NYSEG RG&E

July 27, 2007

VIA HAND DELIVERY

Mr. Raj Addepalli
Chief, Resource Policy and Planning
Office of Electricity and Environment
State of New York
Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

New York State
Dept. of Public Servi...

JUL 30 2007

Office of Electricity
and Environment

Re: Case 06-M-1017 – Proceeding on Motion of the Commission as to the Policies, Practices and Procedures for Utility Commodity Supply Service to Residential and Small Commercial and Industrial Customers

Dear Mr. Addepalli:

New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation (respectively, "NYSEG" and "RG&E," and collectively, the "Companies") are responding to the letter dated July 3, 2007 ("Letter"), from James T. Gallagher, Director – Office of Electricity and Environment, Department of Public Service ("Department"). As requested in the Department's Letter, the Companies are submitting these comments to you in order to facilitate collaborative discussions "for the purpose of developing standards for measuring price volatility, goals for limiting price volatility, and mechanisms for reporting, on a quarterly basis, utility supply portfolio price information in an aggregate form."[1] The Companies also are addressing the Letter's request for a description of their current portfolio management principles.

Companies' Current Hedging Practices

Both NYSEG and RG&E offer customers several supply service options that hedge risk to varying degrees. The Companies offer a fixed price commodity option ("FPO") for customers concerned about price volatility.[2] The goal of the FPO is to provide consumer protection through

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1 Case 06-M-1017, supra, Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II to Address Longer-Term Issues (issued April 19, 2007) ("April 2007 Order"), Ordering Clause 1.

2 On July 10, 2007, NYSEG, Department Staff, New York State Consumer Protection Board, Multiple Intervenors and eight other parties filed an unopposed Joint Proposal in Case 07-E-0479, Tariff Filing of New York State Electric & Gas Corporation to Offer Customers a Single Fixed Supply Service. The Joint Proposal, among other things, provides customers price stability and predictability associated with a three-year plan, responds to residential and small commercial/industrial customers' desire for a utility-offered

stable, market-based prices that eliminate price uncertainty. Another supply service option offered by the Companies, the variable price commodity option ("VPO"),[3] partially hedges risk depending upon the customer's load-ratio share of the Companies' legacy resources (i.e., utility-owned generation, including hydro; and non-utility generator, Nine Mile 2, Ginna and New York Power Authority purchased power contracts).

In addition, pursuant to the NYSEG Rate Order (at page 18),[4] NYSEG was instructed "to use its judgment, based upon its considerable experience," to manage its supply portfolio to balance the goals of price, supply, and rate stability for residential and small commercial customers (SC1, SC8, SC12, SC6 and SC9) taking service under the Default Service Option ("DSO"). Through its portfolio management practices, NYSEG has begun evaluating alternative hedging arrangements to replace the expiring legacy resources for its DSO customers to maintain a similar level of hedging that they historically received under the VPO. The cost of new hedges will be included in the calculation of the commodity price charged to DSO customers. NYSEG already separately reports its FPO hedges and DSO hedges to the Department pursuant to the NYSEG Rate Order.[5]

Companies' Hedging Practices on a Going-Forward Basis

Using the structured process proposed below, NYSEG will continue replacing certain expiring legacy resources with new hedges for DSO customers. In order to hedge on behalf of DSO customers, NYSEG will explore the range of available strategies, including extensions of physical bilateral contracts with generators, financial contracts to cover physical purchases and physical supply (such as resource acquisition). Moreover, NYSEG will continue to separately report its FPO hedges and DSO hedges to the Department, consistent with the NYSEG Rate Order, and to post daily VPO and DSO prices on its public website. In order to determine the impact of NYSEG's hedging on DSO customers (i.e., compared with the commodity rate for VPO customers), NYSEG would be willing to provide, in addition to the data already reported (e.g., the number of MWh for each hedging transaction), the average price for each quarter's hedging transactions.[6]

FPO and establishes a "Price-to-Compare" that simplifies comparisons between NYSEG supply services and supply services offered by energy services companies. The Joint Proposal is scheduled for hearing on July 31, 2007, and NYSEG is hopeful that the New York State Public Service Commission ("Commission") will consider the Joint Proposal at its August 22, 2007 session.

3 The VPO applies to NYSEG's larger non-residential customers and RG&E's residential and small commercial customers.

4 Case 05-E-1222, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corporation for Electric Service, Order Adopting Recommended Decision with Modifications (issued August 23, 2006) ("NYSEG Rate Order").

5 NYSEG Rate Order, Ordering Clause 6 ("NYSEG is directed to report to the Director of Regulatory Economics all commodity hedging transactions within two weeks after they are entered into and to identify whether they are transacted on behalf of default or fixed price customers."). NYSEG also posts on its public website daily VPO and DSO prices.

6 In order to protect and not divulge actual pricing information, NYSEG may need to request trade secret protection for certain pricing data. The Commission has recognized the importance of protecting market participant data: "Reporting requirements should ... mask[ ] the identity of the individual market participants." April 2007 Order, p. 28.

RG&E is already hedged within a reasonable range under its existing practices. Thus, RG&E is not proposing any changes to those practices at this time.

Companies' Proposal

The Commission has determined that the existing hedging practices used by the gas utilities are working well.[7] Consequently, the Companies propose establishing a structured electric hedging process based upon the existing hedging practices used by the gas utilities. As a starting point, the Companies offer the following framework for the structured electric hedging process. The Companies would hedge a predetermined percentage level of its load on a monthly basis for an agreed-upon duration. In order to begin implementing this proposal for months not yet hedged, the Companies at first would need to hedge above that predetermined percentage level. After that initial "catch up" phase, the Companies then would hedge, on a rolling 12-month basis, one-twelfth of its load for each of the upcoming twelve months. The level of hedges would be subject to the market standard block of approximately 50 MW.

One key factor in determining the duration of the hedging transactions is that the Companies' customers may switch rate options at any time. Consequently, the monthly costs and benefits of new hedges taken on behalf of DSO customers that later switch to another supply option need to be considered. The Commission concluded in the April 2007 Order (at page 22) that "[p]roper cost causation principles require that commodity costs like hedging be recovered through commodity charges imposed on the ratepayers that subscribe to the commodity service." Consistent with the Commission's conclusion, the Companies would spread these monthly costs and benefits over the billed kWh for remaining DSO customers. In the extreme case, the Companies may not have DSO load to spread the cost over. A process to address cost recovery needs to be established for that possibility.

The Companies look forward to discussing this proposal with participants of the upcoming collaborative process.

Closing Remarks

The Companies take this opportunity, prior to the commencement of the collaborative, to reinforce the following five important points about the impact of hedging on volatility:

1. Hedging will reduce price volatility but will not guarantee low prices. Although volatility can be fixed for a designated period of time, the resulting commodity price may be above or below the price that would have existed absent hedging.

2. Although the price volatility experienced by a customer will be reduced proportionately to the level of hedging, hedging will not guarantee a certain volatility level.

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7 April 2007 Order, pp. 2, 25.

3. Seeking to guarantee a level of volatility through hedging assumes that future volatility will be the same as historic volatility. Historic volatility, however, is not necessarily indicative of future volatility.

4. Although hedging will reduce price volatility, it will not necessarily reduce bill volatility, because a customer's load may vary month-to-month.

5. Applying strict quantification guidelines is not necessarily advisable because doing so may result in a commodity price that is higher than the price that would have existed absent hedging.

The Companies appreciate this opportunity to submit these comments in preparation for the upcoming collaborative process in this proceeding. Although the Companies have presented a proposal for establishing a structured electric hedging process, the Companies are receptive to considering other suggestions in the collaborative process that are consistent with the Commission's primary goal of providing customers "safe, adequate and reliable ... service at just and reasonable prices."[8]

Respectfully submitted,

Jeffrey M. Converse
Manager – Electric Supply

cc: James T. Gallagher

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8 Case 06-M-1017, supra, Order Instituting Proceeding and Notice Soliciting Comments (issued August 28, 2006), p. 1 (quoting a passage appearing on page 18, and adopted on page 20, of the Commission's Statement of Policy on Further Steps Towards Competition in Retail Energy Markets, issued August 25, 2004, in Case 00-M-0504) ("The provision of safe, adequate, and reliable gas and electric service at just and reasonable prices is the primary goal.").