

**STATE OF NEW YORK
PUBLIC SERVICE COMMISSION**

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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 the Development of Retail :
Competitive Opportunities - Unbundling Track :
: :
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**TRIAL BRIEF OF
THE NATIONAL ENERGY MARKETERS ASSOCIATION**

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Dated: Washington, DC
November 4, 2002.

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This Trial Brief is submitted by The National Energy Marketers Association (NEM) in the above-referenced proceeding, as provided for in the Procedural Ruling, dated July 23, 2002. NEM submits that NYSEG failed to comply with Commission Orders requiring the filing of an embedded cost study and should be required to file a study in conformance with the recommendations of ESCO Coalition witness Hornby. NEM also argues that NYSEG's stranded cost recovery mechanisms do not comply with Commission Orders and should be modified to conform with Commission directives. NEM also supports the Trial Brief filed by ESCO Coalition in this proceeding.

I. Clear Mandate to File Embedded Cost Studies Not Complied With by NYSEG

The first paragraph of the Commission's guidelines for performance of studies in the instant case provides that, "[e]ach utility will perform embedded cost of service studies."¹ Despite the precedents of numerous Orders to the contrary, NYSEG has filed a cost study in this proceeding that amounts to an avoided cost study, not an embedded cost study as was required. Implicit in the various cost allocations are NYSEG's inappropriately included

¹ Case 00-M-0504, Order Directing Filing of Embedded Cost Studies, November 9, 2001, at page 11.

assumption of costs it will not be able to avoid when customers migrate,² resulting in improper allocations of costs to delivery. The filing of a study constrained by these assumptions is clearly in contravention of the Commission's Orders.

Even though the Commission did give the utilities some discretion in how the studies would be performed, that discretion must be informed by the overall nature of the study - which was to be an embedded cost study, not an avoided cost study. The Commission's guidelines for filing the embedded cost studies provide,

each utility will have the discretion to perform the study using its own approach and will provide an explanation and justification of its assumptions and methods as described in this order. Thereafter, other parties will have the right to propose alternative assumptions and methods.³

However, the grant of discretion given to the utilities was not unfettered and does not equate to a foregone conclusion that whatever assumptions the utilities chose to use were appropriate or correct.

As noted by Coalition Witness Hornby,

"Because utilities have not traditionally viewed themselves as providing several distinct services as separate business units, there are no generally accepted methodologies for functionalizing those indirect and common costs. Moreover, to the extent that utilities wish to discourage retail competition or to inflate their rates for delivery service, they have an incentive to minimize the level of costs functionalized to contestable services and to maximize the costs functionalized to monopoly services." (Hornby Testimony, page 7, lines 12-17).

At a minimum, the cost reallocations of Coalition Witness Hornby are necessary to rectify the inappropriate avoided cost assumptions that prevail throughout the study. However, NEM

² The Commission gave guidance on this subject as long ago as the Customer Billing proceeding in which it stated, "[t]he utilities' arguments to the contrary, which stress the costs they continue to incur to bill their own customers, where they continue to bill customers, are irrelevant to the task of setting an economically efficient backout credit." Case 99-M-0631, Order Denying Petitions for Rehearing, September 1, 2000, page 5.

³ Page 12, Order Directing Filing of Embedded Cost Studies, November 9, 2001.

also notes that of NYSEG's \$ 1.3 billion total electric revenue requirements, NYSEG only functionalized 3% to contestable services. (Hornby Testimony, page 5, lines 12-16). As this deficient functionalization makes clear, NYSEG's approach does not allow the parties to evaluate the fully allocated embedded costs of contestable services because a disproportionate share has been functionalized to delivery.

NYSEG's study allocated 87.03% of A&G costs, 44.52% of uncollectibles, 85.56% of customer care Accounts 907 to 912 and 77.90% of customer care accounts 901, 903 and 905 to delivery. (Hornby Exhibit RH-2). Hornby discussed the deficiencies of NYSEG's allocations. For example, NYSEG assigned 100% of the costs of credit and collection to delivery rather than customer care reflecting an avoided cost approach (Hornby Testimony, page 11, lines 9-15) and only allocated calls to billing service, "that would be 'avoided' if all customers chose consolidated billing." (Hornby Testimony, page 11, lines 5-8). NYSEG also did not allocate any of the allowance for return on working capital to supply-commodity. Such an allocation is not reasonable because it would imply, "that there is absolutely no time lag between the payments that NYSEG makes to the NYISO for power purchases and NYSEG's recovery of those costs via revenues from its retail customers." (Hornby Testimony, page 13, lines 1-14).

NYSEG's allocations, at a minimum, should be modified consistent with the recommendations of Coalition Witness Hornby: functionalize working capital costs to supply-commodity service; functionalize credit and collections and energy services among all services based on direct costs; functionalize customer service and information expenses among all services based on direct costs. (Hornby Testimony, page 13, lines 21-23, page 14, lines 1-2). Hornby also recommended the allocation of uncollectibles and all customer care

clearing account costs, including costs from Accounts 906 to 917, amongst all services in proportion to their direct costs. (Hornby Supplemental Direct Testimony, page 1, lines 16-19). Hornby noted that it would be appropriate to allocate certain costs A&G according to revenues such as A&G salaries (Account 920), Outside Services (Account 923) and Regulatory Commission costs (Account 928). (Hornby Testimony, page 12, lines 3-18). As noted by Hornby, this approach would reflect the, "relevance of revenues to the activities covered by those accounts." (Id.) This method is a better reflection of cost causation principles and more accurately reflects the role of senior management in all of the services provided by the NYSEG family of companies. However, NEM maintains that even a direct allocation of costs based on 40% of total revenues functionalized to delivery may, in fact, be an understatement of costs that should be allocated to potentially competitive services. (Hornby Testimony, page 6, lines 4-7).

The Commission recently held, with respect to the performance of long-run incremental studies that, "eliminating all joint and common, administrative and general costs from the studies and limiting the extent of the contestable market in the studies to less than 100% as proposed by the utilities, would result in a study that would not include all costs which a customer should be able to avoid in migrating to an ESCO."⁴ NEM submits that eliminating consideration of joint and common and A&G costs and limiting the extent of the contestable market in an embedded cost study, or nearly doing so as in NYSEG's filing, is inconsistent with the Commission's Order, and may grossly understate the costs attributed to potentially competitive services. The Commission has ordered that electric customer choice be provided for at least five unbundled services - supply, meter ownership, meter service, meter data

⁴ Case 00-M-0504, Order on Rehearing and Clarification Petitions, May 30, 2002, at page 6.

service, and billing. NYSEG must be required to fully unbundle the costs associated with those functions, including an appropriate allocation of indirect costs and overhead.

Coalition Witness Hornby developed alternative functionalizations of costs to estimate rates for contestable services. (Hornby Exhibit RH-7). NEM urges, at a minimum, that the results of Hornby's alternative approaches be utilized in adjusting NYSEG's deficient filing until parties have been given adequate information upon which to develop truly embedded costs of services rather than merely "avoided costs" as has been provided to date.

II. NYSEG's Stranded Cost Recovery Mechanism Does Not Comply with the Requirements Set Forth by the Commission

NYSEG's proposed stranded cost recovery mechanisms are defective on their face as they do not conform to the Commission Orders⁵ requiring a two-part method, whereby competitive service costs would not be applied solely to customers that migrate. The first part of the mechanism is to address the concern that, "a portion of the existing embedded rate supports the provision of provider of last resort service, many of the costs of which cannot be avoided. All customers benefit from that service, and all customers should contribute to recovery of its legitimate costs."⁶ The second part of the mechanism must provide that, "a portion of the revenue shortfalls should be recovered only from customers who remain on the utility service."⁷ The Commission explained that, "customers who migrate to ESCOs must be able to avoid the utility's retail service costs. No market can develop if the ESCO customer must continue to pay the utility for retail service the utility no longer provides."⁸ Limiting this case

⁵ Case 00-M-0504, Order Establishing Parameters for Lost Revenue Recovery and Incremental Cost Studies, issued March 21, 2002, pages 23-25, and Order on Rehearing and Clarification Petitions, May 30, 2002, pages 5-7.

⁶ Page 24, Order Establishing Parameters for Lost Revenue Recovery and Incremental Cost Studies.

⁷ Page 24, Order Establishing Parameters for Lost Revenue Recovery and Incremental Cost Studies.

⁸ Rev Recovery Order on Rehg. Page 5.

solely to costs avoided by migrating customers has significantly understated the total embedded costs that are attributable to potentially competitive services.

In NYSEG's electric filing it does not include a two-part method for recovery of lost revenues claiming that, "there would be no need for a market transition surcharge to recover reconciled amounts," during the term of its "Price Protection Plan" due to its Asset Sale Gain Account. (NYSEG Filing Letter dated May 14, 2002, page 6). NYSEG's proposed gas stranded cost recovery mechanism includes a two-part method for recovery of lost revenues, but the method is flawed because the only retail cost it excludes is the cost of capacity, and it limits customers eligible for the lesser surcharge by imposing a November 2, 1995, cutoff date and excluding SC13 and SC14 transportation customers. (NYSEG Draft Tariff Leaf 99). Furthermore, neither of NYSEG's electric or gas filings includes a mechanism to review whether NYSEG, "appropriately manages and mitigates its costs and its customer base and/or sales are below those assumed in its rate proceeding."⁹

NYSEG's electric and gas revenue recovery mechanisms both set forth incremental cost recovery elements. (NYSEG Draft Revised Leaf No. 14-C and Draft Tariff Leaf 99). However, the Commission noted that, "[u]tility rate plans generally contain deferral provisions for unforecasted costs imposed by regulatory requirements, and the recovery of such costs should be considered under those provisions rather than in the context of migration-related revenue shortfalls."¹⁰ Therefore, NYSEG's stranded cost recovery mechanisms improperly include an incremental cost recovery element and should be rejected.

⁹ Case 00-M-0504, Order on Rehearing and Clarification Petitions, May 30, 2002, page 7.

¹⁰ Case 00-M-0504, Order Establishing Parameters for Lost Revenue Recovery and Incremental Cost Studies, March 21, 2002, page 24, note 23.

III. Conclusion

For the foregoing reasons, NEM urges that NYSEG's embedded cost of service study and stranded cost recovery mechanism be modified, at a minimum, consistent with the recommendations set forth herein and that NYSEG be further ordered to supply parties and the Commission with a more accurate reflection of embedded costs associated with delivery and non-delivery related functions.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Craig Goodman". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Craig G. Goodman, Esq.
President,
National Energy Marketers Association

cc: Active Parties (via email)
Judge Jeffrey Stockholm (via email and Express Mail)