



National Energy Marketers Association

STATE OF NEW YORK PUBLIC SERVICE COMMISSION

Proceeding on the Motion of the)
Commission Regarding Provider of) Case 00-M-0504
Last Resort Responsibilities, the Role)
of Utilities in Competitive Energy)
Markets, and Fostering the Development)
of Retail Competitive Opportunities -)
Unbundling Track)

COMMENTS OF THE NATIONAL ENERGY MARKETERS ASSOCIATION

The National Energy Marketers Association (NEM) hereby submits comments on Issues 2, 3, and 4 pursuant to the December 14, 2002, January 4, 2002, and January 16, 2002, Procedural Rulings issued by Judge Stockholm in the above-referenced proceeding.

As set forth in the Commission's March Order, Issue 2, is the, "methods for performing forward-looking incremental cost studies."¹ Issue 3 examines "the rate treatment that should be accorded stranded costs or competitive losses."² Issue 4 is an inquiry into, "the degree of statewide consistency in defining utility functions, assigning costs, and defining customer classifications (among other issues) that is necessary to promote the development of retail markets."³

In the first phase of this proceeding, the Commission ordered the utilities to perform streamlined embedded cost studies by March 15, 2002, and to file tariffs based on those studies thirty days later.⁴ The Commission recently denied the utilities' request for a stay and rehearing of this requirement.⁵ The Commission noted, "[a]s to the appropriateness of using ECOS studies as the basis for establishing competitive rates, it should suffice to observe that we have, on a number of occasions, found it appropriate to use embedded costs as the basis for

¹ Case 00-M-0504, Competitive Opportunities-Unbundling Track, Order Directing Expedited Consideration of Rate Unbundling, issued March 29, 2001, at page 2 [hereinafter March Order].

² Id.

³ Id.

⁴ Case 00-M-0504, Competitive Opportunities-Unbundling Track, Order Directing Filing of Embedded Cost Studies, issued November 9, 2001, at page 15 [hereinafter November Order].

⁵ Case 00-M-0504, Competitive Opportunities-Unbundling Track, Order on Rehearing Petitions and Motions, issued January 24, 2002, at page 13 [hereinafter January Order].

setting competitive rates.”⁶ NEM strongly supports the Commission's commitment to implementing embedded cost-based unbundled rates as expeditiously as possible.

The issues for review in this second phase of the proceeding are of equal importance in establishing a competitive retail market. NEM urges implementation of the following recommendations with respect to Issues 2, 3 and 4. In particular, NEM urges that streamlined and thereafter fully allocated embedded cost-based unbundled rates be implemented to, “provide utility price information to consumers to allow them to compare utility rates with competitive offers,”⁷ at the earliest possible time. Implementing unbundled rates or shopping credits based on less than the just and reasonable rates that consumers are currently being charged for products and services that are available from competitive sources is inherently unjust and unreasonable.

A. Issue 2 – Whether Incremental Cost Studies Should be Used

1. Incremental Costs Should Not be Used by a Monopoly to Price Competitive Services

The Commission recently addressed the issue of long-run incremental cost (LRIC) studies in its January Order. In denying the utilities request to delay the filing of embedded cost of service (ECOS) studies to coincide with the filing of LRIC studies, the Commission stated that,

Whether and how such cost studies will be used in this proceeding will be decided in accordance with the orders we have issued in this proceeding and following the procedures established by the Administrative Law Judge for the second phase of this unbundling track.⁸

Clearly, the threshold issue with respect to quantifying incremental costs (either long run, total or otherwise) is whether the resulting information will undermine the Commission’s stated intentions of “fostering retail market development,” and to “provide utility price information to consumers to allow them to compare utility rates with competitive offers.”⁹ NEM submits that quantification of incremental utility costs may be an interesting accounting exercise, however, the resulting information would undermine both market entry and price competition and be both speculative and misleading if used as a price to beat by ultimate consumers.

NEM urges that the Commission remain committed to its multiple Orders that utilities compute streamlined and then fully allocated embedded costs and that such costs be the basis of unbundled rates and/or shopping credits for consumers.

⁶ January Order at 6.

⁷ January Order at 6.

⁸ January Order at 5.

⁹ January Order at 6.

The Commission stated in the January Order that, "the unbundling of rates is being pursued to provide utility price information to customers to allow them to compare utility rates with competitive offers."¹⁰ The Commission also stated in the November 9 Order that its "primary goal is to provide price signals (i.e. unbundled rates) for contestable services."¹¹ NEM submits that the proper prices to beat for contestable services are those costs that the Commission has already determined to be just and reasonable, namely the utilities' embedded costs. Not only are embedded costs the basis for rates which customers currently and historically have been charged, but utility revenue requirements are established based on fully allocated embedded costs, and importantly, such costs have already been determined by the Commission to be "just and reasonable." Consumers deserve no less than "just and reasonable unbundled rates" based on the same embedded costs they currently pay in bundled rates for competitive, and potentially competitive products, services information and technologies.

Unbundled rates based on the same just and reasonable rates currently paid by consumers will also help to establish efficient competitive market prices for contestable services. As long as utilities collect marginal revenues based on embedded costs (that are presumably just and reasonable) than the most economically efficient, just and reasonable unbundled rates to pay a departing customer should be based on the same embedded costs. This will be true until the utility no longer offers such services and competition to provide these services at or below current utility prices permits a truly competitive price for these services to equalize at the point where marginal revenues paid for these services in fact equal the marginal costs to produce them by competitive non-regulated, non-subsidized vendors. As a result, marginal utility revenues received by adding a new customer will and should be exactly equal to the marginal utility costs of losing an existing customer while at the same time providing an unbundled price to beat that the Commission has already determined to be "just and reasonable."

By comparison, unbundled rates based on or guided by incremental costs (either long run, total or otherwise) will not accurately reflect the true prices that consumers actually pay for competitive services currently provided by utilities and will therefore undermine the Commission's expressed intention to "provide utility price information to consumers to allow them to compare utility rates with competitive offers."¹² Furthermore, the use of unbundled rates or shopping credits that are less than the just and reasonable bundled rates that consumers are currently paying for competitive services will, by definition, result in unbundled rates that are less than just and less than reasonable.

In addition, properly quantifying incremental costs (either long run or total) presents considerable problems. Quantification of either long run or total

¹⁰ January Order at 6.

¹¹ November 9 Order at 4.

¹² January Order at 6.

incremental costs will require extensive speculation or unsubstantiated conjecture pertaining to migration rates, the timing of the migration rates, the "best available technology" in the marketplace, and competitive cost of capital. Such speculation and conjecture is totally unnecessary if either streamlined or fully allocated embedded costs are provided to the consumer as the price to beat.

2. Inapplicability of TELRIC Methodology

The use of LRIC studies has been reviewed in the context of the telecommunications industry and unbundled network elements. NEM asserts that the rate-setting methodology adopted in the telecommunications industry is inapplicable to the current inquiry. In the telecommunications cases, the Commission was establishing rates for the sale of unbundled network elements to be purchased from incumbent local exchange carriers by competing telecommunications carriers. This examination was guided by federal statutes and regulations on the matter.¹³ The FCC promulgated rules setting forth how network elements should be priced under the Federal Telecommunications Act that adopted a total element long run incremental cost (TELRIC) approach.¹⁴ The Commission adopted this approach to price network elements.¹⁵

¹³ The Telecommunications Act of 1996 imposes on local exchange carriers the duty to provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of this section and section 252 of this title. An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service. 47 U.S.C. § 251 (d)(3).

The Act goes on to proscribe the method of determining rates for network elements as follows:

Determinations by a State commission of . . . the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section -

(A) shall be -

- (i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and
- (ii) nondiscriminatory, and

(B) may include a reasonable profit. 47 U.S.C. § 252 (d)(1).

¹⁴ 47 CFR § 51.505. Total Element Long-Run Incremental Costs are defined as, "the forward-looking cost over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element, calculated taking as a given the incumbent LEC's provision of other elements." 47 CFR 51.505 (b).

¹⁵ Cases 95-C-0657 et al., Wholesale Provisioning of Local Exchange Service by New York Telephone Company, Opinion 97-2, Opinion and Order Setting Rates for First Group of Network Elements, issued April 1, 1997, page 15 [hereinafter Opinion 97-2]. NEM notes that the Commission adopted the TELRIC approach without engaging in an analysis of the different costing methods. Rather the Commission decided that,

NEM asserts that the methodology adopted by the Commission for unbundling network elements in the telecommunications industry is not an appropriate manner to unbundle competitive products, services, information and technologies currently bundled in utility network sales that are available elsewhere from competitive vendors. As noted above, the Commission instituted the instant case to provide price signals to customers to facilitate choice for competitive products, services, information and technologies. By comparison, the telecommunications proceedings involved the pricing of network elements that were not available from competitive suppliers and were to be purchased by communications carriers, not end-use customers. Accordingly, the telecommunications inquiry focused on best available technology and efficiency concerns as relevant to the determination of prices that would permit competitive entry because the prices under development were to be charged for monopoly assets to competitors. By contrast, in the energy unbundling proceeding, the quantification of either LRAC or TELRIC are being proposed to be developed and used "to help guide the establishment of unbundled rates." In turn, it is proposed that these LRAC or TELRIC-based unbundled rates will operate as price signals for competitive services provided by monopolies, presumably at the same time that the same competitively available services are available in fully bundled rates and therefore fully allocated embedded cost-based rates to consumers who do not migrate for whatever reason. In essence, use of unbundled rates that are based on less than fully allocated embedded costs will permit utilities to under-price competitive services to consumers who wish to shop, and thereby permit utilities to compete as a regulated monopoly against companies that have no guaranteed revenue requirements or rates of return under state law.

In adopting the TELRIC methodology for the telecommunications industry, the Commission in Opinion 97-2 reasoned that, "prices based on embedded cost are apt to be inconsistent with prices determined by competitive markets."¹⁶ NEM asserts that this is the reason why the Commission's Orders requiring embedded cost-based unbundled rates are precisely what is needed to implement the competitive restructuring of energy markets in New York. One of the primary purposes of opening markets is to create downward pressure on prices arising from competitive forces. The use of embedded cost-based unbundled rates for customers to see and use to price competitively supplied products and services

"[o]ther than observing that prices based on embedded cost are apt to be inconsistent with prices determined by competitive markets, we need not evaluate the various costing methods on theoretical grounds, and we therefore decline to do so. The case was litigated on a TELRIC basis; all parties contemplate its being decided on that basis; TELRIC is certainly a reasonable approach to use, though just as certainly not the only one; and, as New York telephone recognizes, as a practical matter there is no alternative other than the very unattractive one of temporary rates while a lengthy new case is litigated."

Opinion 97-2 at page 15.

¹⁶ Opinion 97-2, page 15.

creates the maximum price competition with the maximum efficiency in the fastest practical time. Instituting unbundled rates based on anything other than the utilities' embedded costs under-prices utility services consumers have been historically charged and undermines the entry of truly competitive suppliers into the New York market.

B. If Utilities Charge Less than Embedded Costs for Competitive Services They Will Incur Stranded Costs.

1. Effect of Embedded Cost-Based Rates on Stranded Costs

NEM asserts that instituting rates based on less than the utilities' fully embedded costs will cause the utilities to incur much higher stranded costs. If utilities' unbundled rates for competitive services are less than fully allocated embedded costs, customers will be paying an artificially low, subsidized utility price for services that are competitively available. Additionally, if customers pay less than fully embedded costs to the utility for competitive services, the utility will incur stranded costs. Yet, if the utilities remaining customers do not pay for the services that the utility provides to them, the Commission has correctly noted that departing customers end up paying twice for these services.

Increasing stranded costs and recovering them from departing customers will not only punish migrating customers, thereby slowing migration and the development of functional retail markets, but it will also encourage utilities to continue to invest in competitive services thereby further increasing future stranded costs. In the end, Society will pay a far higher transition cost, the longer utilities remain in competitive lines of businesses. In contrast, “just and reasonable unbundled utility rates” based on fully embedded costs will allow utilities to both quantify and, if properly mitigated, recover stranded costs within a reasonable time frame without necessarily incurring and imposing new costs on departing customers. It will also provide customers and competitors with “just and reasonable” price signals that will permit meaningful price competition in the shortest possible time.

However, if incremental costs are developed and/or negotiated and parties speculate on all the variables that underlie the proper quantification of either long run or total incremental costs, NEM is seriously concerned that the resources necessary to properly compute and implement either streamlined or fully allocated “just and reasonable” embedded cost-based unbundled rates or shopping credits will be diminished. Moreover, use of any method of quantification that results in lower unbundled rates for competitive services than bundled rates for the same services means that utilities will under-price competitively available products and services at exactly the time when competitive investments and business models are being developed to enter the New York market. If either long run or total incremental costs are used as alternatives to fully embedded cost-based unbundled rates or shopping credits it will both undermine market entry as well as price

competition while at the same time maximize the time that utilities continue to provide competitive services and thereby continue to incur additional costs which could later become stranded. NEM urges the Commission to Order just and reasonable unbundled rates based on current just and reasonable bundled rates. and thereby, “provide utility price information to customers to allow them to compare utility rates with competitive offers.” Once this information is available in the form of unbundled rates, migration will or will not occur and stranded costs will be properly quantifiable, not speculative. NEM submits that the issues of avoidability and actual stranding are clearly issues that should and will be addressed as soon as any sizable migration occurs, and all attempts at aggressive mitigation have been made, so that a fair and actual quantitative analysis of unrecovered costs can be made.

2. Before the Fact Recovery of Lost Revenues is Improper and Unnecessarily Speculative

In the November Order, the Commission clarified that they, "intend that utilities be provided a fair opportunity to recover prudently incurred revenue requirements, subject to the utilities' obligation to productively manage and reasonably mitigate their costs."¹⁷ NEM supports the conclusion of the Order that "stranded costs" should be dealt with, if and when, they occur.

Stranded costs or revenues lost due to migration should be calculated after just and reasonable unbundled rates or shopping credits based on fully embedded costs have been implemented and actual migration has occurred. A reasonable period of time (e.g. one year or a migration rate of 25%) should be given to customers to comparison shop with shopping credits based on fully embedded cost-based unbundled rates (i.e. credits against utility bills) for contestable services.

Once a reasonable time (e.g. one year or 25% migration) has elapsed during which consumers are able to shop for one or more competitive services with embedded cost-based credits, then a calculation of the difference between the revenues that the utility would have received using fully embedded cost-based rates and the revenues actually received by the utility due to lost sales of specific services from the menu of competitive products, services, information and technology that each customer actually elects to purchase from the utility versus a competitive supplier should be compared to determine the maximum amount of potentially "qualifying revenue losses" that may be arguably recoverable, subject to the following qualifications:

1. The utility must show that the costs are material.
2. The utility must demonstrate that they have productively managed and reasonably mitigated costs in the subject areas.

¹⁷ November Order at page 5.

3. The utility must not be earning in excess of their earnings/sharing cap, and
4. The utility must identify specifically which costs or revenue losses are a result of (a) the utility being required to provide POLR services and/or (b) the utility's need to provide fully bundled services to customers that do not migrate.

3. Recovery Methods

NEM urges the Commission to ensure that any costs that are unavoidable because utilities must incur such costs to perform POLR-related services be recovered through adjustments to the rates charged for POLR-related services. By contrast, the Utilities propose to recover revenue shortfalls through a transition surcharge in delivery rates based on a formula that assumes all unavoidable costs are caused by migration rather than by the necessity to provide POLR-related services.

Providing revenue recovery based on estimates of migration and the assumption that migration itself rather than the cost of POLR-related services causes the revenue shortfall will under-price POLR-related services and unfairly penalize customers who migrate. Any determination of costs that are truly stranded must necessarily address the issue of whether the "unavoidable" costs at issue are, in fact, costs properly attributable to POLR-related services. Accordingly, NEM urges the Commission to implement embedded cost-based rates at the earliest possible time and to quantify the levels of migration and monitor utility mitigation efforts prior to developing just and reasonable methods to ensure utilities receive the appropriate revenue requirements based on the embedded costs associated with the actual services provided to migrating customers versus full sales customers versus POLR customers.

Only then can a fully-informed analysis of stranded cost recovery methods be implemented in a just and reasonable pricing structure. The Commission should clarify that utilities should provide a sufficient explanation of the costs they claim are "unavoidable" because of service obligations to remaining customers and/or to "unavoidable costs" relating to provider of last resort services. The embedded costs of rendering competitive versus POLR-related services should be separately set forth and identified. This is a proper, just and reasonable way to avoid customer confusion and to avoid hidden cross-subsidies in delivery rates. Any costs or lost revenues not connected with utilities provision of POLR-related services and fully bundled sales service should be added to distribution rates in a competitively neutral fashion.

C. Statewide Consistency will Lower Costs

NEM asserts that statewide consistency in defining utility functions, assigning costs and defining customer classifications is critical to facilitate energy price competition and lower energy costs to the retail consumer. Creating an

environment that allows each marketer to create a single system capable of transacting business with all New York utilities on a uniform basis will permit marketers to aggregate larger numbers of customers over the entire state and to achieve efficiencies and economies of scale. When marketers are able to achieve economies of scale, they can devote their resources to the development of innovative energy products, services, information and technologies. The savings that energy service providers could realize by spreading costs over larger numbers of customers and only having to program systems one time as opposed to developing utility-specific programs, can be passed on to consumers in the form of lower prices.

The creation of uniform tariff language, rate service classifications, and names and descriptions of utility service offerings in tariffs, operating manuals, and regulations will allow marketers to design single information systems capable of transacting business with all of the utilities. It will also facilitate marketers' abilities to design offerings of products, services, information and technologies for various customer classifications.

Uniformity in customer service provision, particularly the creation of a unique customer identification number that is easy for a customer to remember will facilitate customer switching. In a restructured energy market, switching energy suppliers must be simple and inexpensive. Customer information must be available to appropriate parties in a timely, accurate, low-cost and easily usable format. Utilities, suppliers, vendors and consumers must be able to exchange vital information in the lowest-cost, most efficient manner possible. Relatedly, differences in the information protocols between each utility service territory are significant, slowing the progress of restructuring and increasing substantially the cost of doing business. Adoption of Uniform Business Practices and the adoption of Standard Information Protocols that integrate Uniform Business Practices will lower costs and help the existing billing, back office and customer care systems to accommodate a competitively restructured energy market. NEM notes that the utilities were directed by Judge Stockholm to provide a report with their comments on the incorporation of unbundled commodity, billing and metering rate information on customer bills. NEM asserts that detailed and uniform unbundled rate information is imperative to aid in consumers evaluation of competitive offerings and marketers ability to convey competitive offerings.

Uniformity in the methodology employed to determine natural gas balancing charges and penalties will help ESCOs better manage natural gas deliveries. Furthermore, standardization of the rules for declaration of OFOs and the application of those rules will provide greater certainty to ESCOs that utility decisions are fairly and uniformly applied.

The goals of deregulation are to lower costs, improve the quality of service and provide value-added services to consumers. These goals are attainable if the state

implements uniform, consistent standards, processes, contract terms, and information protocols that allow competitive suppliers to effectively compete in multiple utility service territories and jurisdictions at the lowest cost to consumers.

D. Conclusion

NEM urges the Commission to implement streamlined and then fully allocated embedded cost-based unbundled rates at the earliest possible time. NEM submits that embedded cost based unbundled rates for the competitive services provided in bundled rates is just and reasonable, and that consumers deserve no less than just and reasonable unbundled rates. Resources that would be used to negotiate and speculate on the numerous variables that are required to quantify either long run or total incremental utility costs of competitive services can be better used to develop and implement just and reasonable embedded cost-based unbundled rates and shopping credits.

Sincerely,

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Cc: Active Parties (via Priority Mail)
The Honorable Jeffrey Stockholm (via Priority Mail)
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