NATIONAL ENERGY MARKETERS ASSOCIATION

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Hon. Janet Hand Deixler
Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, New York 12223-1350
VIA FEDERAL EXPRESS

RE: Case 00-M-0504 - Competitive Opportunities Proceeding - Unbundling Track

Dear Secretary Deixler:

The National Energy Marketers Association (NEM) hereby files this Motion for Clarification of the Commission's November 9, 2001, Order[1] issued in the above-referenced proceeding. The Order required the utilities to perform streamlined embedded cost of service studies, to be filed by March 15, 2002, with tariff amendments to be filed thirty days later containing unbundled rates based on the streamlined embedded cost of service studies. NEM strongly supports the Commission's directive. However, NEM seeks clarification of the intended use of forward looking cost studies. The Commission discussed in the November 9 Order that its goals for the proceeding,

> included examination of fully allocated embedded cost of service studies and the development of long-run incremental cost (LRIC) or other forward-looking cost studies for competitive functions to help guide the establishment of unbundled rates. We have previously held that LRICs 'represent an appropriate benchmark' for calculating

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

> unbundled rates, but precisely how they should be developed and used are open issues.[2]

NEM specifically seeks clarification of how the forward-looking cost studies are intended to "guide the establishment of unbundled rates." NEM asserts that the Commission-ordered embedded cost-based studies and rates should be permitted to become effective and remain in effect without having been adulterated by heretofore undefined LRIC considerations, so that customers are able to know precisely what they are currently paying for competitive products, services, information and technology supplied by their utility and use these rates to comparison shop for comparable products and services from competitive suppliers.

In this Motion, NEM requests that the performance of all cost and/or pricing studies other than the embedded cost of service studies ordered by the Commission on November 9, 2001, be suspended until one year after unbundled rates based on the embedded cost of service have been implemented and actual experience with customer migration, pricing of competitive services and actual stranded costs can be quantified for use in future utility rate cases. NEM's Motion is premised upon the need of all parties to this proceeding as well as consumers in the State of New York to receive correct pricing signals, correct stranded cost numbers, and for stranded costs to be transparent and minimized.

The National Energy Marketers Association (NEM) is a national, non-profit trade association representing both wholesale and retail marketers of energy and energy-related products, services, information and technologies throughout the United States. NEM's membership includes: small regional marketers, large traditional international wholesale and retail energy suppliers (as well as wind and solar power), billing and metering firms,

[2] Id. at 4-5.

Internet energy providers, energy-related software developers, risk managers, energy brokerage firms, information technology providers as well as suppliers of advanced metering and distributed generation technology. Many of our members are anxiously awaiting these unbundled embedded cost-based rates to enter the New York market and compete against these rates based on price, quality of service and new technology.

I. Unbundled Rates Based on Embedded Costs Promote Maximum Price Competition and Minimize Transition Time and Costs

In its initial Order opening the unbundling track, the Commission set forth the purpose of the proceeding. It stated that, "unbundling of functions, costs, and rates, performed with an appropriate degree of statewide consistency, will permit charges for each of the utilities' services to be identified for customers, who could then choose to purchase the services from the utility or the competitive market."[3] The Commission further stated in the November 9 Order that its "primary goal is to provide price signals (i.e. unbundled rates) for contestable services."[4] NEM asserts that proper prices to beat for contestable services are the utilities' embedded costs because the rates which customers currently and historically have been charged are based on embedded costs. Utility revenue requirements are currently established based on fully allocated embedded costs that have been determined by the Commission to be just and reasonable. These just and reasonable rates include embedded costs associated with competitive, workably competitive and potentially workably competitive products, services information and technologies. Accordingly, institution of rates based on or guided by long run incremental costs (LRICs) will not reflect accurately the true prices that consumers actually pay for

[3] Case 00-M-0504, Competitive Opportunities Proceeding Unbundling Track, Order Directing Expedited Consideration of Rate Unbundling, issued March 29, 2001.
[4] November 9 Order at 4.

competitive services provided by utilities and therefore undermine the Commission's primary goal of providing accurate price signals to customers.

NEM members are seriously concerned about the impact on the competitive marketplace, the opportunity for meaningful price competition, the increase in total social costs, the total amount of stranded costs, the reduction in economic efficiency as well as the drain on marketer, utility and staff resources that will occur in order to produce another set of marginal/incremental/decremental avoided cost numbers, the theoretical and computational validity of which could have serious flaws and potentially profound implications on the timing and structure of a truly competitive energy marketplace.

II. Stakeholder and Consumer Certainty

Utilities have been ordered to produce streamlined embedded cost of service numbers that transparently identify and adequately explain the fully embedded costs that consumers currently pay for competitive products, services, information and technologies bundled in current full service rates. However, despite repeated protests about the uncertainty of timely producing embedded cost-based numbers, utilities would also be charged with simultaneously producing alternative incremental/decremental/avoided/avoidable costs studies, either short run or long run, total or partial, that could substantially undermine the stated intentions of the Commission to: 1) speed a transition to a competitive marketplace with the minimum amount of stranded costs, lower total costs to society and maximize economic efficiency; and 2) encourage the lowest, most efficient price signals for workably competitive products and services.

NEM is very concerned that the ambiguity in the current Order about the intended meaning and use of "long run avoided costs," given the Commission's Order to perform embedded cost studies to unbundle rates or provide credits to consumers based on embedded costs, will permit parties to reargue the need for embedded costs. At the same time it will potentially undermine the finality and certainty that the November 9, 2001, Order represents and undermine investments made by competitive suppliers to enter the New York markets and offer workably competitive products and services.

Moreover, the guesswork that will be necessary to compute alternative incremental/decremental/avoided/avoidable costs studies, either short run or long run, total or partial, is stunning. To compute these numbers without any actual market experience using unbundled rates or shopping credits based on the actual embedded costs consumers are currently paying for such services requires guesses as to among other things: (1) actual migration rates, (2) the timing of the migration rates, (3) the "best available technology" in the marketplace, (4) a competitive cost of capital and (5) what a competitive price might actually be if consumers had the total costs they are currently paying to use to shop for competitive services. Moreover, the use of any numbers generated that are less than the just and reasonable rates that consumers are currently paying in bundled rates for these competitive services will by definition be less than just and less than reasonable.

NEM urges that the Commission give competition based on embedded cost-based unbundled rates or shopping credits a chance before all the parties are required to use resources to address and produce numbers that will by definition be less than fully embedded costs, particularly if the intended use of these numbers is to "competitively price competitive services provided by utilities" or to provide consumers unbundled rates or shopping credits that are less than what they are currently paying for these competitive services (i.e. fully embedded costs).

III. LRIC Methodologies Should Not be Employed to Set Unbundled Rates for Competitively Available Products, Services, Information and Technology

The Commission previously examined the use of LRIC studies in the context of the telecommunications industry and unbundled network elements. 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 performed in the context of federal statutes and regulations guiding the matter.[5] The FCC promulgated rules setting forth how network elements should be priced under the federal Telecommunications Act that adopted a total element long run

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[5] 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).

incremental cost (TELRIC) approach.[6] The Commission also adopted the TELRIC approach for pricing network elements.[7]

NEM asserts that the methodology adopted by this 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 TELRIC studies are being conducted "to help guide

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[6] 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).

[7] 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,

> "[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.

the establishment of unbundled rates" that will operate as price signals for competitive services provided by monopolies to end use customers.

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."[8] NEM asserts that this is precisely the reason why the Commission's November 9 Order is 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 unbundled embedded cost-based rates for customers to see and use to price competitively supplied products and services 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.

This issue has also been examined by the Illinois Commerce Commission (ICC). The ICC determined that the proper method of determining delivery services rates is based on utilities' embedded costs. The ICC correctly reasoned that:

> In theory, marginal cost pricing promotes efficient competition because it sends efficient "price signals" to potential competitors. . . The problem with this theory, however, is that in a regulated environment that is in transition, it also unduly protects an incumbent from competition. These "accurate price signals" that marginal cost pricing sends to competitors also promote inefficiencies in the incumbent utility. The Commission is of the opinion that while an efficient price signal to a potential competitor is a good thing, there must also be a symmetric price signal to the incumbent. This price signal to the utility is an incentive to provide good service and keep its customers. ***Embedded costs provide the best measure of a utility's ability to***

[8] Opinion 97-2, page 15.

> ***compete with alternate providers***. The Commission refuses to accept the argument that price signals travel in only one direction.[9] (emphasis added).

The ICC further explained in its discussion of computation of single billing option credits that an embedded cost-based methodology should be employed. The ICC explained that,

> use of marginal cost methodology over the long run will inflict the same burdens on the RES that Edison complains it would suffer if an embedded methodology is used. This tariff will be in effect over the long-term and, therefore, the credit must be calculated using long-term embedded costs. Use of embedded costs will ensure that customers pay only for costs that they incur. The Commission also supports Staff's recommendation that the SBO credit should be given to the Delivery Services customer and not the RES.
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> While these costs are fixed in the short run, and the Company can do nothing to avoid them, the company can put some of the elements that make up these costs to better use. It is unfair to give the RES a credit for only the incremental short-run savings while ComEd has the opportunity to reallocate those resources to a different use in the short-run and eliminate them in the long-run.[10]

NEM asserts that the analysis of the ICC is also applicable in the instant case. The tantamount concern should be providing end-use customers with transparent and accurate pricing signals for the workably competitive products, services, information and technologies they are currently purchasing from the utility. Embedded costs are precisely the price that customers currently pay but do not see. Use of LRIC to unbundle rates will understate and distort the prices customers actually pay, hinder the development of the competitive market and both increase the costs and timing of a transition to a fully competitive market for competitive services.

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[9] Case No. 99-0117, Commonwealth Edison Company - Petition for Approval of Delivery Services Tariffs and Delivery Services Implementation Plan and for Approval of Certain Other Amendments and Additions to its Rates, Terms and Conditions, Order issued August 26, 1999, at page 57.

[10] Id. at page 122.

IV. The Commission's November Order, if Implemented Properly, Will Minimize the Time and Costs of Transition to a Competitive Market

NEM also believes that instituting rates based on any measure other than the utilities' fully embedded costs will cause the utilities to incur much higher stranded costs. If utilities' rates reflect and utility customers pay less than fully embedded costs, customers will be paying an artificially low, subsidized price for competitively available services. If utilities' unbundled rates reflect and utility customers pay less than fully embedded costs, the Commission correctly noted that customers end up paying twice for these services. In conjunction, these two effects will slow customer migration and utilities will continue to incur costs for competitive services that may ultimately become stranded. In contrast, 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. It will also provide customers and competitors with true, accurate price signals that will permit meaningful price competition in the shortest possible time.

However, if alternative incremental/decremental/avoided/avoidable costs studies, either short run or long run, total or partial, are simultaneously conducted, negotiated, or otherwise conducted, NEM is seriously concerned that the resources necessary to properly compute and implement embedded cost-based unbundled rates or shopping credits will be diminished, and 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 unbundled rates based on less than embedded costs are used as alternatives to fully embedded cost-based unbundled rates or shopping credits or if they are used to determine a "competitive price" for utilities to provide competitive services, either result will undermine the long awaited

November 9th Order and understate the costs and the prices consumers pay for competitive services that can and will be available from competitive suppliers. It will also simultaneously maximize the time that utilities continue to provide competitive services and thereby continue to incur additional costs for competitive services that could later become stranded. 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.

However, to simultaneously develop studies based on incremental/decremental/avoided/avoidable costs, either short run or long run, total or partial, will allocate resources to the computation of numbers that will necessarily be guesses at reality and seriously undermine the chance that streamlined embedded costs studies and resulting unbundled rates or shopping credits will in fact be implemented and will impose enormous financial uncertainty and risk onto competitive suppliers planning to enter the New York market. Moreover, the reaction of consumers to embedded cost-based rates for competitive services will not be given a chance to succeed before resources are devoted to compute alternative lower numbers that necessarily undermine the potential supply of competitive services and the opportunity of competitive service providers to actually compete against these embedded cost-based unbundled rates.

V. Effects of Delaying Alternative Studies

Delaying alternative computations harms no one. Yet, generating and rearguing these numbers simultaneously with embedded cost studies can harm everyone. If numbers lower than embedded costs are used to either compute unbundled rates or shopping credits or to price competitive services provided by a utility during a transition period, several things will happen, all of which will produce negative unintended results.

A. New captive consumers on utility systems will pay fully embedded costs and when they choose to leave they get less than embedded costs to shop for alternative competitive services. Not only does this result in a double payment as stated in Commission Orders, but it delays the utility exit from these functions and maximizes the transition period and the total costs associated with the transition.

B. As everyone knows, an efficient "market price" is one at which marginal revenues equal marginal costs. 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 rate to pay a departing customer is 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.

C. The Commission's November 9th Order properly implements the most efficient pricing signals because the marginal revenues to the utility of the embedded costs of the competitive portions of bundled rates will equal the marginal costs to the utility of embedded cost-based unbundled

> rates or shopping credits for the same competitive services. We urge the Commission not to force the parties to guess at what an "efficient" firm might spend over a long-term to establish a new product to serve a market that is yet to be defined in either scope or timing as it would be economically inequitable and inefficient, quantitatively unreliable and yield potentially unjust results.

Moreover, NEM submits that the Commission has correctly determined that unbundled rates or shopping credits based on embedded costs would not only mirror existing costs to captive bundled consumers of competitive products (and would therefore be the most just and reasonable rates assuming existing rates are just and reasonable) but would also encourage maximum price competition among non-regulated, non-subsidized market participants. As a result, the marginal revenues paid by consumers for competitive services would in fact have a chance to equal the marginal costs of producing them over the shortest possible time horizon without performing any guesswork about incremental costs of an "efficient" firm or best available technology and potentially without additional governmental intervention mandating anything other than what the Commission has already ordered.

NEM submits that the performance of alternative studies, simultaneous with the Commission-ordered embedded cost studies, in order to compute a number that purports to represent an "efficient" firm's total long run incremental costs for competitively available products, services, information and technologies, that is based on a guess of critical migration numbers at issue, competitive costs of capital, who is efficient and what is the best available technology today, is not only dangerous precedent but will divert vitally needed resources. Utility time and resources have been argued apparently persuasively to be required to accurately determine truly embedded costs for each competitive product and service that can be workably competitive. NEM strongly supports the Commission's decision to compute unbundled rates or shopping credits based on embedded costs as the price to beat for competitive companies operating solely on risk capital and the best, lowest cost technology available. The Commission's Order, if implemented, will represent an important step forward in resolving many if not most of the remaining issues including the amounts, if any, of actual stranded costs as well as the specific costs associated with providing POLR services.

VI. Conclusion

For the foregoing reasons, NEM would urge the Commission to clarify the intended use of the forward looking cost studies and adopt a timeline that delays computation of any such cost or pricing studies until a reasonable time after unbundled rates or shopping credits based on the embedded costs studies that have been Ordered are completed and consumers can see and use the amounts they are currently paying in bundled rates to compare with truly competitive product and service offerings.

Respectfully submitted,

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President
National Energy Marketers Association

cc: active parties (via e-mail)
Judge Stockholm and Judge Garlin (via email and Federal Express)