy statement should be applied to electric utilities, seeing a need for some portion of the electric

supply portfolio to be hedged. It expressed concern, however, that if market prices fall below the hedged price or if the utility is not 100% hedged and prices go up, claims of utility imprudence could be levied. It recommends that retail access rules and recovery mechanisms be created for the cost of hedging to be borne by all customers.

- Additional guidance to that contained in the gas purchasing policy statement should be provided regarding Commission expectations for the near-term and long-term objectives of utility supply procurements.
- NM believes it imperative that cost analyses be undertaken to examine the question of total costs of adopting any end-state model before any decision to adopt such a model is made. It believes that analysis was not adequately undertaken in this case.
- NM urges that the issue of legal impediments be resolved before any end-state models are adopted and before any POLR pilot programs are undertaken.
- The company believes it is still premature to decide such questions as whether all ESCOs should be POLRs, and whether POLRs should be selected by bidding.
- Given current market conditions and the preferences expressed by small customers, NM believes conditions do not now support its ending commodity service to small customers. Instead, it should remain the POLR for those customers.
- NM notes that detailed requirements have not been set forth regarding POLR assurances, financial viability, etc. and that the Straw Proposal merely assumes the POLR will fulfill its obligation. It accordingly argues that final decisions should not be made and it would not adopt the Straw Proposals' rejection of the position that all ESCOs should have the obligation to serve.
- NM objects to the Straw Proposal suggestion that utilities could be appointed as default POLRs by the Commission in the event a bidding scheme were not successful, especially if the utility had already exited the business. It argues that alternative or backup POLRs need to be designated or that all ESCOs should be designated as POLRs.
- Niagara Mohawk opposes a forced migration strategy for customers except as an approach of last resort. It argues

that forced migration should not occur unless a small minority of customers are the only ones left on utility service and that any migration strategy should not violate existing contracts.

- NM deeply opposes the suggestion in Straw Proposal 2 that the utility recover some stranded costs through commodity charges. It notes that this proposal would result in inefficient pricing signals and could cause underrecovery of stranded costs if migration proceeded at a faster than assumed pace. It also notes that the Commission has held that fairness requires collection of stranded costs from all groups of customers.

#### IV. Public Benefit Programs

- NM objects to examining NYPA residential hydropower benefits as a source of inexpensive power for a lifeline or other low-income rate, noting that to change the current allocation would create both winners and losers. It argues that low-income programs are better funded from the broadest of societal resources and that redirecting NYPA power would limit the costs to a narrow class of electric residential customers.
- NM is not averse to the creation of a separate public benefit council limited to low-income programs, noting that for energy efficiency R&D renewables, the Systems Benefits Charge Advisory Council should be adequate.
- NM endorses of the recommendation that deregulation and the transition to competitive energy markets should not disadvantage low-income customers. It notes that such customers are likely to be particularly vulnerable to price volatility and must have protection against it.
- NM notes its grave reservations concerning the inclusion of a lifeline rate with other components of a coordinated statewide low-income program. It states that this discount would be given to many customers who can otherwise pay their bills and that such a program does not target the specific needs of this class, which tend to be diverse in terms of energy consumption, bill payment capabilities and payment histories. Low-income programs must take account of the diversity of the needs of low-income customers rather than a lifeline discount, and NM recommends placing greater emphasis on market-based solutions such as aggregated purchasing of commodity.

- Niagara Mohawk favors public funding of low-income programs through governmental appropriations from the general fund and/or taxes, arguing that progressive taxation would place fewer burdens on those less able to pay. It also notes that using utility rates to fund such programs runs counter to the policy of maintaining lower utility rates.
  - Whatever may be done, NM believes the cost should not be incremental to the existing utility programs and System Benefit Charge.
  - Niagara Mohawk recognizes the need to account for local conditions and service providers, but endorses the concept of program coordination under a statewide governing entity to regulate all low-income programs and services.
  - NM urges that further study be undertaken of low-income customer needs. It notes that as long as utilities maintain retail relationships with customers, utility sponsored low-income programs can be undertaken. It adds its concern about whether sufficient consideration has been given to the needs of low-income customers during and after transition and how those needs will be met; it accordingly recommends that this area be set for the study.
  - Niagara Mohawk supports broad-based public funding for public benefit programs rather than funding from utility rates, noting that funding such programs through charges on energy delivery is not competitively neutral. Increasing energy delivery charges to pay for such programs provides an incentive to self-generate rather than use the existing transmission and distribution system. It also notes that if such charges are applied only to electric service, users of gas, oil, and other fuels would be exempt. Such charges also artificially enhance the benefits of municipalization.
- r NM reiterates its position that no lifeline rate should be adopted and that if such a rate is adopted, it should be a limited interim measure pending the development of other public funding sources.
- r No surcharges should be added to utility rates in excess of the current system benefits charge because any such incremental surcharges assessed against distribution would encourage bypass and self-generation in an uneconomic way. NM strongly objects to a gas SBC incremental to the existing gas and research and development charge, contending it would amount to a double charge on

combination service customers as well as underscore the inequity resulting from the lack of contributions made by propane and fuel oil.

- r NM argues that funding for energy efficiency programs should decrease over time as the number of competitive providers increase the offering of such programs and services.
- r Any public benefit council that may be established should be limited to low-income issues and should be advisory only. NM opposes placing such issues in the competition council contending that the council would not have the special expertise for such matters.

#### V. Public Input and Outreach

- The company notes that the research performed in this proceeding consistently shows that small-use customers want utilities as possible providers. It alleges that Straw Proposal 2 "completely ignores the voice of the customer" and suggests that without customer support, no vision can succeed.

### **PUBLIC UTILITY LAW PROJECT (PULP)**

#### I. Process

- While the process followed in this proceeding has not resulted in an adjudicated factual record, a characterization that should be specifically affirmed by the Commission, it has nevertheless been "singularly adept in following the interest of the parties to explore various alternative scenarios and to provide useful new information that has not been available previously."

#### II. Vision

- Safe and adequate service at just and reasonable prices must be at the core of the Commission's policy analyses in this proceeding.
- There is no clear choice between the models analyzed in the proceeding from the perspective of the above statutory requirements. Any choice made now could be reversed or significantly amended in the future if the implementation of competition threatened in any way the provision of safe and adequate service at just and reasonable rates.

- For a number of reasons, many of the observations in the gas policy statement do not seem appropriate for adoption in the electric industry. These include the questionable observation that it is necessary to remove the utility as a competitor in order for markets to develop. In addition, the statement's reference "customer inertia" is seen by PULP as "customer choice" at work.
- Still, the goals included in the vision for the natural gas industry may, in PULP's view, represent one area in which the policy statement could guide the transition to competition in the electric industry.
- From the prospective of the customer, removing the utility from the commodity market before there is competition could jeopardize the provision of reliable and reasonably priced service; and removing the utility as a competitor once robust competition exists probably makes little difference to the consumer.
- If utilities are allowed to remain in the competitive business, the regulation of their services should not be used as an opportunity to recover stranded costs that might be associated with the regulated entity's inability to compete effectively.
- Consumer protections in a competitive market should meet or exceed consumer expectations. Those expectations are currently based on HEFPA. If consumers do not perceive that they are at least as well off in a competitive market with regard to the consumer protections available, policy decisions designed to create markets are unlikely to be accepted.
- The competitive market, including the protections brought by competition, must produce level of consumer protections at least as great as now provided in the monopoly environment. There can be no basis for the relaxation of existing consumer protections as suggested in Staff's Straw Proposal 2.
- PULP supports the Straw Proposal's assertion that all providers should comply with the same set of consumer protections and urges that the standard basic level of consumer protections be explicitly recognized in the Commission's vision for the end-state.
- All providers need not assume the obligation to supply commodity in order to meet consumer expectations.

### III. Market Transition

- The fundamental differences between residential/small commercial customers and large commercial/industrial customers must be recognized in designing the regulatory approach for the transition in competition. Those differences include the smaller bills paid by low use customers; the large customer's view of these products as an economic good, in contrast to small customers' view of them as a life necessity; the sizeable difference between the number of small customers and the number of large customers; and the fact that the class of small customers includes payment-troubled individuals whose disconnection is disfavored. PULP suggests that a "universal service objective" exists with regard to small customers and may not exist with regard to commercial or industrial customers.
- Differences in customer size make differences in the approach toward hedging both appropriate and necessary.
- Hedged service is not re-regulated service; it is a market-based price.
  - Rate stability for residential customers is inherent in the concept of just and reasonable rates.
  - Because of the personal finances of residential customers (especially low-income) and the more limited purchasing choices they enjoy, hedged resources should be provided to them to a greater extent and for a longer period than to larger customers.
  - PULP agrees with Straw Proposal 2 that spot market pricing may be appropriate for larger-use customers earlier than for smaller-use customers.
  - The transition to competition contemplated by Straw Proposal 2 should be successfully completed by at least one other customer class before the residential class is committed.

### IV. Public Benefit Programs

- Because NYPA hydropower is required to be distributed as widely as possible, reallocation of that hydropower for low-

income programs could not be supported under existing statutes.

- PULP also argues that the costs of such a reallocation would be solely within the residential class, suggesting that such reallocation would not be equitable. It suggests instead that rates designed to achieve a particular public policy, whether it is low-income programs or economic development rates, should be funded by rates charged to all customer classes.
- PULP recommends however that the allocation of NYPA power (currently on the basis of kilowatt-hours) should be adjusted in the competitive market in order to produce a competitively neutral result and to provide customers a more accurate price signal of the cost of their marginal usage.

r PULP objects to the opposition raised to a lifeline rate program, arguing that only the negatives identified in the proceeding were noted and the positives of such an approach were omitted. PULP supports as part of the overall program to assist low-income customers the establishment of a lifeline rate program.

r PULP particularly objects to the argument that if customers are current on bills, they have no need for a lifeline discount. PULP notes that the purpose of such a discount is to reduce the energy burden faced by these customers, many of whom must decide between paying a utility bill and purchasing other necessities. According to PULP, a lifeline rate would reduce the instances in which residential consumers are forced to make this "Hobson's Choice". PULP finally notes that even if customers on public assistance have their energy bills paid by the counties, a reduced payment by the counties would provide a dollar-for-dollar increase in the amount of assistance received.

#### V. Public Input and Outreach

- PULP believes that the input and outreach material adduced and developed in this case make an important contribution to the value of the record.

**ROCHESTER GAS AND ELECTRIC CORPORATION (RG&E)**

II. Vision

- RG&E first urges that the Commission's decision in this proceeding be based on a judgment that the end-state chosen will be better for all consumers than one in which the local utility continues to operate under traditional regulation. It argues that the single retailer Model 3 offers the greatest opportunities for competitive service providers and customers. It suggests that adopting a more limited end-state vision would only be appropriate if the Commission concluded that customers would be better off under those circumstances. It also argues that it would be disingenuous to conclude that customers have benefitted by commodity markets that were opened as a result of retail access credits and incentives that "were essentially funded by those very customers or their neighbors." The benefits enjoyed by customers should demonstrably exceed those offered by any regulatory incentives.
- RG&E strongly opposes establishing firm or estimated dates by which the utilities would be required to exit identified competitive functions. While it does not relish an "in-between" state where it is expected to satisfy customers while encouraging them to leave, build new infrastructure while avoiding costs, and nurture new markets while remaining poised at any time to meet the reemerging of old ones, the otherwise desirable idea to set dates could cause even greater problems. It suggests that artificially forcing the utilities to exit creates significant risks; that the preconditions for such an exit are not under the sole control of the Commission and the utilities; that an arbitrary state-wide exit date will likely be inappropriate for some utilities and some service classes; and that it is vital that customers not regret that the utilities have exited. RG&E argues instead that the parties should focus on achieving the preconditions for a successful exit from each market segment, followed by the prompt implementation of the utilities' exit from that market segment.
- RG&E suggests modifications to the Straw Proposal 2 preconditions for utilities exiting various markets. Its amendments are designed to accommodate a phased exit and to make it easier to develop measurable criteria for determining when the preconditions have been met. It notes that insuring customer satisfaction with a process is extremely important

and observes that the utilities' departure from a particular function will not be easily reversible.

- RG&E argues that the Commission's focus subsequent to this proceeding should be on the most difficult and time consuming preconditions, in particular the establishment of a workably competitive wholesale market.
- r RG&E notes that statewide standardization and uniformity can be achieved only at the price of forgoing variety and experimentation. It further notes that while some variations are mere historical artifacts, others may exist for perfectly valid reasons and should not be undone. It adds that uniformity has a cost and should be pursued only to the extent that it makes economic sense.
- r If the Commission concludes that Model 2 should be adopted as the end-state, RG&E would urge that those who wish to move directly to Model 3 be allowed to do so. It questions whether removing the utility from commodity alone will substantially benefit customers and argues that the greatest potential benefits to customers can be derived by transferring not only commodity responsibility but all other retailing responsibilities to the competitive market. The company adds that utilities implementing Model 3 will provide a pilot program for the transition of other utilities. It asserts that requiring utilities who have chosen the single-retailer model to now implement Model 2 could be very expensive. It requests an exemption from any determination that all utilities should move to Model 2, noting that it has received such exemptions in the past.
- r RG&E opposes the establishment of a predetermined schedule for utilities leaving competitive market segments, preferring the Straw Proposal approach of establishing preconditions that must be met. A set time would incur the risk of premature departure by the utility. RG&E notes that the preconditions for exit in the Straw Proposal are not completely within the Commission's and utility's control. Any dates that might be set (including those in the Straw Proposal) therefore would be arbitrary, and, to the extent the same schedule was established statewide, it could be incompatible with local circumstances or with the circumstances of particular customer classes.
- r RG&E urges that a new track be established in this proceeding to identify objective criteria for determining whether the preconditions in the Straw Proposal have been met and when a date certain for utility exit should be

triggered. It agrees with other parties that no one can be expected to apply directly the preconditions set forth in the Straw Proposal as they currently stand. Instead, RG&E recommends a four-part approach;

- Develop objective and clear criteria in a further track of this proceeding.
- Identify not only the criteria, but also the evidence that will be needed to show them to be satisfied and the parties who should produce that evidence.
- Limit the competition council to an advisory role, including review of the evidence and recommendations to the Commission as to whether utilities should exit markets.
- Once the triggering criteria have been met, a date certain no later than two years distant should be set for the utilities' exit from the competitive services.

r RG&E urges that the more detailed statement (referred to as metrics) of the preconditions be developed under the oversight of the Judges and approved by the Commission, not the competition council. It notes that the Straw Proposal assumes the competition council would perform its reviews on a statewide basis, which may not be adequate given the differences among the utility territories and across the state. It adds that the Straw Proposal appears to assume that the preconditions could be met in orderly 12-month segments, which may not be the case. Further, the schedule set forth in the Straw Proposal does not appear to take into consideration potential statutory impediments. RG&E believes it quite unlikely that the preconditions set forth in the Straw Proposal will be met at the same time for both electricity and natural gas, at the same time upstate as downstate, at the same time in all service territories, and at the same time for all classes of customers.

r Until such time as the criteria have been met within a utility territory for a customer class, a date certain for the utility to exit should not be established.

r RG&E identifies a number of questions that might be relevant to determining whether the precondition of workable competitive wholesale markets has been met. For example, it asks whether the condition should be based on

the number of buyers and sellers participating; whether there is a tight range of asking and bidding prices; whether a standard tradable forward contract exists; whether there is firm capacity available from liquid trading points to the utility; whether prices are low and consistent across the state; whether the Commission would be willing to place all remaining utility customers on unhedged wholesale rates; whether the wholesale market is functioning efficiently and in the absence of the exercise of market power; and whether prices generally available in the market are lower than the utility's prices.

r RG&E warns that utilities should not exit the merchant business without some increased clarity concerning the responsibility for ensuring that the state has adequate dedicated pipeline capacity, electric transmission capacity, and electric generation capacity. It argues that there is so little incentive for anyone to bear the costs of maintaining reliability in the system that reliability cannot and should not be left solely to market forces because those forces will not maintain reliability at acceptable levels. It also notes the need to maintain fuel diversity and to determine where the responsibility for maintaining that diversity should lie.

r Regarding the precondition that ESCOs are collectively able and willing to provide service, RG&E argues that the keys to meeting this precondition are longevity, turnover, financial soundness, and redundancy. In its view, this precondition is designed to insure that transferring customers to an ESCO will not lead to a degradation in service, that there is sufficient ESCO capacity to ensure that the largest providers will still leave the market with sufficient choice for customers, and that the loss of the utility in the retail market would not lead to an increase in retail prices or a decrease in service quality. RG&E also notes that utilities may need to be able to demonstrate their ability to support ESCOs. It further argues that even the commitment of numerous ESCOs to enter the market is far from a guarantee of adequate service at a reasonable price.

r Regarding the POLR service, RG&E argues that if the POLR is going to closely resemble a regulated utility, the POLR should remain the regulated utility. If the POLR has rates that are regulated, an obligation to serve like that of a utility, minimum service mandates much like those of a utility, and a requirement to offer statutory protections

much like a utility, then the exit of the utility from the market will have served very little purpose.

- r RG&E argues that a phased exit by the utilities on a customer-class basis will help in achieving the precondition that all customers have an acceptable source of service.
  
- r Regarding the condition that there be widespread customer acceptance of energy market restructuring, RG&E notes that this condition will not be fulfilled until competitive product and service packages are consistently attractive. While RG&E agrees with the findings of the customer survey that most today would not want the utility eliminated as a choice, it argues that actual customer experience with attractive product offerings, positive customer service from competitive vendors, favorable word-of-mouth recommendations from other customers, and other similar factors may result in much greater acceptance of the restructured energy market. It suggests that customer acceptance should be measured in part by the fraction of customers that have switched to ESCOs, by relatively few customers returning to the utility, and by the absence of customer concerns that they will be treated poorly if assigned to an energy service provider. It notes that the arguments raised by some suggest that ESCOs may not be offering alternatives in the near term that will be sufficiently attractive to create the sort of positive customer experiences that would lead to a more broad-based acceptance of the restructured markets. In the absence of such offers, it implies, the utilities should not be required to completely exit the market. RG&E opposes the implied suggestion in the Straw Proposal that ESCOs and marketers receive the names of customers who expressed an interest in migrating from the local utility. The company argues that a customer should not receive a solicitation just because it asks the utility about retail access.
  
- r RG&E argues that public acceptance of restructuring will not be achieved by either raising utility rates or recovering utility costs in the commodity charge. In its view, subsidizing the migration of customers either by raising utility rates or by providing other credits is nothing more than a shell game, and customer savings based on such efforts are illusory in the long run. It also opposes collecting stranded costs in commodity rates, agreeing with CPB that customers remaining with the utility will see this as punishment for their choice.

- r RG&E argues that requiring utility customers to be involuntarily transferred should be a last resort and should not be used for any substantial fraction of utility customers. It also notes that utilities with performance measures that could be affected by such involuntary transfers should be provided waivers.
- r A utility's exit from a market, in RG&E's view, should be a final step taken only when a relatively small number of customers remain with the utility. It opposes the view that utility exit should be a market-making step taken when most customers still remain with the utility. It says states that such a sudden and large market share transfer of customers to energy service providers increases the risk that the infrastructure of the companies to which the customers are transferred will prove inadequate, that errors will be made in the transfer process, and that the quality of service they will receive after transition will be poor.
- r Regarding the possible need to modify state law, RG&E notes that it is impossible to predict with any certainty how long such an effort would take and that the outcome can not be controlled by the parties to this proceeding.

### III. Market Transition

- r RG&E urges that commodity pricing issues, including the level of hedging, rate design, the evolution of the commodity rate over time, and its relationship to the back-out rate are all matters that should be left to individual utility cases to resolve, taking into account local concerns and issues as well as the utilities retail access programs.
- r RG&E argues that the cost of maintaining the utility interface with ESCOs, including the costs of achieving some degree of uniformity, should be fully recoverable in utility rates.
- r RG&E believes the proposed competition council should not be given responsibilities for outreach and education nor should it be given funding, a budget, or budgetary responsibilities. It argues that if the responsibilities of the council are narrowly defined and the criteria it is to apply in evaluating whether the preconditions are met are developed in a separate track of this proceeding, the council will probably be manageable.

r With regard to the proposals on aggregation, RG&E warns that New York should not lose sight of the importance of insuring that aggregators be held accountable for their actions and commitments. It argues that if some or all of the contracts and liability are between the customer or the ESCO or the utility and the aggregator, then the aggregator is a de facto energy service provider (ESCO), which may be outsourcing most of its operations to another firm but which should nevertheless remain responsible for the service provided to the customer. Under these circumstances, RG&E argues, the aggregator should be considered an ESCO. Alternatively, if the contracts and liability are entirely among the customer, the utility and the ESCO with the aggregator having no responsibility for the nature, quality or price of service, then the aggregator should not be held to the same standards as an ESCO.

#### IV. Public Benefit Programs

r RG&E opposes the proposal that the public benefit programs council be included as part of the responsibility of the competition council. The company suggests that the competition council would not have the expertise to deal with the low-income programs.

r If a public benefit programs council is instituted, RG&E argues that it should be only an advisory body with a scope limited to low-income programs and market-based solutions for serving low-income customers. The focus of such a group should not be on traditional programs, but on ways to accommodate low-income customers to competitive markets and competitive marketers to low-income customers.

r RG&E opposes standardized low-income and other public benefit programs on a statewide basis, claiming that insufficient evidence has been brought forth in this case to justify such standardizations.

#### VI. Conclusion

- RG&E stresses that the charge to all parties in this process is to make it worthwhile for customers. It contends that the greatest chance of achieving those benefits is through the adoption of the single retailer and Model 3 end-state. It acknowledges that it will ultimately be desirable for

utilities to cease providing certain functions and selling certain products and services but stresses that it would be unwise at best to set a date by which such an exit would occur.

## **STAFF OF THE DEPARTMENT OF PUBLIC SERVICE**

### **I. Process**

- Staff says the proceeding benefited from an apparently unique approach in the history of the Commission's generic proceedings. It notes that the scope, orientation, public interest implications and large number of parties presented unprecedented challenges. While it initially was skeptical, it believes the process was ultimately able to capture the complex diversity of interests and views of the numerous parties.
- Staff states ". . . the development and evolution of the Straw Proposals based upon the hard work of the parties and committees and working groups and also upon discussions between and among the parties, suggests a successful collaborative process that exceeded all reasonable expectations."
- Staff offers the following observations about process:
  - The press of deadlines forced parties to work together.
  - The separation of policy and legal issues greatly facilitated development of the policy issues; the presiding officers offered dispute resolution assistance as required.
  - The team leader approach and the committees were effective.
  - The participation of the presiding officers effectively limited positional posturing to a very few parties.
  - The development of Straw Proposals provided Staff the opportunity to gain significant insight about the parties' interests and concerns.

- The participation of the presiding officers was appropriately limited, thereby providing parties the flexibility to solve challenges themselves as they arose.
- The success of the effort is demonstrated by the range of issues covered, the depth of analysis in the Phase I and Phase II report, and the significant support among the parties for Straw Proposal 2.

r "The breadth and depth of thought devoted to these issues [in the parties' initial briefs] suggests to Staff that regardless of the proceeding's outcome, this proceeding should be viewed as a success . . . we do not view the absence of consensus as a failure."

r Staff disagrees with those parties who argued that the process was flawed because legal issues were not addressed and resolved at the outset. According to Staff, the separation of policy and legal issues facilitated the development of many policy areas, which ultimately enabled the development of Straw Proposal 2.

r Staff further notes that many aspects of the restructuring can be implemented without any changes to the legal structure and that waiting until all legal uncertainties are resolved is not necessary to develop improvements to the Commission's restructuring initiatives.

r Staff disputes the assertion that the Straw Proposals could have been created much earlier in the proceeding. It disputes as well KeySpan's objection to the meetings with various interest groups, contending they were essential to successfully capturing in the Straw Proposal the various parties' interests.

r Staff regards achieving full consensus an unrealistic goal, given the complex issues and widely diverse interests in this proceeding. Staff suggests that a similar process may have application in other Commission proceedings, and it believes the opportunities presented here might never have been presented under traditional litigation or some other form of a collaborative proceeding.

r Staff agrees with KeySpan that the Commission should consider developing ground rules and procedures for collaborative efforts but cautions that the results should not be overly restrictive and should preserve flexibility. Staff suggests the development of such guidelines and

principles could create new process opportunities; clarify expectations of the parties; facilitate the evolution of proceedings toward greater use of cooperation and participation based processes; and legitimate a new type of regulatory forum that promotes institutional learning and the evolution of party interests.

## II. Vision

- Staff asserts that competitive markets should be relied upon to provide all products and services with respect to which they can result in additional choices and additional value for customers consistent with the continued provision of safe and adequate service at just and reasonable rates.
- Staff supports the adoption of a generalized standard for the Commission's vision of future energy markets. Although the development of the models within the case greatly facilitated discussion and analysis, Staff does not favor choosing a specific end-state, preferring to allow markets to develop without artificial constraints or dictates.
- Staff generally supports the adoption for the electric industry of the gas policy statement, noting that without the separation of the monopoly delivery function from the competitive commodity function, utilities would likely remain dominant providers. It cites as support for this view the experience in the telephone industry.
- Staff also argues that removing the utilities from the provision of energy commodity would level the playing field between the utilities and competitive suppliers. It notes that the federal policy resulting in the interstate pipelines exiting the commodity business is consistent with the approach recommended here.
- Staff recommends that regulated entities cease offering competitive services but only if several preconditions are first met. It believes that having regulated and unregulated participants providing the same functions in the market will create fundamental problems including price regulation of services offered by regulated companies in competitive fields; the advantages related to the utilities' position as dominant providers; and potential cross-subsidy issues between the rates established for regulated bottleneck services and services and related but competitively available services. Staff sees precedent in the Commission's removal of the

regulated utilities from the competitive appliance repair business.

- Staff lists the following preconditions to be met before utilities exit the commodity function:
  - Workably competitive wholesale markets must exist.
  - ESCOs and marketers must be collectively able and willing to serve the entire market; all customers requiring service must be able to obtain it.
  - There is widespread public acceptance of the competitive energy market.
  - Statutory issues regarding obligation to serve and consumer protections are resolved.
- Staff recommends the establishment of a Competition Multi-Stakeholder Competition Council to monitor the status of market development and to report to the Commission when the criteria have been met. Staff makes this proposal in part to continue the collaborative efforts of the parties in this case, believing that such an approach will be more likely to result in meeting the interests of all parties.
- Staff sets forth a detailed schedule under which utilities would be expected to exit the commodity business within 48 months of the Commission's order in this proceeding, depending on market developments and potentially varying by customer class and region. Staff notes there is a appreciable uncertainty at this time and urges that movement be slow in conjunction with monitoring market development.
- With regard to the obligation to serve and the potential adoption of the telephone market model (where all competitors would have an obligation to serve), Staff notes two contradictory approaches: imposing the obligation to serve on some but not all, and imposing the obligation on all. It argues that imposing such an obligation on gas marketers might not be feasible because of pipeline capacity issues and points out numerous alternatives to these two extreme positions. It believes more time and experience is required before a decision on these issues can be reached.
- Regarding consumer protections, Staff urges that the parties develop, in a collaborative setting, standardized rules to be applied to all market participants.

- r Staff believes that all functions that can be provided competitively should be so provided.
- r Objecting to NYSEG's claim that customers should not be denied the right to choose the utility as a supplier, Staff notes that the Commission has already addressed this issue in the gas policy statement.
- r Staff indicates that the preconditions identified in the Straw Proposal would not in fact force customers to switch.
- r In response to arguments that the benefit of bringing retail competition to energy markets has not been proven, Staff points to information contained in the Phase I/Phase II report and attaches a graph indicating significant benefits to deregulation in the airline, trucking, railroad, and long distance telephone markets. It also cites studies finding that natural gas pipeline capacity has been more effectively utilized since the interstate pipelines were deregulated.
- r In reply to those who prefer keeping the utilities in both regulated and unregulated markets, Staff notes that such circumstances create fundamental problems. It disputes the assertion that any regulated utility has a legitimate business interest in the competitive commodity markets, noting that utilities make no profit on retail sales commodity. Staff also notes that each of the regulated utilities has been permitted to create an unregulated affiliate (using the same corporate name) in order to compete in the commodity business. Staff adds that the Commission has previously ended the regulated utilities' ability to participate in the competitive market for gas appliance repair.
- r In response to the observation that the public involvement study showed a majority of customers today want the utility as an available option, Staff notes that a precondition to removing utilities as set forth in Straw Proposal 2 is that there be widespread public acceptance of restructuring. Staff notes both the market and the public perception of it will likely change significantly over time.
- r While Staff believes that progress has been made on POLR issues, it nevertheless acknowledges that more work needs to be done, especially on the issue of obligation to serve.
- r Regarding the Straw Proposals' competition council, Staff notes that the Department would coordinate the council and

that the council would provide the parties with meaningful opportunities to have more input into forming Commission outcomes.

- r Arguing that the obligation to serve should be viewed as the combination of obligations to deliver and obligations to supply, Staff expresses its continuing concern that imposing the obligation to supply on all ESCOs would discourage them from entering or remaining in New York in the absence of sizeable forced migration programs. Staff notes that all but one of the utilities nevertheless supports imposing the obligation to serve on all ESCOs.
- r Staff notes that auctions may be necessary even if all ESCOs have an obligation to serve, because there may be no ESCO operating in a particular geographic area or serving a particular service class. Staff further asserts that if all commodity providers had the obligation to supply, department resources would have to be devoted to reviewing the tariffs Staff assumes they would be required to file.
- r Staff suggests that if only some ESCOs were POLRs, two markets would develop, one including and one not including the obligation to serve, and it notes that these markets would have significantly different costs. Staff says it is not clear whether there would be any interrelationship between the markets and questions whether a vibrant market with some having an obligation to serve would encourage the development of a vibrant non-obligation market or visa versa. Staff also wonders what the impact on each of these markets would be if a POLR ESCO were to commit significant resources to fulfilling its winning bid and then lost the bid in the next cycle.
- r In response to the question of whether it is an efficient use of resources to replace the incumbent regulated utility with a rotating regulated designated POLR, Staff argues that while the POLR would be subject to some of the same elements of regulation as a utility, it would be a competitive endeavor rather than a regulated monopoly. Staff acknowledges that a number of important issues have been raised in this area that need further study before any final conclusions can be reached.

### III. Market Transition

- In Staff's view, the migration of energy customers to competitors should occur on a voluntary basis and such

migration should not be forced. Staff urges the removal of all regulatory barriers to the development of competition in order to provide appropriate incentives to all customers to switch suppliers.

- During the transition period Staff urges that the following actions be taken:
  - Appropriate utility price signals should be developed through unbundling.
  - Ideally utilities should flow through spot market prices, but the immaturity of the wholesale market suggests that utilities should continue to offer protection from price volatility. Staff notes that utilities offering solely fixed price service could impede the ability of ESCOs to compete and could impede the development of fully workable markets. However, Staff strongly endorses the expansion of spot market pricing for large-volume electric customers as an essential ingredient for the development of competitive markets, with such treatment extended to smaller volume customers as markets become more competitive. Staff endorses the adoption of the gas purchasing practices policy statement.
  - Staff generally supports the adoption of requiring hedging, at least for residential and small commercial customers. It notes that if the incumbent utilities offer fully hedged, long-term, fixed priced options, then marketers and ESCOs will undoubtedly be unsuccessful in signing up new customers, effectively slowing down the development of competitive markets.
  - Efforts be made to improve and implement various programs critical to the development of the markets (such as UBP, EDI, billing and metering).
  - Aggregation programs should be encouraged and pursued by all interests.
  - Other avenues to promote voluntary migration should be considered.
  - Utilities should treat ESCOs as allies rather than competitors.

- Continuing customer education is vital for the promotion of vibrant competitive markets.
- ESCOs have an obligation to provide value to customers in transforming the market and are expected to develop new offerings for customers to help the retail market develop.

r Staff supports moving to Model 2 as quickly as practical, but does not support setting a date certain. Asserting that a working schedule is helpful, Staff says its approach strikes an appropriate balance between the need to set a destination and the need to ensure a smooth ride.

r Staff argues that proposals to establish a date certain by which the utility would exit the commodity business suggest mandatory migration, which Staff opposes under present circumstances. It also opposes suggestions that migration be paid for in utility rates, preferring market-based rather than artificial inducements.

r Staff believes that programs that promote migration voluntarily should be pursued vigorously.

r Regarding the claim that the law needs to be changed before action may be taken, Staff notes that migration has already occurred and will continue to occur. It believes the legal impediment to requiring the utilities to exit the commodity business concerns only the final step in arriving at the end-state.

r Staff believes that the need for consumer protections may be greater in transitional markets and that further collaborative efforts are needed to develop the rules that would be required both during the transition and in the end-state.

r Staff believes that the power of customer choice will act to ensure basic market fairness, in contrast to the monopoly environment, where customers must rely on the Commission's rules to provide market safeguards.

r Staff disagrees with MI's suggestion that ESCOs be prohibited from marking up or otherwise making a profit on regulated delivery services. Staff believes that market forces should preclude excessive profits on the resale of delivery services.

- r Noting, contrary to CPB's suggestion, that Staff in fact does investigate and resolve some customer complaints against ESCOs, Staff nevertheless agrees with CPB that all complaints against ESCOs should be handled by a single state agency at least during the transition phase.
  
- r Staff likewise supports the CPB's request that information on both complaints against ESCOs and price comparisons be made more readily available to consumers in order to facilitate market transition. Regarding ratemaking and the use of hedges, Staff believes the continued availability of long-term hedged utility commodity supplies for large customers will deter the development of more robust wholesale and retail competitive markets. It also notes that smaller-use electricity customers tend to have fewer competitive options and will continue to rely more exclusively on the utility to provide reasonably stable electricity pricing, particularly in the near term.
  
- r Staff reiterates its support for the principle of hedging in the near term to mitigate price volatility, particularly in the immature electric market. Staff agrees with the DYNEGY proposal to amend the definitions of ESCO and marketer.
  
- r Staff disagrees with CPB's proposal that all aggregators be registered, pointing out that aggregators will neither take possession of commodity nor bill customers.

#### IV. Public Benefit Programs

- Staff believes that meaningful and comprehensive low-income programs are critical and supports examining the use of NYPA residential hydropower benefits as a source of inexpensive power for a lifeline rate. Staff also supports removing NYPA hydropower from general rate calculations to eliminate distortions to market price signals.
  
- While supporting surcharges on bottleneck functions (for example the SBC) during the transition period, Staff generally believes that such programs should ideally be funded in a more broad based manner.
  
- In Staff's view, the following components should be considered as part of a coordinated statewide low-income program:
  - Targeted energy efficiency and weatherization.

- Energy education and budget counseling programs.
  - Forgiveness of arrears linked to improved payment behavior.
  - A "lifeline discounted rate".
  - Market-based solutions for low-income customers.
  - Market-based solutions such as aggregation programs that will allow low-income customers to receive the benefits of competitive markets.
- Staff says it may be possible to expand the membership of NYSERDA's current advisory group and supports the initiation of a process to address low-income issues in a coordinated manner. It suggests that such a process should include NYSERDA, DPS, Office of Temporary and Disability Assistance, Division of Housing Community Renewal, and the several utilities that offer low-income programs.

r As long as utilities maintain a retail relationship with customers, Staff believes they will have an integral role to play in the implementation of low-income programs. Staff further notes that market-based solutions should be developed to address the long-term needs of these customers.

r Noting that the needs of low-income customers programs have been addressed only in general terms, Staff believes those needs, the types of programs that should address them, and the sources of funding for those programs should be continually reassessed. Staff urges that the public benefits council begin now to develop statewide standards for the components for meaningful low-income programs to guide their implementation in all service territories.

r Staff notes that the production of NYPA hydropower is from facilities owned and operated by an authority of the New York State and, as such, the benefits derive from broad-based public funding. Staff agrees with PULP that removing hydropower from general rates would relieve market distortions and that the reallocation of these benefits to low-income programs would eliminate the need to fund those programs through delivery rates. Any further consideration of this proposal, however, must include an analysis of the impact on other residential customers. Noting that the primary purpose of all low-income programs is to reduce the

energy burden faced by low-income households, Staff maintains that a lifeline discount should remain among the components to be considered.

r Staff joins in NYSERDA's recommendation that a public benefit council be created to facilitate the coordination of low-income programs and to ensure consistency of low-income services throughout the state. Staff also agrees with the list of entities suggested by NYSERDA for such a council. In the alternative, Staff suggests that a legislative mandate for such an organization could be sought. With regard to the recommendation that the SBC be applied to a natural gas, Staff supports the status quo "because these programs (SBC) are broader than R&D, the primary focus for gas."

#### V. Public Input and Outreach

- Although the primary research undertaken did not provide answers to every outstanding question and issue, Staff believes it added statistically valid depth to the information on the major issues that had otherwise been gathered.
- Staff characterizes the public input in this case as "extensive and wide reaching" and urges that the information be used by the Commission in its decision-making process. It recognizes however, that the survey results have limitations such as their recording only one moment in time. Staff recommends that further public input be sought before a final Commission decision in this case is issued, an effort that should be designed and executed collaboratively by the public involvement and input committee.

r Responding to the claim that the public input research did not include large customers, Staff notes that large customers have actively participated in the proceeding through Multiple Intervenors and that there was therefore no need to perform any special outreach.

r Staff characterizes the complaints raised by Niagara Mohawk and KeySpan as unwarranted criticism. Staff notes that the process, while not perfect, was open to all parties and that all parties had a number of opportunities to provide their input.

r Staff denies it ignored the findings of the research, noting that a critical component of the listed preconditions is public acceptance of restructuring.

**TEXAS EASTERN TRANSMISSION CORPORATION**

I. Process

- Texas Eastern believes it critically important that the results of this proceeding be coordinated with other ongoing matters before the Commission, especially the gas restructuring cases. Its primary concern in fostering retail competition is the maintenance of reliability and safety.

II. Vision

- Texas Eastern supports the effort to identify a POLR entity but emphasizes the need to select a POLR entity that can demonstrate long term contractual commitments for firm interstate pipeline capacity to meet the requisite obligation to serve. It also notes the importance of demonstrable creditworthiness.
- With regard to the gas POLR, Texas Eastern believes the local utility or other entity charged with regional load growth should continue to hold capacity on a permanent basis.
- Texas Eastern believes it is critical for the POLR to possess long-term contractual commitments for firm upstream pipeline capacity and that any standard less stringent would seriously compromise system reliability.
- Noting the volatility of the short term gas market and the growth of gas-fired merchant generation in the Northeast, Texas Eastern believes it critical that POLR entities sign up additional capacity to meet projected growth. It notes that market participants must be assured of cost recovery for these increased commitments.

r Texas Eastern opposes an approach that would force local utilities out of the POLR or other competitive functions.

r The Commission's approach to the end-state should be one that encourages ESCOs and marketers to make long-term capacity planning decisions, including contracting for capacity to meet peak demand requirements, with a meaningful degree of certainty. It recommends that the LDCs continue to dedicate long-term firm pipeline capacity into the New York market by contract.

- r Texas Eastern asserts that the POLR entity must have long-term contractual relationships for firm upstream capacity or have other meaningful access to contractual rights for that capacity.
- r With regard to rate incentives mentioned by KeySpan, Texas Eastern cautions that any such incentives should not include incentives for utilities to relinquish upstream pipeline capacity.
- r Texas Eastern says its own position is consistent with KeySpan's recommendation that capacity planning and procurement continue to be done by utilities as long as the utilities are responsible for maintaining the integrity and reliability of the distribution system.
- r Texas Eastern urges the Commission to resist setting hard and fast artificial timelines without examining the state of the market and the potentially profound effect on reliability of service that such timelines might create.

#### IV. Public Benefit Programs

- Texas Eastern believes that a basic level of reasonably affordable service must be maintained for low-income customers.

#### V. Public Input and Outreach

- Texas Eastern believes the information provided in this section of the report will be beneficial in arriving at ultimate policy decisions.

**UTILITY WORKERS UNION OF AMERICA, AFL-CIO LOCALS 1-2 AND  
INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS, LOCAL 97 (THE  
UNIONS)<sup>1</sup>**

I. Process

r The unions urge that any competition council should have as broad a representation as possible to ensure that no interest group is excluded.

II. Vision

r The unions express concern regarding the significantly divergent views of the parties regarding end-state visions and the fact that substantial obstacles must be overcome and details filled in order to successfully implement any model.

r It is clear that no consensus on an end-state has been adopted, given the full spectrum of opinions from no model and no generalized standard to a preference for Model 3. The unions therefore recommend that the Commission work on eliminating great inefficiencies and obstacles to wheeling as well as other infrastructure details before it chooses a model.

r The unions express concern especially with regard to the existing transmission system, which they note, was originally created to efficiently serve franchise areas. They conclude that unless present infrastructure deficiencies, especially inadequate transmission between upstate and downstate, as well as the legal, political and public acceptance obstacles are resolved, the implementation of Model 2 or 3 is doomed to failure. They also note that premature implementation of those models would result in tremendous transfers of wealth from electric ratepayers to the generators and marketers.

r The unions believe that whether or not a customer switches should be left to the customer and not decided by a government agency that thinks it knows what is best for the customer. It accordingly opposes requiring utilities to exit markets that become competitive. It adds that it

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<sup>1</sup> The unions filed comments on the draft Phase I/Phase II reports and appendices on March 27, incorporating those comments as its initial brief.

seems highly inefficient for competing ESCOs to build an infrastructure to handle all retail functions for millions of customers while at the same time forcing the utilities to exit the retail function and potentially strand the present infrastructure.

r The unions contend that opening customer service call centers to competition will inevitably lead to providing these services outside of New York and likely outside of the United States, with a significant detrimental impact on the New York State economy and a devastating impact on represented labor.

r The unions conclude that Straw Proposal 2 should not be adopted and that significant adjustments of the underlying infrastructure in New York should precede any movement to Model 2 or Model 3.

r The unions support the adoption of Model 1 (status quo) with the utilities remaining in the commodity and retail business, a position warranted in particular by the anticipated difficulties in the wholesale markets in the United States in the next few years. It urges the adoption of a more generalized standard rather than a specific model for the end-state.

r The unions oppose the adoption of Model 3, noting that some products and services may better be provided in a regulated environment.

r The unions question how the PSC could designate a utility as an interim POLR, if a suitable bidder were not found, after the utility had already abandoned its infrastructure for providing such services.

r The unions support the adoption of the telephone market model, in which to all competitors in the energy markets would have the obligation to serve.

### III. Market Transition

r The unions recommend that the timing set forth in Straw Proposal 2 be flexible.

r The unions question whether the conventional wisdom that retail competition will be in the public interest remains correct. They cite to recent publications questioning this overall observation.

r The unions question whether competition is necessary for the development and commercialization of the various innovations set forth in the Phase I/Phase II report. In view of the experience to date, they wonder whether retail competition will lead to lower rather than higher prices. They doubt that improvements in consumer service can be expected, noting slamming, cramming and other complaints by telephone customers due to deregulation. Finally, the unions note that airline food clearly got worse after deregulation and that prices increased as well.

#### **WESTCHESTER COUNTY**

(Topical subdivisions are not provided because this brief did not follow the recommended format)

- Electric deregulation has not produced the results expected, and it is too early to relieve the utilities of their role as provider of last resort.
- Citing PSC Staff, Westchester argues that there will not be workable wholesale energy markets in New York City for at least 4 years.
- Utilities should not be forced out of the market until there is true competition, which will require the construction of new generation facilities and new distribution infrastructure.
- Under the current approach, ratepayers are often paying for ESCOs to enter the market. Such subsidies or other market forcing actions should not be taken without demonstrable proof that the ratepayers are also benefiting.
- "The wholesale market must develop and additional capacity must be developed before we remove the protections of the utility safety-net." One of the consequences of not proceeding cautiously is the potential creation of a backlash against competition.
- Consumer protections must be guaranteed; HEFPA standards must remain; and HEFPA does or should apply to all ESCOs.
- A fully functioning and vibrant competitive wholesale market must exist before utilities cease selling energy commodity.