STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission to Review Policies and Practices Intended to Foster the Development of Competitive Retail Energy Markets.	Case 07-M-0458

INITIAL COMMENTS OF THE

NEW YORK STATE CONSUMER PROTECTION BOARD

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By Order and Notice issued April 24, 2007, the Public Service Commission ("PSC" or "Commission") encouraged interested parties "to examine and submit comments on the existing programs and practices of the utilities to promote retail market development."[1] This inquiry is timely and necessary, and the Consumer Protection Board ("CPB") commends the PSC for initiating it.

Over several years, the CPB has grown increasingly concerned that policies and programs initially implemented for the purpose of promoting the development of a regulatory environment in which competitive suppliers of energy commodities could operate profitably, have outlived their usefulness or even become counterproductive. After more than a decade, ratepayer funding of these programs has not declined appreciably despite evidence that consumers are well aware of their competitive options and multiple suppliers are ready and willing to serve them in nearly every service territory. Some programs appear to have become embedded in the business plans of energy service companies ("ESCOs"), to the detriment of marketplace innovation. The PSC's decision to review these policies and programs now is prudent.

[1] Case 07-M-0458, Proceeding on Motion of the Commission to Review Policies and Practices Intended to Foster the Development of Competitive Retail Energy Markets, "Order on Review of Retail Access Policies and Notice Soliciting Comments," April 24, 2007 ("Order"), p. 7.

By almost any standard, New York's efforts to create the conditions for ESCOs to enter the market and provide retail services to energy consumers have generally been successful. As the PSC points out in its Order, there are over 100 such companies now operating in the State and the load they serve is approaching half of the statewide total. Continued ratepayer subsidization of ESCOs, however, is not in the public interest. Nor are regulatory policies which deny customers protections from volatile prices, ostensibly to protect ESCOs.

In Part I, we recommend that certain existing programs to promote or subsidize retail competition be terminated immediately. These include the migration incentive payments incorporated in the current Consolidated Edison electric rate plan, and, with one exception, the various outreach and education ("O&E") efforts that are aimed at promoting retail competition. However, utilities should inform current and prospective customers of the availability of energy commodities from ESCOs as part of their normal outreach and education efforts.

In Part II, we discuss utility programs aimed at promoting retail access that should be modified immediately, but continued. We conclude that ESCO referral and purchase of receivables ("POR") programs should continue, although the costs of designing, implementing and administering these programs should be recovered solely from ESCOs. We also explain that unbundling utility rates to accurately reflect the full cost of utility-provided commodity service is necessary and should continue in order to present accurate price signals to consumers. It is not, however, in the best interests of consumers to shift costs from migrating customers to the general body of ratepayers. The Commission should carefully

reexamine utility merchant function charges and lost revenue recovery mechanisms to ensure that they are properly cost-based.

Finally, in Part III, we explain that although retail energy markets are generally expanding in New York, in some regions, and for some customers, they cannot be considered competitive. We urge the PSC to monitor retail energy markets for residential and small business customers, and to tailor its policies to reflect market realities. Where retail markets are not competitive, the PSC should authorize utilities to offer commodity services to mass market customers at fixed, regulated prices.

I. CERTAIN PROGRAMS TO PROMOTE RETAIL COMPETITION SHOULD BE TERMINATED IMMEDIATELY.

A. Migration Incentive Payments

In a few cases, the Commission has authorized ratepayer-funded incentive payments to utilities for achieving customer migration to ESCO-provided commodity service. Some of these programs have expired and were not renewed, at the CPB's request.[2] It is the CPB's understanding that the only

[2] E.g., Case 05-G-1494, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Orange and Rockland Utilities, Inc. for Gas Service, Order Establishing Rates and Terms of Three-year Rate Plan, October 20, 2006, p.23, wherein the Commission explained that the Joint Proposal adopted the CPB's recommendation to exclude a migration incentive despite proposals by the utility and DPS Staff; Case 06-G-1332, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulation of Consolidated Edison Company of New York, Inc. for Gas Service, Joint Proposal, June 1, 2007. That proposal excludes a migration incentive as recommended by the CPB, despite utility proposals to continue the incentive.

continuing migration incentive program is for Consolidated Edison's electric business.[3] That program should be eliminated promptly.

In general, incentives should be utilized only when it is in the ratepayers' interests to encourage utilities to undertake activities that they might otherwise consider to be inimical to shareholder interests. With few exceptions, that is not the case with commodity sales. Utilities earn no margin on such sales, and lose none when customers migrate to ESCOs.

Moreover, incentives should align utility interests with those of the customers who fund them. Providing incentive payments for customer migration does not necessarily achieve that objective. Indeed, rewarding a utility based on the number of customers that obtain commodity service from an ESCO, may actually give it a powerful incentive to make its own commodity service less palatable to consumers.

The CPB previously urged the Commission to remove the retail migration incentive in Con Edison's rate plan since it distracts the company from what should be its primary objective – providing safe and reliable service.[4] The PSC has not yet taken action on our request. We urge it do so immediately.

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3 Case 04-E-0572, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Electric Service, Order Adopting Three-Year Rate Plan, March 24, 2005, Joint Proposal, §F.5.

4 Case 06-E-0894, Proceeding on Motion of the Commission to Investigate the Electric Power Outages in Consolidated Edison Company of New York, Inc.'s Long Island City Electric Network, Initial Comments of the New York State Consumer Protection Board, March 2, 2007, pp. 22-26.

B. Promotional Outreach

National Grid reports that as of October 2006, 82% of its natural gas customers were aware that they had the ability to choose alternative commodity suppliers.[5] In the same time period, National Fuel Gas Distribution Company found that 84% of its residential and commercial customers were aware of retail choice.[6] A New York State Electric & Gas Corporation survey conducted in February 2007 produced similar results. NYSEG found that 81% of its electric customers were aware of retail choice.[7]

Both the magnitude and the similarity of these numbers strongly suggest that utility efforts to educate existing customers concerning their retail commodity options have been very successful, but have already reached a point of diminishing returns. Such "outreach and education" ("O&E") efforts -- including direct mail, television and radio advertising, bill inserts, and programs such as Market Match, and Market Expo -- have been funded almost entirely by consumers for over a decade. Spending additional ratepayer money to push these already very respectable numbers a few percentage points higher is completely unjustifiable.[8]

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5 Case 99-G-0336, Niagara Mohawk Power Company d/b/a National Grid, Gas Rates and Restructuring – Compliance Filing, January 22, 2007.

6 Case 07-G-0141, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of National Fuel Gas Distribution Corporation for Gas Service, Direct Testimony of NFG Witness Mr. Eric H. Meinl, January 29, 2007, p. 51.

7 Case 07-E-0479, New York State Electric & Gas Corporation's 2008 Supply Service, Exhibit___(NYSEG Panel-4), April 5, 2007, p. 10.

8 Consider that by 2004, the retail access awareness index for National Grid was already nearly at 80%, and increased by only 3.4% over the next two years. Case 99-G-0336, supra.

With the exception identified below, utility O&E expenditures regarding retail access, and for surveys, studies and reports concerning the state of customer awareness of retail competition, should be terminated immediately. Funds for these purposes under existing rate plans should be deferred for the benefit of ratepayers, subject to future Commission disposition. In addition, provisions in utility rate plans which reward the companies for increasing retail access awareness levels should be terminated.[9]

Utility efforts to inform customers of the availability of energy commodity service from ESCOs, however, should continue. Utilities should provide current and prospective customers clear, complete and unbiased information concerning their options for obtaining commodity service, to ensure that customers have an opportunity to make an informed decision. For example, utilities should include basic information regarding the availability of supply options in materials describing customer rights and responsibilities. Because utilities currently provide these general materials to customers, the incremental cost of including information on commodity options should be negligible.

II. CERTAIN PROGRAMS REGARDING RETAIL COMPETITION SHOULD BE MODIFIED, BUT CONTINUE.

A. ESCO Referral Programs

In December 2005, the Commission directed all utilities that had not yet done so, to establish ESCO referral programs under which customers contacting

[9] National Grid, for example, can earn up to a 50 basis point increase in the earnings sharing threshold for its gas business. Id. Similarly, the recently approved rate plan for Orange and Rockland's gas operations includes, over the CPB's objections, an incentive of 20 basis points each year, if residential customers' awareness of competition exceeds certain levels. Case 05-G-1494, supra, p. 14.

the utility would be informed of a defined discount for commodity service available from competitive suppliers and would be referred to a specific ESCO if they expressed an interest.[10] The generic model was based on a program for Orange and Rockland Utilities, Inc. that was reputedly very successful in promoting the migration of residential customers from utility service to ESCOs. Currently, referral programs with minor variations among service territories are in place throughout the State.

In general, the number of customers taking service from an ESCO continues to grow, but it is not clear that the growth can be ascribed to this, or any other, specific program. What is clear, however, is that if properly designed, the programs appear to do no harm. The CPB is unaware of any significant number of complaints about the operation of ESCO referral programs coming from either consumers or ESCOs. Consequently, there does not appear to be any compelling reason to end them.

What is necessary, however, is that all these programs be re-examined to assure that their costs are borne fully by the ESCO participants and are not being subsidized by ratepayers. We understand, for example, that in some cases, O&E funds collected in rates are used to promote the programs.[11] This practice should be discontinued. The Commission should promptly review all ESCO referral programs to ensure that all costs incurred by utilities for the design,

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[10] Case 05-M-0858, In the Matter of State-Wide Energy Services Company Referral Programs, Order Adopting Esco Referral Program Guidelines and Approving an Esco Referral Program Subject to Modifications, December 22, 2005.

[11] See, e.g., the program promotion proposals described in Case 05-M-0858, supra, Order Adopting Niagara Mohawk Power Corporation's Plan for an ESCO Referral Program, April 19, 2006, p. 5.

implementation and administration of the programs are recovered in fees charged to the ESCOs.

B. Purchase of Receivables

All of the major utilities in New York now have programs in place under which they purchase the accounts receivable of ESCOs that use the utility's consolidated billing service. The receivables are purchased at a defined discount off their face value which is intended to compensate the utilities for the collection risks they are assuming, and for the costs of implementation and administration of the POR programs. Properly designed, the programs eliminate payment risk for the ESCOs without causing the utilities to incur any incremental cost.

POR programs may also benefit consumers. ESCOs who participate in the programs have no incentive to "cherry pick" utility customers. They cannot reduce the discount rate by choosing only the most creditworthy customers, and they suffer no penalty by signing higher risk accounts. As a result, ESCOs are free to advertise broadly and to provide service to all customers interested in their offerings. Ultimately, this helps assure that all consumers who wish to do so have the opportunity to acquire services from competitive energy commodity suppliers.

Because POR programs provide security for ESCOs, which in turn promotes the availability of a wider range of commodity choices for consumers, the CPB supports the continuation of these initiatives, provided they are fully funded through the discount rate. The PSC should immediately review all POR

programs, and modify them as necessary, to ensure that this objective is achieved.

C. Unbundled Rates

In order to present consumers with utility commodity prices suitable for comparison with the offerings of alternative providers, the Commission has directed utilities to clearly separate, or unbundle, costs associated with the provision of the commodity from those related to delivery service. This, in turn, has spawned a number of rate mechanisms aimed at ensuring that customers who switch to ESCOs do not continue to pay commodity-related costs that are avoided by the utility, and that the utility continues to be kept whole for any costs it cannot avoid.

The Merchant Function Charge, or MFC, is intended to reflect the cost incurred by a utility to provide a unit of commodity, beyond the cost of the commodity itself. Prior to the unbundling of rates, these costs were included in delivery rates, thereby overstating the cost of delivery service, or understating the cost of the commodity. Now, the MFC is stated separately and is not charged to customers who choose an ESCO for their energy supplies, assuring that those customers fully avoid the cost of utility commodity service.

In theory, the MFC charges avoided by migrating customers should be equal to the costs avoided by the utilities. In practice, however, costs included in the MFC may be greater than the savings realized, resulting in an undercollection of revenue. This difference is made up through lost revenue recovery

mechanisms (LRRMs) which are typically recovered from all customers through a non-bypassable charge.

The CPB has no concern with this overall scheme for unbundling commodity and delivery rates. However, the MFC must be properly cost-based, and reflect only relevant commodity-related costs that are actually incurred by the utility. We understand that in many cases, MFCs have been overstated, so as to create an artificial margin to encourage migration to ESCOs. Similarly, we are concerned that the costs to be recovered through LRRMs may be inflated, thereby shifting cost responsibility from migrating customers to the general body of consumers. The Commission should immediately review the MFCs and LRRMs for all utilities to ensure that they are properly cost-based, and modify them, if required.

III. THE COMMISSION MUST MONITOR RETAIL MARKETS FOR RESIDENTIAL AND SMALL BUSINESS CUSTOMERS AND TAILOR POLICIES TO MARKET REALITIES.

The April 2007 Order states that the retail energy marketplace for mass market customers "is established in New York and is continuing to expand."[12] Although generally true, the Commission does not give proper consideration in its Order to the fact that in several areas of the State, the retail energy market for small volume customers is not competitive. Commission policies which deny or limit the ability of residential and small business customers to obtain fixed price commodity service from the utility are not in the public interest where such services are not competitively available from ESCOs. We urge the PSC to

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[12] April 2007 Order, p. 5.

monitor the development of retail competition for mass-market customers, accurately measure the extent of such competition, and tailor policies in recognition of those facts.

For example, according to the most recent data on the PSC's webpage, as of March 2007, numerous ESCOs offer electricity to residential customers in the service territory of Central Hudson Gas & Electric Corporation. In fact, however, these companies serve a total of only 1% of customers. Such a "market" cannot be considered competitive. Residential customers in Central Hudson's service territory who seek to obtain electricity at a fixed price cannot be assured that an offer will be available at a just and reasonable price because none is available from the utility.

Similarly, the retail energy market for residential and small business customers in some areas of the State is highly concentrated and cannot be considered competitive. For example, the Herfindahl-Hirshmann Index ("HHI"), a standard measure of market concentration, for ESCOs serving residential customers in NYSEG's service territory exceeds 6000, based on data from March 2007, the most recent available to the CPB. The Department of Justice considers any market with an HHI greater than 1800 to be "highly concentrated." In reviewing proposed mergers, where the post-merger HHI exceeds 1800, DOJ presumes that mergers increasing the HHI by more than 100 points are "likely to create or enhance market power or facilitate its exercise."[13] According to the HHI and any other credible measure, the retail electricity market for residential

[13] U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines, Section 1.51 (issued April 12, 1992; Revised April 8, 1997).

customers in NYSEG's service territory is very highly concentrated and cannot be considered competitive.

The Commission must enhance its efforts to monitor the development of retail energy markets, particularly for residential and small business customers. Where markets are not competitive, even a decade after most barriers to competition have been removed, PSC action is required to protect consumers. In those circumstances at a minimum, the Commission should authorize utilities to offer commodity to mass-market customers at a fixed, regulated price.

CONCLUSION

The CPB requests that the Commission resolve the issues presented in the order initiating this proceeding in accordance with the comments presented herein.

Respectfully submitted,

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