STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on April 13, 2005

COMMISSIONERS PRESENT:

William M. Flynn, Chairman
Thomas J. Dunleavy
Leonard A. Weiss
Neal N. Galvin

CASE 03-E-1761 – Proceeding on Motion of the Commission to Reexamine Policies and Tariffs for Flexible Rate Contract Service to Economic Development Customers.

ORDER APPROVING GUIDELINES FOR FLEXIBLE RATE SERVICE CONTRACTS

(Issued and Effective April 14, 2005)

BY THE COMMISSION:

INTRODUCTION

Background

The Commission's Order Instituting Proceeding, issued January 12, 2004, established this case for the purpose of updating its policies regarding flexible rate service contracts offered by electric utilities, in light of changes in the electric utility industry since 1994.

In 1994, the Commission adopted the following general guidelines, among others, for flexible rate service:

- Flexible rates could be offered to "maintain contestable customers on the utilities' systems, in a way that benefits all ratepayers." Flexible rates could be offered to customers who have "realistic competitive alternatives to utility service," but a utility would not be required to offer flexible rates "if, in the utility's

judgment, the rates would not be advantageous to the utility's customers as a whole."

- Any revenues "lost" because of discounted flexible rates could be recovered in part from utility ratepayers through mechanisms established in individual utilities' rate cases.

- Flexible rates could not be offered without "independent and comprehensive" demand-side management audits.

- The cost to a potential customer of complying with environmental regulations applicable to the claimed competitive alternative (e.g., on-site generation) should be taken into account to determine whether the alternative is actually available.

- In general, the flexible rate offered to a customer should be no less than the marginal cost of service to the customer plus 1¢ per kilowatt-hour (kWh). The term of a flexible rate contract should not exceed seven years unless specifically authorized by the Commission.[1]

Subsequently, some utilities offered flexible rate service for the purpose of attracting new customers or encouraging existing customers to increase their loads. In addition, on two occasions a utility was directed to enter into flexible rate contracts on terms less restrictive than those set forth in the general guidelines.[2]

When the current guidelines were adopted in 1994, most electric service was provided by vertically-integrated utilities. Since then, the electric industry in New York has

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[1] Case 93-M-0229, Competitive Opportunities for Electric and Gas Service, Opinion No. 94-15 (issued July 11, 1994), pp. 31-32.

[2] Case 01-E-0680, Nucor Steel Auburn, Inc. - Complaint, Order Directing Entry into a Flex-Rate Contract (issued March 25, 2002); Case 01-E-1628, Corning Incorporated - Complaint, Order Directing Entry into a Flex-Rate Contract (issued April 2, 2002).

been restructured, so that most electricity generation stations are owned by independent power producers, and most electricity purchased from utilities at the retail level is acquired by the utilities in wholesale markets and resold to the retail customers (end users). End users have opportunities to purchase electricity supplies in wholesale markets (either directly or through marketers) and have them delivered by utilities, paying unbundled delivery charges. Thus, this proceeding was established to (i) explore the policies and procedures that will best advance continued use of flexible rate service contracts to promote economic development in light of the restructuring of the electric industry, and (ii) develop guidelines that allow end users and utilities to avoid disputes over the formation of future flexible rate contracts.

In the instituting order, the Commission listed four policy issues to be addressed by the parties:

- Whether prospective flexible rate service contracts should be limited to delivery rates (which might include non-bypassable wires charges).
- The proper minimum price for flexible-rate delivery service, including a contribution to a utility's common costs. (As noted above, the current guidelines include a general rule that the minimum contribution should be 1¢/kWh.)
- The proper measurement and assessment of marginal energy costs in flexible rate contracts for combined commodity and delivery service, given certain end users' expressed preference for rate stability.
- The extent to which marginal delivery costs (and, as applicable, marginal energy costs) should be calculated on the basis of individual end users' locations or load patterns.

The Commission also identified the following regulatory, administrative, and implementation issues:

- Whether to extend, to end users connected to other utilities, the applicability of a provision in Niagara Mohawk Power Corporation's flexible rate contracts allowing end users to take service under standard tariff rates in the event that the latter rates are lower than the contract rates.

- Whether the offering of flexible rates should be coordinated with other economic development rates, including the New York Power Authority's Power for Jobs, Economic Development Power, and Expansion and Replacement programs (among others).

- How to allocate economic development program rates and flexible rates to the loads of end users participating in such programs.

- Providing trade secret protection to flexible rate contracts whose submission to the Department of Public Service's Staff is requested.

- Methods for calculating lost revenues and allocating them between shareholders and ratepayers, taking into account the need for or propriety of incentives to encourage utilities to enter into flexible rate contracts with end users.

Procedural History

The Commission directed interested parties to participate in consultations and submit a joint proposal addressing the foregoing issues. In the alternative, the Commission directed the Department of Public Service Staff (Staff) to prepare a report to be issued for comments from interested parties.

On July 7, 2004, Staff submitted to the Secretary a "Straw Proposal for Flex Rate Guidelines" and proposed that interested parties be allowed to file comments on the proposal and replies to other parties' comments. Staff reported that the parties attempted, but were unable, to reach a consensus policy. By a notice issued July 20, 2004, the Secretary authorized the

parties to file comments by August 31, 2004 and reply comments by September 28, 2004.

Comments were filed by Staff, Empire State Development (ESD), the New York State Energy Research and Development Authority (NYSERDA), the New York Power Authority (NYPA), National Fuel Gas Distribution Corporation (NFG), Multiple Intervenors (MI), Nucor Steel Auburn (Nucor), New York State Electric & Gas Corporation, jointly with Rochester Electric and Gas Corporation (NYSEG), Niagara Mohawk Power Corporation (NMPC), and Orange and Rockland Utilities (ORU). Reply comments were filed by Staff, ESD, MI, Nucor, Constellation NewEnergy (Constellation), NMPC, ORU, and NYSEG (again, jointly with RG&E).

CONTESTED ISSUES

Scope of Flexible Rate Service

1. General

The 2002 State Energy Plan (SEP) stated that "[e]ven though a competitive electricity market is expected to result in lower prices, New York's energy prices may remain somewhat higher than those of most other states in the short-term."[3] Therefore, the State Energy Planning Board concluded, "effective energy-related economic development programs for businesses will continue to be necessary to help preserve and expand the State's economic base."[4] The Board stated that "[d]uring the transition to competitive markets, there is a continuing need to maintain economic development incentives and discounts that will ensure that the State will have the ability to retain, expand, and attract businesses."[5]

Two years later, in the Retail Competitive Opportunities case, the Commission concluded that "the role of [energy service companies (ESCOs)] in supporting economic development should be expanded," and that "[i]n the future and

[3] 2002 State Energy Plan, p. 2-23.

[4] Id., p. 2-24.

[5] Id., p. 2-21.

based on the record in this proceeding, utility-offered economic development programs should focus on delivery rates."[6] The Commission explained that "[w]e are not requiring that the utilities now offer a hedged retail service to any customer class which is not offered such a service or for which we have approved the elimination of a hedged service."[7]

This proceeding began after the 2002 SEP was adopted and before the decision in the Retail Competitive Opportunities case was issued. The order instituting this proceeding asked interested parties to discuss whether future flexible rate agreements should be limited to delivery service, or continue to be available for full (delivery plus commodity[8]) retail service.[9]

The Staff proposal provides that "[a]t a minimum, utilities shall offer customers, eligible under their tariffs for new, individually-negotiated [flexible] rate contracts entered into in conformance with these guidelines, delivery-only service at a specified rate, or at a discount from the otherwise-applicable delivery rate." The proposal states that "[flexible] rate customers are encouraged to obtain electricity commodity service from a competitive market supplier, or may purchase commodity service from the utility, with the rate for that service stated separately from the delivery rate or discount."

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[6] Case 00-M-0504, Retail Competitive Opportunities, Statement of Policy on Further Steps Toward Competition in Retail Energy Markets (issued August 25, 2004), p. 39.

[7] Case 00-M-0504, supra, Order on Petitions for Clarification or Rehearing, p. 4 n. 15.

[8] For convenience, this order refers to the service of selling energy (kWh) as "commodity" service, as a useful distinction from the service of delivering energy. In employing this term, we are not concluding that electricity is a commodity under the federal Robinson-Patman Act [cf. City of Newark v. Delmarva Power & Light Co., 467 F. Supp. 763 (D. Del 1979)].

[9] The decision in Case 00-M-0504 deferred the resolution of this issue to this proceeding (Statement of Policy, pp. 39-40).

The Staff proposal goes on to provide that a customer taking flexible rate delivery service may call on its utility to "facilitate the customer's access to market commodity options available from [ESCOs] by offering the customer the assistance of a utility customer representative knowledgeable in the workings of the competitive market, and devising Market Match or similar programs that generally facilitate the linking of a [flexible] rate customer to ESCOs that offer, at a minimum, fixed price commodity service for a period of at least six months." The proposal provides, moreover, that "[i]f a customer can demonstrate that, notwithstanding the benefits under the [flexible] delivery rate and economic development measures offered by other entities, market commodity prices prevent reaching the price objective, utilities shall pursue innovative solutions to overcoming commodity cost barriers on a customer-specific basis." "Innovative solutions" could include the utility's issuing a request for proposals (RFP) on behalf of customers, aggregating customers, or directly purchasing and streaming energy from ESCOs or specified generation sources (or supplies with hedged prices).

The Staff proposal is supported by ESD, MI, and Nucor. According to ESD, business customers value electricity price stability, and should have the option to enter into discounted full service contracts with their utilities. MI agrees, and argues as well that "to the extent that tariff commodity options fail to meet a contestable customer's pricing objectives, and there is a compelling public need to combine delivery and commodity, the utility should be required to issue an RFP soliciting bids from all market participants (i.e., generators, ESCOs, etc.) for a fixed financial or physical commodity hedge agreement for the specific contestable customer for up to the term of the flex-rate contract."[10] Nucor adds that customers' commodity options should include electricity priced at their delivery utilities' power portfolio weighted average hedge costs, or electricity "streamed" from specified power resources (whether utility or ESCO supplied) at fixed or indexed prices.

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[10] MI's Initial Comments, p. 11.

MI contends that utility RFP arrangements on behalf of flexible rate customers would not necessarily hinder the development of energy markets, because they would be entered into with market participants, and would provide "stability" for both suppliers and customers.[11] But if competitive suppliers cannot provide the least-cost service (compared with a possible utility supply alternative), MI continues, customers should not be forced to turn to a non-utility supplier for the sake of promoting competition. Nucor contends that nearly all of the State's successful efforts in attracting or retaining business customers have involved economic development program rate discounts or full service flexible rate contracts with utilities.

Staff's proposal that utilities be required to offer full service flexible rate contracts or "innovative solutions" at the behest of eligible customers is largely opposed by NYSEG, NMPC, ORU, and Constellation. The parties are not averse to utility efforts to assist customers in obtaining commodity supplies directly from ESCOs,[12] but they object to other aspects of the proposal. They raise the following criticisms (among others):

- The guideline provides no standards for determining whether or when a utility has undertaken sufficient efforts to provide an innovative solution. Moreover, the guideline does not preclude customers from insisting that

[11] Id.

[12] NMPC states that its delivery-only flexible rate service has been successful, having resulted, since 1998, in 148 contracts leading to investments totaling $311 million and the creation of over 5,000 new jobs. NMPC notes that 15 ESCOs are active in its service territory, and that it entered into only six full service contracts, of which only one remains active. (NMPC reports that 70% of its large business customers and 50% of its medium business customers have replaced utility commodity service with ESCO offerings.) Constellation adds that it provides products and service to customers who previously took utility commodity service under flexible rate contracts.

the solutions be pursued iteratively, or that utilities repeatedly issue RFPs.

- Utilities could incur significant costs (administrative and risk-related) in attempting to provide the specified solutions, especially if they become contractual intermediary parties between suppliers and customers, but there is no guidance about how those costs would be recovered.

- Streaming – the allocation, for billing purposes, of a commodity supply from a specified source – could result in a reallocation of the costs and benefits of a utility's supply portfolio among flexible rate and other full service customers.[13]

- A requirement that a utility procure commodity supplies for a flexible rate customer would result in an unwarranted preference for that customer, while creating the false impression that there is a "best price" in the electricity market available only to the utility.

- There are no limits on the eligibility of customers for innovative solutions. NYSEG would limit eligibility to individual customers with loads of 10 megawatts (MW) or greater, contending that larger loads would attract a greater response from prospective suppliers. NMPC supports an eligibility threshold of 2 MW.

In response to the various criticisms, Staff argues that utility participation in commodity markets on behalf of flexible rate customers would not be substantially more costly or burdensome than ongoing efforts to procure electricity for other customers (e.g., residential customers).

Staff's proposed guidelines properly emphasize that prospective flexible rate customers should first seek to obtain commodity supplies from ESCOs. However, as noted earlier, the existing 2002 State Energy Plan points out that market prices in

[13] ORU notes that it does not maintain a portfolio of supply contracts, but instead acquires electricity in the same markets as do ESCOs.

New York might be higher than prices in other states, and concludes that utilities' "energy-related economic development programs for businesses will continue to be necessary to help preserve and expand the State's economic base."[14] The currently effective flexible rate service guidelines provide that flexible rates may be offered to maintain contestable customers on the utilities' systems in a way that benefits all ratepayers, and that a utility would not be required to offer flexible rates if the rates would not be advantageous to the utility's customers as a whole. These two criteria – necessity for attracting or retaining load, and a demonstration of economic benefits to non-participating customers – should determine whether utilities would be expected to provide discounted (below tariff price) commodity service to flexible rate service customers.

The utilities have questioned whether their costs of providing discounted commodity service as part of a flexible rate service offering – which, if prudently incurred, would be borne, in part or in whole, by non-participating customers – would outweigh the economic benefits to those customers and their communities of attracting or retaining loads. As suggested by the utilities' comments, that determination will have to be made on a case-by-case basis. Therefore, proposed guideline I.E.3 will be modified to state that utilities should pursue "innovative solutions" if doing so would not result in an economic detriment to non-participating customers.

Proposed guideline I.E.4 sets forth six examples of innovative solutions. The sixth item provides that a utility "may stream to a flex rate customer the price for commodity purchased directly from a generation source, or the price hedged with financial institutions or other entities that mitigate commodity price risk." This item will be modified to make it clear that "streaming" is the solution of last resort, and that any commodity that would be streamed may not be drawn from an investor-owned utility's existing supply portfolio used to provide commodity service to all customers, if doing so would

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[14] 2002 State Energy Plan, p. 2-24.

result in increased commodity costs to non-participating customers over the term of flexible rate contract.

2. Commodity Price Calculation

The Staff proposal does not include guidelines about how to calculate the price of electricity supplied by utilities under multiple-year flexible rate service contracts. ORU, while opposing any requirement that utilities provide commodity service to flexible rate service customers, argues that prices for such service, if required, should be negotiated on a case-by-case basis. Nucor, in contrast, argues for a guideline providing that the floor price for commodity service to flexible rate customers should be "based on the average weighted costs of a utility's purchase obligations for the prior year and known changes (e.g., expiration of major supply contracts)."[15]

Nucor's position is opposed by Staff, NYSEG, and ORU. Staff and NYSEG note that Nucor's position was previously considered and rejected by the Commission. Staff argues that historic contract prices are stale and reflect "lapsed expectations not relevant to existing or future conditions in electricity markets."[16] Moreover, Staff continues, past contracts might have had differing terms and conditions that would make it difficult to derive comparable costs for a forecasted period. ORU notes that it does not maintain a portfolio of supply contracts, and argues that a prior year's cost of market purchases should not be used to set prices under a prospective flexible rate contract.

Because electricity prices have proven to be unpredictable and volatile, a guideline specifying that a future contract price should be calculated by starting with historic prices would not be useful. Prices for commodity service provided under flexible rate contracts should be individually

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[15] Nucor's Initial Comments, p. 13.

[16] Staff's Reply Comments, pp. 10-11, citing Case 03-E-1306 et al., Nucor Steel Auburn et al., Order Granting Petitions in Part and Establishing Methods and Procedures for the Billing of Marginal Cost Adjustments (issued April 19, 2004).

negotiated, subject to our policy that "discounts on commodity below a utility's costs are not favored"[17] and should not result in an economic detriment to non-participating customers.

3. Commodity Price Updating

Proposed guideline I.F.2 provides as follows:

> No particular term shall be required for the time a commodity price arrangement remains in effect under a flex rate contract, except that prices for commodity supplied pursuant to a utility's tariff shall remain in effect for the time periods established in the tariff. Other commodity price arrangements with utility suppliers may provide for the expiration and prospective updating of commodity prices and may be structured flexibly, so long as the contract includes a comprehensive provision setting forth the pricing mechanism and its operation.

Most parties commenting on this provision agree that updating should apply only on a prospective basis (i.e., there should be no back-billing for variances between commodity prices and commodity costs arising after the prices are set). ESD recommends a requirement that prices be updated, but no more frequently than once per year. ESD and Nucor argue similarly that (in ESD's words) "[o]nce updates are calculated, the customer should be able to accept the rate change or, on 60 days notice, opt for delivery service only (if the utility is supplying commodity) or opt for the applicable tariff service."[18] Staff responds that a requirement that flexible rate service contracts include provisions for commodity price updating would introduce unnecessary complexity into the contract formation process. MI, on the other hand, appears to oppose Staff's proposal to allow but not require commodity price updating, arguing that such a contract provision would deprive economic development customers of the price certainty they require.

[17] Case 00-M-0504, supra, Statement of Policy, p. 39.

[18] ESD's Initial Comments, p. 2.

Our general policy is that "in future rate proceedings, utilities should not propose fixed rate commodity tariffs creating a profit center for commodity sales."[19] A provision in a flexible rate service contract fixing a commodity price – presumably, with a profit margin for the utility – with no provision for updating to reflect market prices would not be consistent with the principle underlying that policy. However, it is possible, as MI suggests, that a fixed-price provision might provide the pricing stability required by certain customers, resulting in the maximization of economic development benefits. Accordingly, we will approve proposed guideline I.F.2.

Information About Alternatives

The Staff proposal includes two provisions requiring the acquisition or disclosure of information about, respectively, economic alternatives or non-utility commodity supplies available to prospective flexible rate customers.

First, guideline I.B.1 in the proposal requires that "[b]efore making a [flexible] rate offer to an eligible customer seeking to remain, newly locate or grow within a utility's service territory, the utility shall conduct a complete analysis of the [flexible rate] customer's contestable alternative and the pricing objective needed to retain or attract its contestable load." ORU, joined by NMPC, asserts that the requirement of a "complete analysis" could be interpreted as requiring a utility to retain consultants or expend resources to review a variety of scenarios. ORU argues that satisfaction of the requirement should be determined on a case-by-case basis, with the detail of the analysis depending upon the circumstances. Staff contends in response that ORU "reads too much into the guideline, which does not differ substantially from other utility obligations to analyze customer circumstances and alternatives."[20]

[19] Case 00-M-0504, supra, Statement of Policy, p. 40.

[20] Staff's Reply Comments, p. 19.

Second, proposed guideline I.E.3 provides as follows:

> If a customer can demonstrate that, notwithstanding the benefits under the [flexible] delivery rate and economic development measures offered by other entities, market commodity prices prevent reaching the price objective, utilities shall pursue innovative solutions to overcoming commodity cost barriers on a customer-specific basis. In making the requisite demonstration, customers shall not be required to submit information that would violate confidentiality arrangements with competitive market participants, but may be required to proffer other proof in support of its demonstration, including submittal of an affidavit making pertinent affirmations.

NMPC argues that should utilities be required to offer commodity service to flexible rate customers, they should be authorized to obtain complete disclosure of the details of the commodity supply offers the customers were able to obtain in the marketplace.

The two guidelines should have parallel information gathering requirements. Because the likely source of much of the information needed for the analysis required by guideline I.B.1 would be a prospective flexible rate service customer, the demonstration requirement in guideline I.E.3 will be adapted for and included in guideline I.B.1.

Customer’s Pricing Objective

Guideline I.B.1 provides that the pricing objective for flexible rate service should be “the minimum relief from standard tariff rates that is necessary to retain or attract the customer’s load, taking into account the economic development measures offered by other entities for the purpose of retaining or attracting the customer.” MI opposes a “minimum relief necessary” standard, arguing that “utilities should be obligated to seek, through all available means, the lowest possible rate to retain or attract new customers.”[21]

[21] MI’s Initial Comments, p. 5.

As just discussed, we are modifying guideline I.B.1 to provide that information about a prospective customer's pricing objective should be supplied by the customer. Therefore, the adjective "minimum" is superfluous and will be deleted from the guideline.

Economic Development Programs

1. Coordination of Programs

The Staff proposal provides that utilities shall refer customers seeking flexible rate service to the economic development programs offered by NYPA, NYSERDA, ESD, other state agencies, and local entities. The proposal states further that prospective flexible rate customers "may be required to demonstrate participation or involvement in those programs to the extent eligible and required by the utility's tariffs."

The parties commenting on this provision do not oppose a utility role in referring prospective flexible rate service customers to other economic development programs, and NMPC states that it "firmly embraces the practice of enabling [flexible] rate customers to achieve the full benefit of any power that may be available to these customers through NYPA's economic development programs."[22] ESD, in addition, envisions a process in which it and the Department's Office of Economic Development & Policy Coordination would be involved both in referring prospective customers to the economic development programs, and in "coordinate[ing] the review, in cooperation with the utility, of a particular company's situation prior to making [flexible] rate contract awards."[23] NYSEG, responding to ESD, states that it would not object to involving ESD in consultations, but asserts that no agency other than the Commission should be involved in negotiating flexible rate contracts or determining whether contracts should be awarded.

Several parties have commented on the proposal that prospective flexible rate customers "may be required" by utility

[22] NMPC's Initial Comments, p. 9.

[23] ESD's Initial Comments, p. 2.

tariffs to demonstrate participation or involvement in economic development programs for which they are eligible. NYSEG would include that requirement in the guidelines, while ESD, MI, and Nucor would oppose any such requirement in utilities' tariffs. MI and Nucor express similar concerns that the requirement would engender delays and disagreements in situations where a rapid utility response is necessary. MI is also concerned that participation in economic development programs might be delayed because of a lack of budgetary funding or available energy.

Staff argues in response that a customer seeking economic development assistance should be required to seek the best package of available incentives instead of relying only on its utility. Staff contends that "MI and Nucor have not demonstrated that any utility will seize upon the requirement as a means of obstructing [flexible] rate negotiations, and if a utility were to improperly implement the requirement in that fashion, the Commission could readily intervene to prevent that behavior."[24]

The reasoning underlying the proposal to require prospective flexible rate service customers to "demonstrate participation or involvement" in economic development programs is sound. To allay concerns about delays in being accepted into those programs for reasons beyond the control of prospective customers, the proposed guideline will be modified to authorize tariff requirements that the customers demonstrate reasonable efforts to participate or be involved in economic development programs.

2. Allocation of Benefits

The Staff proposal provides that metering and other protocols for allocating supplies of electricity from two or more sources to a customer's load should be negotiated individually. NYPA, NYSEG and ORU support this proposal.

ESD supports a guideline providing that "[w]hen available, the billing of economic development services should

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[24] Staff's Reply Comments, pp. 18-19.

be 'first through the meter' to provide maximum benefits to the customers seeking the flex rate."[25] According to ESD, recent experience shows that individually negotiated allocations have resulted in customers' not receiving the full economic benefits of NYPA programs.[26]

ESD's position is opposed by Staff, NYSEG, and ORU. Staff and NYSEG argue similarly that individually negotiated allocations are necessary, to ensure that individual program requirements are not violated. NYSEG explains that NYPA economic development programs are handled differently for each utility, and that "[a]ll such programs involve multi-party contracts with unique implementation provisions, all of which could be impacted by a [first through the meter] procedure directed by the Commission for flexible rate customers."[27] ORU notes that the Commission has previously refused to adopt a first through the meter allocation requirement for one economic development rate program.[28]

The proposed guideline provides for a sensible approach to the allocation of benefits from flexible rate service and non-utility economic development programs, and it will be adopted.

Cost Basis for Delivery Rates

1. Generally

Proposed guideline I.C.1 provides as follows:

> The [flexible] delivery rate shall recover the [long-run marginal cost (LRMC)] of delivery service, which includes applicable customer and distribution marginal costs, and applicable ancillary services, NYPA Transmission Access Charge and other transmission marginal costs.

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[25] ESD's Initial Comments, p. 4.

[26] ESD's Reply Comments, p. 2.

[27] NYSEG's Reply Comments, p. 20.

[28] See Case 97-E-1640 et al., Niagara Mohawk Power Corporation, et al., - Power For Jobs Program, Order on Power For Jobs Tariffs(issued March 27, 1998), pp. 4-6.

Staff's proposal is opposed by MI and Nucor, who argue that the base cost for flexible delivery service rates should be the short-run marginal cost (SRMC) of delivery service.

The premise for Staff's proposal is that the utilities' SRMCs of delivery service would be "volatile," because they would be "developed using data limited to an annual period or less."[29] Moreover, Staff contends, utilities' LRMCs of delivery service are readily ascertainable, because they can be calculated from information the utilities already submit to the Department. Staff expresses concern that "[t]he time and effort needed to cobble together and present [an SRMC] study, and resolve the disputes that would inevitably arise over its content, would unreasonably impede and delay the flex rate contract formation process."[30]

MI argues that the base cost used to set flexible rate delivery service rates should be SRMCs, because those would be the costs incurred during the terms of flexible rate contracts. MI adds that SRMCs would be the costs most relevant to contracts entered into for the purpose of retaining loads, because such contracts would not require the augmentation of delivery system capacity. Nucor contends that SRMC-based delivery rates were required for service to NYSEG's Economic Development Zone Incentive (EDZI) customers, and should be generally offered to flexible rate service customers.

In response to Nucor's argument, Staff argues that "[w]hile the [NYSEG] EDZI delivery rate is based on the costs that exist at the time the EDZI commitment is made, those costs are determined on an [LRMC] basis, not an [SRMC] basis."[31] NYSEG asserts that "[t]he delivery marginal cost study filed by NYSEG in support of economic development rates was based on LRMC (includ[ing] costs for adding delivery capacity)."[32]

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[29] Staff's Reply Comments, pp. 5-6.

[30] Id., p. 5.

[31] Id., pp. 4-5.

[32] NYSEG's Reply Comments, p. 7 n. 5.

The disagreement between MI and Nucor, on the one hand, and Staff and NYSEG, on the other hand, appears to stem from differing definitions of short-run and long-run marginal costs. Among the electric utility industry, its regulators, and other interested parties, the commonly accepted definition of SRMC is "[t]he change in total costs when output is increased or decreased by one unit of output for a short period of time (e.g., 1 year), during which system capacity cannot be altered." The commonly accepted definition of LRMC is "[t]he change in total costs when output is increased or decreased by one unit of output for an extended period of time (e.g., 10 years), during which system capacity can be altered."[33]

Put simply, the issue is whether the rates for flexible rate delivery service in contracts whose terms might not exceed five years should be based on marginal costs reflecting capital additions over a longer period of time. A similar issue was presented to the Commission in the proceeding in which we examined NYSEG's proposed tariff for service to customers participating in its Economic Development Zone Incentive, Economic Development Incentive, and Small Growth Incentive.[34] In that case, NYSEG submitted a distribution marginal cost estimate reflecting the costs of replacing a sample of existing electric circuits using current design standards and costs. We concluded that NYSEG's cost estimate "require[d] substantial recalculation," because the utility was in fact planning "minimal load-related investments on its

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[33] Electric Utility Rate Design Study, "Glossary: Electric Utility Ratemaking and Load Management Terms" (September 11, 1978), p. 53.

[34] Case 02-E-0576 et al., New York State Electric & Gas Corporation - Economic Development Zone Incentive et al., Order Modifying Economic Development Plan and Tariffs and Denying Rehearing (issued May 9, 2003).

distribution lines in the near future."[35]

The same reasoning applies to the issue of what base cost should be used to set flexible rates for delivery service. To avoid subsidization of delivery service to flexible rate customers, delivery rates should be set no lower than relevant marginal costs. Those costs might or might not reflect the costs of delivery system capacity additions, depending upon whether planned additions are expected to occur during or after the term of the contract being negotiated. Proposed guidelines I.C.1 and I.C.2 will be modified accordingly.

Proposed guideline I.C.2 provides that "[marginal] costs shall be based on the most recent [marginal] cost study filed with the Commission in a rate proceeding." MI argues that utilities that have not prepared studies of the marginal delivery costs that were "litigated and approved by the Commission" within the past three years should be required to file new studies. ORU supports MI's position.

MI's proposal is reasonable. The marginal cost estimates used to set flexible delivery service rates should be drawn from studies that are no more than three years old. Updated studies that have not been submitted in rate cases (or as otherwise required by the Commission) should be summarized and attached to flexible service contracts filed with the Commission.

2. Customer-Specific Costs

The order instituting this proceeding posed, as a policy issue, the question of whether and to what extent marginal delivery costs (and, as applicable, marginal energy costs) should be calculated on the basis of individual end users' locations or load patterns.

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[35] Id., pp. 10-12. Thus, NYSEG's argument that "[t]he delivery marginal cost study filed by NYSEG in support of economic development rates was based on LRMC (includ[ing] costs for adding delivery capacity)" is disingenuous, because we declined to accept the marginal cost estimate suggested by that study.

Staff’s proposed guideline I.D.3 provides as follows:

> At sites where utility local delivery facilities are substantially under-utilized, the difference between localized marginal cost and system-wide [marginal] cost may be taken into account in negotiating the contribution needed to arrive at the price that attracts a new customer or induces an existing customer to expand load.

Under this guideline, a delivery rate set equal to a utility’s system average marginal cost could be considered to generate a contribution to system overhead costs, when it is charged to a customer located in an area with excess delivery system capacity.

Nucor argues that “[f]or transmission voltage customers, the location and load pattern of the individual customer should be applied if the floor price is time differentiated.”[36] ORU argues that system average marginal costs should generally be employed, but adds that a utility might reasonably use customer-specific costs based on load shapes, excess local delivery system capacity, or the need for new local delivery system capacity to accommodate a new customer. In response to ORU, Staff states that it would oppose a customer-specific price reflecting costs of nearby new system investment (as distinguished from interconnection plant).

Staff’s objection to ORU’s position is well-taken. Additional system capacity is installed to serve existing loads in common with new loads, and the costs of such capacity should not be used to contrive a higher-than-average locational marginal delivery cost. Otherwise, ORU and Nucor are correct in arguing that local excess capacity and customers’ load shapes could reasonably be taken into account in determining the relevant marginal costs used to set flexible delivery service rates. The modifications to guidelines I.C.1 and I.C.2, previously discussed, may be read as permitting consideration of those factors.

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[36] Nucor’s Initial Comments, p. 14.

3. Niagara Mohawk

NMPC argues that it should be allowed to continue to offer flexible rate delivery service at rates whose base costs are its embedded costs of service. NMPC's rates are "flexed" by providing discounts from the competitive transition charge (CTC) loadings included in standard tariffed delivery service charges. Contending that its embedded costs of delivery service would not be materially different from its LRMCs of delivery service plus a mark-up, NMPC requests that it be excused from preparing a new marginal cost study.

Nucor criticizes NMPC's position as "altogether indifferent to the marginal cost of delivery." Nucor asserts that NMPC "does not explain how it expects to retain or attract manufacturing loads simply by offering a limited discount from its CTC."[37]

As noted earlier, NMPC's flexible rate delivery service has been successful, having resulted, since 1998, in 148 contracts leading to investments totaling $311 million and the creation of over 5,000 new jobs. Given those accomplishments, NMPC will be authorized to continue its flexible rate program. In addition, we will add guideline I.C.3 to provide that proposals to use an alternate cost basis for flexible delivery service rates will be considered.

Mark-Up on Delivery Rates

Proposed guideline I.D.4 provides that "[t]he minimum contribution shall be no less than 10% of the full standard tariff delivery rate, by service classification and voltage level, for which the [flexible rate service] customer otherwise qualifies." Proposed guideline I.D.2 provides that "[w]here tariff rates are temporarily set below [marginal] cost at the time of the flex rate contract negotiations, the difference may be taken into account in negotiating the contribution."

ESD contends that a guideline fixing a minimum contribution level should not be adopted. ESD states that while

[37] Nucor's Reply Comments, p. 4.

it "agrees that some contribution should be made towards common costs, such contribution must not be based on a 'one price fits all' approach and must be determined on a case by case basis without any minimum floor."[38] ESD argues that the factors to be taken into account should include anticipated investment, anticipated employment creation, and availability of other ED incentives.

Staff and NYSEG oppose ESD's position. Staff contends that the factors advanced by ESD are subjective in nature, and that consideration of them would impede the contract formation process. NYSEG argues that those factors are irrelevant to the determination of a reasonable mark-up.[39]

MI argues that the mark-up should be fixed at a level equal to 10% of the delivery cost portion of a utility's standard tariff. According to MI, it is not clear whether Staff is proposing a mark-up equal to 10% of delivery costs, or 10% of the tariff charges that include CTCs and other stranded cost recovery charges. MI points out that the difference between the two amounts can be significant, and argues that achievement of the objective of rate stability desired by prospective flexible rate service customers could be threatened by inclusion of CTCs in the calculation base, because CTCs can fluctuate from month to month. MI contends that a mark-up set at 10% of delivery costs would provide a reasonable contribution while ensuring that rates for flexible rate delivery service would remain stable.

Staff opposes MI's position, arguing that its (Staff's) proposed 10% mark-up should be based on total standard tariff delivery service charges, which could include loadings

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[38] ESD's Initial Comments, p. 3.

[39] ESD also takes the position that non-bypassable wires charges should not be included in flexible delivery service rates. NYSEG opposes ESD's position, pointing out that it collects NYPA Transmission Access Charges (NTACs) and ancillary services charges through its wires charge. NYSEG's concern is unnecessary, because the guidelines will include, in the definition of marginal costs, NTACs and ancillary services charges.

for the recovery of stranded costs. Staff contends that adoption of MI's position would shift responsibility for recovering stranded costs to non-flexible-rate customers, resulting in an economic burden on those customers that might exceed the economic benefits of retaining or attracting the loads of customers requesting flexible rate service.

Nucor argues that the mark-up should be fixed at .25 mills/kWh for transmission-level customers. NYSEG opposes Nucor's position, arguing that Nucor's proposed mark-up would be too low.

ORU and NYSEG contend that the minimum mark-up proposed by Staff is too low. ORU characterizes the proposed minimum mark-up as "remarkably low, to the point where we could not envision circumstances where the percentage would have relevance."[40] NYSEG argues that the minimum contribution should be the greater of 20% of the full standard delivery rate or 5 mills/kWh. According to NYSEG, use of only a percentage standard would not assure a contribution, where delivery rates are below marginal cost.

In response, Staff contends that setting the mark-up at the level it proposes might be necessary in some circumstances. Nucor, responding to NYSEG, points out that NYSEG's marginal delivery cost at the transmission level is 6.7 mills/kWh.[41] Thus, Nucor argues, NYSEG's "greater of" mark-up would be 75% of its marginal cost.

The currently effective flexible rate service guidelines provide that flexible rates may be offered to maintain contestable customers on the utilities' systems in a way that benefits all ratepayers, and that a utility would not be required to offer flexible rates if the rates would not be advantageous to the utility's customers as a whole. These two criteria – the necessity for attracting or retaining load, and a demonstration of economic benefits to non-participating

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[40] ORU's Initial Comments, p. 6.

[41] See Case 02-E-0576 et al., supra, Order Modifying Economic Development Plan and Tariffs and Denying Rehearing, Appendix C.

customers – should determine the amount of the mark-up over relevant marginal costs to be included in flexible delivery service rates.

It is clear from the parties' comments that any mark-up specified as a minimum will be viewed by prospective flexible rate service customers, including those who could afford a higher mark-up, as a targeted cap. As discussed earlier, guideline I.B.1 will require a prospective flexible rate service customer to specify "the relief from standard tariff rates that is necessary to retain or attract the customer's load, taking into account the economic development measures offered by other entities for the purpose of retaining or attracting the customer." The mark-up the customer is willing to pay should be determined through this process, on a case-by-case basis.

Delivery Service Contract Term

1. Generally

Proposed guideline I.F.1 provides that "[flexible] delivery rates, including the contribution, identified in a [flexible] rate contract subject to these guidelines shall remain in effect for a term of up to five years." This proposal is opposed by ESD, MI, and Nucor. ESD contends that businesses value price certainty, so flexible rate contracts with terms up to 10 years should be provided if prospective customers request them. MI supports retention of the current guideline, which provides that the term of a flexible rate contract should not exceed seven years unless specifically authorized by the Commission. Nucor argues that the five-year limit should apply only if delivery service rates are based on short-run marginal costs, and that rates based on long-run marginal costs should be available for up to 10 years.

Staff argues that a five-year term "dovetails economic policy with the anticipated growth of retail electric markets." In Staff's view, flexible rate service is "a transitional device that may prove increasingly unnecessary as markets continue to develop, and a term of more than five years could result in contracts that obstruct a change in [flexible] rate policy as

the transition nears completion." Staff argues in addition that a longer term would result in a "growing disconnect" between fixed delivery rates and long-run marginal costs projected as of the beginning of the contract term.[42] Staff's position is supported by NYSEG and NMPC.

Staff's argument that flexible rate delivery service would be "transitional" is unconvincing, because there has been no indication that a competitive market for such service is developing. However, it is possible that, over a period longer than five years, some utilities' delivery rates might diverge from delivery costs. Accordingly, the guidelines will set forth a general rule that the term for flexible rate delivery service contracts should be five years. We will retain the current provision that longer terms may be proposed but must be specifically approved.

2. Return to Standard Tariff Service

Proposed guideline I.F.3 provides that "[n]o particular termination or price substitution provisions are required, but may be negotiated . . . ." ESD, MI, and Nucor argue similarly that a flexible rate service customer should have the option to return to standard tariff service if the standard rates fall below the rates fixed in the flexible rate contract. ESD supports adoption of "a system where entry into and exit from flexible rate contracts is seamless and not cumbersome."[43] ESD states that it would support clear exit provisions that preclude "gamesmanship" by customers, including a minimum term for taking standard tariff service and a requirement that departed flexible rate service customers must formally reapply for flexible rate service. Nucor argues that the option to return to tariff service should be available on terms no more stringent than those applicable to other customers. MI asserts that availability of the option to leave flexible rate service for tariff service would be consistent

[42] Staff's Reply Comments, p. 17.

[43] ESD's Initial Comments, p. 4.

with Commission policies that favor maximization of customer choice.

In response, Staff contends that there is no need for a guideline requiring that flexible rate service customers have the option to return to standard tariff service prior to the end of the flexible rate contract's term, because there has been only one instance in which a utility's tariff rates dropped below a customer's flexible contract rates. NYSEG and NMPC argue similarly that the availability of such an option would deprive a utility of the benefit of the bargain resulting from securing a customer for a fixed contract term, because the customer could simply cease taking service once it was released from the contract. NMPC and ORU argue that provisions for terminating flexible rate contract service and returning to standard tariff service should be individually negotiated and include clearly specified triggering conditions.

We see no need for a guideline governing a circumstance that has occurred only once since flexible rate services have been offered. Should a prospective flexible rate customer foresee that circumstance while negotiating a service contract, it should propose a service termination provision.

Dispute Resolution Process

Proposed guideline II.B provides as follows:

> The Business Advocate, as designated by the Department of Public Service's Director of the Office of Economic Development & Policy Coordination, will facilitate the negotiation of disputes between utilities and customers over [flexible] rates and assist in expediting resolution of complaints filed by customers concerning [flexible] rates.

NYSEG argues that the decision in this case should recite the extent of the Commission's jurisdiction over contracts under which flexible rate service would be provided. According to NYSEG, "it is not clear whether the Commission would respect forum selection clauses that specify how and [in] what forum disputes are to be resolved, or whether the

Commission will assert general jurisdiction over such contracts as it [has] indicated it [has] the authority to do . . . ."[44]

Staff and Nucor object to NYSEG's request. Staff points out that the Commission's jurisdiction was explained in the order cited by NYSEG and in an earlier order involving Nucor.[45] Staff notes further that the Commission's determinations have been upheld on judicial review,[46] and argues that the issue should not be reopened in this proceeding. Nucor argues that it "sees no basis for the Commission to volunteer in a policy statement that the vehicle chosen for service arrangements . . . will affect the Commission's authority to ensure that the rates and terms of service are just and reasonable."[47]

The bases for the Commission's jurisdiction over contracts for flexible rate service are set forth in various paragraphs within subdivision 12 of Public Service Law §66, and they were explained to NYSEG in Case 01-E-0680.[48] There is no need for an additional statement regarding this matter, and NYSEG's request is denied.

Proposed guideline II.B will be modified to inform the parties that other means of alternative dispute resolution are available to parties through the Department of Public Service, should facilitated negotiations fail to result in resolution of a dispute.

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[44] NYSEG's Initial Comments, pp. 18-19, citing Case 03-E-1306 et al., supra, Order Granting Petitions in Part and Establishing Methods and Procedures for the Billing of Marginal Cost Adjustments (issued April 19, 2004).

[45] Case 01-E-0680, supra, Order Denying Rehearing and Stay and Authorizing an Enforcement Proceeding (issued May 23, 2002), pp. 12-14.

[46] See New York State Electric & Gas Corporation v. Public Service Commission, 308 A.D.3d 108 (3rd Dept, 2003).

[47] Nucor's Reply Comments, p. 8.

[48] See footnote 46, supra.

Filing of Contracts and Reports

Proposed guideline II.C.1 requires that each flexible rate contract be jointly filed with the Commission by the utility and the customer, subject to full confidentiality protection for both the utility and the customer as a trade secret. Proposed guideline II.C.2 requires utilities to file a quarterly summary of contract activity, with most individual customer information being accorded full confidentiality protection as a trade secret.

Nucor supports these guidelines, asserting that Staff should be apprised of the terms and conditions of flexible rate contracts. NMPC suggests that the quarterly reports should reflect actual activity, not "some benchmark contained in a [flexible] rate contract."[49] In response to NMPC, Staff argues that the reports should show usage estimates at the time flexible rate contracts were entered into, that is, the usage estimates on which the utilities relied when negotiating the contracts.

Staff's quarterly report format is adopted; the usage data should be the estimates contemplated during contract negotiations. No party has objected to providing trade secret protection to flexible rate service contracts and much of the individual customer information listed in the quarterly reports. Such information would be commercially sensitive, and disclosure would likely result in a substantial competitive injury to flexible rate customers.[50] Accordingly, trade secret protection will be given to that information.

Lost Revenue and Cost Recovery

Proposed guideline II.D.1 provides as follows:

> Utility recovery of revenues lost because of entry into a [flexible] rate contract shall be addressed in rate proceedings, and existing rate plan provisions shall be continued for the periods of time the rate

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[49] NMPC's Initial Comments, p. 13.

[50] See Trade Secret 01-06, Determination of Appeal of Trade Secret Ruling (issued January 30, 2002).

> plans remain in effect. In addition, a utility may recover revenues lost due to [flexible rate] contracts entered into pursuant to these guidelines as an uncontrollable cost, exogenous cost, regulatory change, or other similar cost under an applicable rate plan provision, to the extent that provision permits.

No party opposes this guideline. Nucor comments that the calculation of lost revenues should be based on "revenues reasonably expected under the best available tariff arrangement (or lost delivery revenues, if applicable)."[51] NMPC points out that its existing rate plan has a specific mechanism for recovering lost revenues associated with flexible rate service, and requests that the proposed guideline be read as leaving that mechanism in effect. Staff agrees with NMPC's request, and we find that request reasonable.

Proposed guideline II.D.2 provides as follows:

> Utilities shall recover, through a deferral or other appropriate mechanism, the incremental cost incurred in designing, conducting and implementing an RFP to procure commodity for [flexible] rate customers, and the incremental cost of balancing commodity supply streamed to a [flexible rate] customer that is not recovered from the customer.

NYSEG argues that the proposed guideline recognizes some of the costs utilities might incur in offering flexible rate commodity service, but does not specifically address various other costs that would or could be incurred in providing "innovative solutions" (whether or not their provision is required). NYSEG recommends that the guideline be amended to provide for full recovery of default-related costs, recurring administrative costs, and additional credit costs.

As just discussed, NMPC's current rate plan provides a mechanism for the recovery of lost revenues. NMPC notes that the rate plan does not provide for the recovery of the costs associated with the provision of flexible rate commodity

[51] Nucor's Initial Comments, p. 16.

service, and argues that such costs should be immediately recoverable.

Staff responds that the proposed guideline provides for the recovery of RFP-related costs, and argues that the recovery of other commodity procurement costs should be considered in rate proceedings or pursuant to existing rate plans. Nucor contends that the costs identified by NYSEG are not unlike costs incurred to procure electricity for resale to retail customers under standard tariff service, and argues that there should be no different allocation of the recovery of such costs to flexible rate service customers.

The literal limitation of the applicability of proposed guideline II.D.2 to RFP-related and balancing costs is not well-explained. Accordingly, we will modify the guideline to authorize a utility to recover, through a deferral or other mechanism, other reasonable costs incurred in procuring commodity supplies for flexible rate service customers.

Offering Flexible Rate Service to Customers Considering Distributed Generation

Proposed guideline II.E provides as follows:

> Utilities shall not offer [flexible] rate contracts as an alternative to customers that are considering the installation of [distributed generation (DG)] systems. The public policy of the State is to encourage DG installations, but [flexible] rate offers may obstruct those installations. Recently-established standby rates for back-up and other utility delivery service to customers that self-supply with DG, which can be flexed as an alternative to the "islanding" of a DG installation, are a satisfactory replacement for the prior policy of allowing [flexible] rate alternatives to DG installations themselves.

Staff contends that the foregoing restriction is justified, because "[a] DG developer might expend considerable effort to persuade a customer to consider DG, and incur substantial costs in designing and engineering a DG installation for that customer, only to find that the utility has undercut its offer.

DG developers are thereby unreasonably discouraged in their efforts."[52]

The proposed restriction is supported by NYSERDA, NYPA, and NFG. NYSERDA raises the following argument (with which NYPA concurs):

> With regard to economic development, where a customer is considering the installation of on-site generation, and particularly where that alternative is truly 'realistic,' the community is not faced with the threat of job losses and the peripheral economic damage that results from plant closings or relocation. In fact, the installation of on-site generation represents a capital infrastructure investment in New York. Simply stated, the use of [flexible] rates in competition with on-site generation is in neither the ratepayer nor the public interest.[53]

NFG adds that the availability of flexible rate service to electric customers considering a DG installation would discourage or prevent the development of a DG market.

The proposed restriction is opposed by MI, Nucor, NYSEG, and ORU. MI argues that the restriction would have the effect of limiting a customer's opportunity to choose between competing sources of energy, contrary to the Commission's policies. Staff contends in response that MI's argument is misplaced, because utility flexible rate service "does not qualify as a competitive market initiative that falls within the scope of Commission policies for promoting customer choice in deregulated or lightly regulated competitive markets."[54]

NYSEG argues that the proposed restriction ignores the interests of customers who would prefer to continue taking utility service instead of resorting to self-supply. Moreover, NYSEG continues, the rate plans in effect for NYSEG and RG&E do not contemplate such a restriction, so there are no provisions for the recovery of lost revenues resulting from a prohibition

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[52] Staff's Initial Statement, p. 9.

[53] NYSERDA's Initial Comments, p. 2.

[54] Staff's Reply Comments, p. 15.

on their attempting to retain customers considering DG. NYSEG contends that standby charges collected from DG customers might not be sufficient to offset the lost revenues. In response, Staff characterizes NYSEG's argument as "posit[ing] that its existing Rate Plan creates a right for it to compete against DG" while "provid[ing] no citation in support of its purported right."[55] Staff argues that NYSEG is not automatically entitled to recover lost revenues attributable to "competitive losses," and suggests that if NYSEG is faced with significant revenue losses, it should seek to institute a rate proceeding in which all revenue forecasts underlying its rate plan can be examined.

ORU argues that a narrow restriction against using flexible rate service to compete with certain DG technologies, such as solar installations, might be warranted, but a blanket restriction is not. ORU asserts that a utility should be free to offer a flexible rate contract to a customer considering uneconomic and/or environmentally undesirable DG installation. Staff responds that all types of DG facilities "should at least be allowed to compete on an economically-level playing field, without facing a barrier to market entry in the form of a utility [flexible] rate offering priced below the utility's tariffed prices and embedded costs."[56]

The currently effective flexible rate service guidelines provide that flexible rates may be offered by utilities to retain or attract contestable customers in a manner that benefits all ratepayers. In the circumstance where a customer is considering installing DG instead of leaving a community (or is not planning on leaving in any event), flexible rates offered as an alternative to installing DG might not result in incremental economic benefits to the community. Were the two criteria discussed earlier – the necessity for attracting or retaining load, and a demonstration of net economic benefits to non-participating customers – not met, there would be grounds for disallowing the recovery of lost

[55] Id.

[56] Id., p. 16.

revenues resulting from a flexible rate service contract offered as an alternative to DG. But that outcome could be reached on the basis of ratemaking principles, and would not depend on adoption of the restriction set forth in proposed guideline II.E.

As suggested by the opponents of that proposal, economic development customers should have a variety of options for meeting their electricity requirements.[57] For example, a customer requiring a reduction to prospective electricity costs in order to remain in or relocate to a community might determine that the greatest savings (and, perhaps, the required savings) would result from a combination of discounted utility service and DG. In that circumstance, the flexible rate service would be a partial alternative to a larger DG installation that could technically serve the customer's entire load, but the economic benefits to the community resulting from a combination of DG and flexible rate service would be significant.

Minimum Bill

NYSERDA argues that any minimum bill authorized by a flexible rate contract should be limited to the charge for a percentage of the expected load (NYSERDA suggests 75%). According to NYSERDA, minimum bills eliminate incentives to manage peak loads or install efficiency measures. MI supports NYSERDA's position.

Staff argues in response that a minimum charge provision would be reasonable, because it would ensure that a utility, which has agreed to advantageous terms in order to retain or attract a customer, recovers the expected contribution

[57] A restriction against offering flexible rate service "to customers that are considering the installation of DG systems" could result in unintended consequences for DG vendors. A customer who is certain that a flexible rate service offer would meet its pricing objective, but is uncertain about whether DG would meet the objective, might refuse to contact DG vendors out of concern that the flexible rate service offer, with its certain benefits, would have to be withdrawn.

toward the recovery of system costs. Staff contends that there has been no showing that limiting the amount of the minimum bill will encourage load management and conservation. In any event, Staff continues, such provisions would be established through negotiations, as is currently the case. NYSEG and NMPC agree with Staff.

There is no apparent need for a guideline limiting the amounts of minimum bills to a specified percentage of expected loads, and none will be adopted.

Negotiation Deadline

MI proposes a requirement that a utility begin negotiations with a prospective flexible rate service customer within 60 days following the customer's application for service, and a requirement that negotiations be completed 60 days thereafter. If an agreement is not executed by that deadline, MI continues, the parties would notify the Commission about their impasse and submit their respective proposed agreements to the Commission for resolution. Nucor argues generally that a streamlined process for setting non-price terms should be established, because negotiations over such terms have continued long after agreement on the rates themselves have been reached.

Staff argues in response that a guideline reflecting MI's proposed deadline would be of little value, because the only proposed remedy is bringing stalled negotiations to the Commission's attention. Staff notes that customers are already permitted to request the Commission's intervention when there is an impasse. NYSEG contends that evaluation of some requests for flexible rate service contracts requires more than 120 days. NYSEG and NMPC argue that a guideline fixing a negotiation deadline would invite gaming by prospective customers, who would threaten to invoke Commission intervention to gain an upper hand in negotiations.

A specified deadline of 120 days would inevitably become the schedule for forming flexible rate service contracts, even in circumstances when all contract terms could be established in a shorter period of time. A prospective customer

should be free to request the Commission’s intervention in any instance when there is an unreasonable delay in contract formation. Accordingly, MI’s proposal will not be adopted.

CONCLUSION

The guidelines adopted here represent a reasonable approach for the provision of flexible rate electric services that support the achievement of economic development goals. The guidelines reflect modifications to Staff’s straw proposal in response to pertinent comments raised by the utilities directed to participate in this proceeding (NYSEG, NMPC, ORU, and RG&E) and the intervening parties. Accordingly, we adopt the attached flexible rate service guidelines. Future contracts for flexible rate service should follow these guidelines.

The Commission orders:

1. The guidelines set forth in the appendix to this order are adopted as guiding principles for the formation of flexible rate electricity service contracts.

2. New York State Electric & Gas Corporation, Niagara Mohawk Power Corporation, Orange and Rockland Utilities, Inc., and Rochester Gas and Electric Corporation are directed to file flexible rate electric service tariffs complying with this order and the guidelines in the appendix no later than 45 days following the date of issuance of this order, to become effective on 90 days’ notice.

3. This proceeding is continued.

By the Commission,

(SIGNED) JACLYN A. BRILLING
Secretary

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 03-E-1761 - Proceeding on Motion of the Commission to Reexamine Policies and Tariffs for Flexible Rate Contract Service to Economic Development Customers.

GUIDELINES FOR FLEXIBLE RATE ELECTRIC SERVICE

I. Delivery and Commodity Options

A. Flexible Contract Services - At a minimum, utilities shall offer customers, eligible under their tariffs for new, individually-negotiated flexible rate service contracts entered into in conformance with these guidelines, delivery-only service at a specified rate, or at a discount from the otherwise-applicable delivery rate. Flexible rate service customers are encouraged to obtain electricity commodity service from a competitive market supplier, or as a last resort may purchase commodity service from the utility, with the rate for that service stated separately from the delivery rate or discount.

B. The Pricing Objective

1. Before making a flexible rate service offer to an eligible customer seeking to remain, newly locate or grow within a utility's service territory, the utility shall review information provided by the customer demonstrating competing alternatives and the pricing objective needed to retain or attract its contestable load. In making the requisite demonstration, a customer will not be required to provide information whose submission would violate confidentiality arrangements, but the customer may be required to offer other proof in support of its demonstration, including affidavits making pertinent affirmations. The pricing objective should specify the relief from standard tariff rates that is necessary to retain or attract the customer's load, taking into account the economic development measures offered by other entities for the purpose of retaining or attracting the customer.

2. Utilities shall refer customers seeking flexible rates to the economic development measures available through programs offered by the New York Power Authority (NYPA), the New York State Energy Research and Development Authority (NYSERDA), the Empire State Development Corporation (ESD), and other state and local entities. A prospective flexible rate service customer may be required, by a utility's tariff, to demonstrate that it has undertaken reasonable efforts to participate or be involved in those programs for which it is eligible.

C. Delivery Costs

1. A flexible delivery service rate shall recover the relevant marginal cost of delivery service, which includes applicable customer and distribution marginal costs, and applicable ancillary services, NYPA Transmission Access Charge and other transmission marginal costs.

2. Where tariff delivery rates approximate relevant marginal costs, they may be used as the basis for the flexible delivery service rate. Otherwise, the estimate of marginal costs shall be derived from the most-recent marginal cost study filed with the Commission in a rate proceeding, provided that the study is no more than three years old. Updated studies that have not been submitted in rate cases (or as otherwise required by the Commission) should be summarized and attached to flexible rate service contracts filed with the Commission.

3. The Commission will consider proposals to set delivery rates on the basis of alternative approaches to incremental costs, consistent with statutory requirements.

D. The Contribution

1. A flexible rate for delivery service should include a contribution towards system costs, so that the resulting rate would be consistent with the pricing objective identified under guideline I.B.1. The contribution shall be an individually negotiated amount.

2. Where tariff rates are temporarily set below the relevant marginal cost at the time of the flexible rate contract negotiations, the difference may be taken into account in negotiating the contribution.

3. At sites where utility local delivery facilities are substantially under-utilized, the difference between the localized marginal cost and the system-wide marginal cost may be taken into account in negotiating the contribution that results in a price that attracts a new customer or induces an existing customer to expand load.

E. <u>The Commodity Rate</u>

1. At the customer's option, a utility shall offer electricity commodity service at the tariffed rate available for commodity under the otherwise-applicable service classification, subject to any load shaping provided for in the tariff.

2. At the customer's option, the utility will facilitate the customer's access to market commodity options available from energy services companies (ESCOs) by offering the customer the assistance of a utility customer representative knowledgeable in the workings of the competitive market, and devising Market Match or similar programs that generally facilitate the linking of a flexible rate service customer to ESCOs that offer, at a minimum, fixed price commodity service for a period of at least six months.

3. If a customer can demonstrate that, notwithstanding the benefits under the flexible delivery rate and economic development measures offered by other entities, market commodity prices prevent its reaching the price objective, the customer's utility shall pursue innovative solutions to overcoming commodity cost barriers on a customer-specific basis, if pursuing those solutions would not result in an economic detriment to other customers. In making the requisite demonstration, a customer shall not be required to provide information whose submission would violate confidentiality arrangements, but

the customer may be required to offer other proof in support of its demonstration, including affidavits making pertinent affirmations.

4. Innovative solutions to commodity cost barriers could include:

   a) A utility may issue a request for proposals (RFP) that solicits bids from ESCOs to serve a particular flexible rates service customer, or group of customers, of sufficient size to attract bids. The utility would tailor the design of the RFP to market conditions, in making its best efforts to obtain the best available commodity price.

   b) An RFP may provide that the utility will purchase commodity from the winning ESCOs and stream it to the flexible rate service customers, or otherwise provide it at the RFP price.

   c) An RFP may provide that the flexible rate service customers will purchase commodity and other services directly from the winning ESCOs.

   d) A utility may aggregate flexible rate service customers, for the purpose of making direct purchases from ESCOs.

   f) As a last resort, a utility may stream to a flexible rate service customer the price for commodity purchased directly from a generation source, or the price hedged with financial institutions or other entities that mitigate commodity price risk; provided, however, that the commodity that would be streamed may not be drawn from an investor-owned utility's existing supply portfolio used to provide commodity service to all customers, if doing so would result in increased commodity costs to other customers over the term of flexible rate service contract.

F. Contract Term

1. Flexible delivery service rates, including the contribution, identified in a flexible rate service contract subject to these guidelines shall remain in effect for a term of up to five years, unless a longer term is specifically approved by the Commission. Flexible delivery service rates shall not be adjusted retrospectively for variations in marginal costs. Prospective adjustments may be negotiated by the parties, but must be identified in a comprehensive contractual provision setting forth the adjustment mechanism and its operation.

2. No particular term shall be required for the time a commodity price arrangement remains in effect under a flexible rate service contract, except that prices for commodity supplied pursuant to a utility's tariff shall remain in effect for the time periods established in the tariff. Other commodity price arrangements with utility suppliers may provide for the expiration and prospective updating of commodity prices and may be structured flexibly, so long as the contract includes a comprehensive provision setting forth the pricing mechanism and its operation.

3. No particular termination or price substitution provisions are required, but may be negotiated, except that if a customer terminates or breaches a contract with a utility supplier for a non-tariffed commodity price prior to the expiration of the term the price was to remain in effect, the customer shall be responsible for compensating the utility for any obligations it has, or any damages it incurs, to a third party related to that price, under a comprehensive contractual provision setting forth the compensation or damages mechanism and its operation.

II. Non-Price Issues

A. Coordination With Other Energy Supply Sources – The metering protocols and allocations necessary to coordinate flexible rate partial commodity service from a utility with partial commodity service from

other sources, or among sources, shall be referenced or identified in the flexible rate contract.

B. Dispute Resolution - The Business Advocate, as designated by the Department of Public Service's Director of the Office of Economic Development & Policy Coordination, will facilitate the negotiation of disputes between utilities and customers over flexible rates and assist in expediting resolution of complaints filed by customers concerning flexible rates. Other means of alternative dispute resolution are available to parties through the Department of Public Service, should facilitated negotiations fail to result in resolution of a dispute.

C. Contract Filing

1. A flexible rate service contract entered into after the adoption of guidelines in this proceeding shall be jointly filed with the Commission by the utility and the customer, subject to full confidentiality protection, for both the utility and the customer, as a trade secret.

2. Utilities shall file a quarterly summary of contract activity in a standardized format. A sample format is attached; individual customers' information shown in the columns, reading left to right, from Service Level through Customer Load shall be filed subject to full confidentiality protection as a trade secret.

3. Additional filing and contract standardization requirements are not needed.

D. Lost Revenue Recovery

1. Utility recovery of revenues lost because of entry into a flexible rate service contract shall be addressed in rate proceedings, and existing rate plan provisions shall be continued for the periods of time the rate plans remain in effect. In addition, a utility may recover revenues lost due to flexible rate contracts entered into pursuant to these guidelines as an uncontrollable cost, exogenous cost, regulatory change, or other

similar cost under an applicable rate plan provision, to the extent that provision permits.

2. Utilities shall recover, through a deferral or other appropriate mechanism, the incremental cost incurred in designing, conducting and implementing an RFP to procure commodity for flexible rate customers, the incremental cost of balancing commodity supply streamed to a flexible customer that is not recovered from the customer, and other reasonable costs incurred in procuring commodity supplies for flexible rate service customers.

Sample Flex Rate Quarterly Report

Customer Designation	Flex Rate Service Class	Parent Service Class	Service Level (Trans/Sub-Trans/ Primary/Secondary)	Execution Date	Termination Date	Peak Demand Under Contract (kW)	Annual Energy Under Contract (kWh)	Customer Load Under Contract (Partial/Full)	Competitive Alternative
#1	SC-11	SC-3A	Trans	5/19/2000	5/19/2004	20,000	100,000	Full	Relocation
#2	SC-12	SC-3A	Sub-Trans	9/20/2000	9/20/2004	10,000	40,000	Partial	Relocation
Cumulative In Effect	**By Class**	**By Class**				**Cumulative In Effect (kW)**	**Cumulative In Effect (kWh)**		
2	SC-11 (1)	SC-3A (2)				20,000	100,000		
	SC-12 (1)								