STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 94-27

CASE 94-E-0952 - In the Matter of Competitive Opportunities Regarding Electric Service

OPINION AND ORDER REGARDING PROPOSED PRINCIPLES TO GUIDE THE TRANSITION TO COMPETITION

Issued and Effective: December 22, 1994

CASE 94-E-0952

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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BY THE COMMISSION:

INTRODUCTION

On August 9, 1994, phase II of the proceeding examining competitive opportunities for electric service was instituted.[1] The overall objective of this phase is "to identify regulatory and ratemaking practices that will assist in the transition to a more competitive electric industry designed to increase efficiency in the provision of electricity while maintaining safety, environmental, affordability, and service quality goals."[2] The parties were asked "to work collaboratively to identify a few comprehensive principles to guide the transition,"[3] and proposed principles were to be presented for

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[1] Case 93-M-0229, Order Instituting Phase II of Proceeding (issued August 9, 1994). The case name and number was subsequently changed to reflect the fact that it is now limited to electric service. Case 94-E-0952, Order Deciding Petitions for Rehearing and Clarification (issued November 30, 1994).

[2] Case 93-M-0229, Order Instituting Phase II of Proceeding, pp. 1-2.

[3] Ibid., pp. 2-3.

consideration by November 9, 1994. This order issues a proposed set of principles for comment.

Also, the parties have pointed out that the order instituting phase II of this proceeding is susceptible to different readings. Some parties interpret it to say that issues related to the establishment of a fully efficient wholesale market should be examined first, in that this appears to offer considerable potential to benefit consumers. An alternative reading of the order, supported by other parties, is that retail competition ought to be explored at the same time as wholesale competition. In order to move the case forward, and to establish a future schedule, issues related to establishment of a fully efficient wholesale market should be examined. Only retail competition not inconsistent with the principles set forth here will be considered during this phase.

PROCEDURAL HISTORY

On September 12, 1994, a conference was held before Administrative Law Judge Judith A. Lee and Deputy Director Ronald Liberty to discuss, inter alia, the schedule and process for developing general principles. By procedural ruling issued September 16, 1994, a schedule was adopted that had been agreed to by the parties. Pursuant to this schedule, proposed principles were submitted by 24 parties (or coalitions of parties) by September 26, 1994, and all-day meetings were held on September 29, October 6, and October 13, 1994, to discuss the proposals. Additionally, at the meeting on October 6, the parties agreed to participate in a fourth meeting on October 17, 1994.

The meetings, generally attended by over 80 individuals representing more than 40 parties, resulted in significant progress toward development of general principles, although consensus was not reached. The parties worked very hard to listen to each other and to appreciate the various interests. In their comments, several parties acknowledged that the

collaborative process was very helpful in assisting the parties.[1] Issues were sharpened through the collaborative process, although it did not appear productive to continue that process because of some large irreconcilable gaps, coupled with the limited time available. Furthermore, submissions of proposed principles included much information about such subjects as specific industry structures and ways to achieve certain goals, and this will be useful in later parts of this proceeding.

At the first meeting, agreement was reached on separating the proposed principles into the following eight categories: resource management, customer service, reliability and safety, competitive market characteristics, regulatory issues, transition issues, economic efficiency, and economic development. At subsequent meetings, progress was made toward narrowing issues and reaching tentative agreement in many areas. However, the parties wanted to evaluate the entire package of principles before agreeing to any specific one. In certain areas, there were extremely divergent views which may be irreconcilable.

Judge Lee and Mr. Liberty prepared a summary of the status of the proposed principles as of the end of the series of meetings, and this was circulated to the active parties on

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[1] For example, the Energy Association stated: "The collaborative process provided an open forum for a valuable exchange of views among the parties. It served to more clearly define the issues to be addressed in this proceeding and identify the areas of major controversy."

The Independent Power Producers of New York and Adirondack Hydro Development Corporation, filing jointly, stated they were "very surprised and pleased by the level of agreement that the parties were able to reach."

The United States Department of Energy and United States Environmental Protection Agency, filing jointly, strongly supported the proposed principles, believing they "addressed all of the relevant issues in an appropriate manner and at the right level of detail." These federal agencies participated actively at the meetings held to discuss proposed principles.

October 19, with comments due October 26, 1994. Comments were received from 25 parties, listed in Appendix A.

ANALYSIS OF COMMENTS

In general, the parties' comments were supportive of a set of principles similar to the ones that were circulated. Clarifications were suggested throughout but, in the spirit of the collaborative process, the parties generally limited their comments to those issues with which they strongly disagreed.

Certain parties had fundamental concerns that were of considerable importance to them, including the following:

- The Energy Association viewed its comments in the context of the entire group of principles and argued that two particular principles must be added:

  1. The Commission should approach the proceeding with an open mind and with no bias for or against a particular industry structure.

  2. All reasonable steps must be taken to reduce <u>all</u> costs related to production and delivery of electric service.

- The Independent Power Producers of New York, Inc., and Adirondack Hydro Development Corporation (IPPNY) urged that a principle explicitly state that the sanctity of existing contracts must be respected.

- The Consumer Protection Board stated that there was not enough focus on the need to reduce rates for <u>all</u> consumers and to protect captive customers.

- Multiple Intervenors did not accept the package of principles, although they agreed with four of them; there was a strong concern that the basic objective should be to minimize retail prices paid by consumers.

- The Utility Workers Union argued that the underlying assumption that increased competition will increase efficiency had not been tested, and questioned whether <u>true</u> competition would really develop.

- The State Energy Office/Department of Environmental Conservation/Energy Research Development Authority suggested an additional principle stating that the State Energy Plan's findings and recommendations should provide policy guidance for the move to greater competition. (IPPNY and Public Interest Intervenors concurred with this.)

The attached summary of comments (Appendix B) provides considerably more detail about the parties' arguments and suggestions.

DISCUSSION

A. BACKGROUND

The Commission's commitment to encouraging competition in place of regulated monopoly under appropriate circumstances has been established policy for several years.[1] To recapitulate here:

Competition has generally resulted in lower prices, expanded customer choice and more rapid technological advance than the regulated monopoly situations that it has displaced. Where genuine competition has replaced regulated monopoly, customers have had little reason for regret.

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[1] Case 29469, Proceeding on Motion of the Commission to Review Regulatory Policies for Segments of the Telecommunications Industry Subject to Competition, Opinion No. 89-12 (issued May 16, 1989); Case 93-G-0932, Proceeding on Motion of the Commission to Address Issues Associated with the Restructuring of the Emerging Competitive Natural Gas Market, Opinion No. 94-26 (issued December 20, 1994). Indeed, the Commission commitment to telephone competition is rooted in decisions in the mid-1970's. Case 26426, New York Telephone Company - Cost of Service and Rate Structure, Opinion No. 76-13 (issued July 2, 1976) (competition costing issues); Case 26635, New York Telephone - Answering and Recording Devices, Opinion No. 76-9 (issued April 16, 1976) (authorizing connection of customer-owned equipment); and Case 27089, New York Telephone Company - Terminal Equipment and Intrastate Toll Rates, Opinion No. 77-22 (issued December 1, 1977) (reducing subsidies from competitive services).

Certain aspects of New York's electric energy circumstances make the transition to competition more complex for the electric industry than for other regulated monopoly sectors. Several significant interests (some beyond utility management control) have a stake in keeping New York's electric prices considerably above the cost either of new supply or of purchasing directly from plants outside New York. Any decision to permit direct purchases by end users from particular power plants while allowing the utility to collect only its actual transmission and distribution costs would result in these other "expectations" either being collected from other customers or going unfulfilled.

A listing of these expectations at this point is necessary to clarify the challenge and the opportunity that competition presents. More precise quantification will be a necessary part of the next phase of this proceeding.

Taxation

State and local taxes paid by New York utilities were $2.1 billion per year in 1993. In addition, petroleum taxes were about $200 million per year and State and local sales taxes collected by the utilities for the State were $600 million. Assuming no change in these taxes, they will amount to nearly $30 billion over the next ten years. These taxes, of course, translate into governmental services of many sorts. Wide open competition will both reduce and redirect these revenue flows and, potentially, the governmental services that they pay for. For example, the taxable value of some power plants would fall (or disappear) if those plants could not make sales. Municipalization would reduce gross receipts tax revenues. Decisions by large customers to buy out-of-state electricity could have a similar effect.

Utility Investor Expectations

In New York, utility investors have enjoyed a high degree of assurance that they will recover investment and related

costs not found to be imprudent.[1] Rough estimates of the extent to which such amounts exceed that which can be recovered over time through competitive pricing range from $5 billion to $20 billion or more.

Independent Power Producer (IPP) Contracts

All electric utilities have, since 1978, been under a duty to buy power from any source when the price was at or below the state's estimate of the utility's own cost of producing that power (Long-Run Avoided Cost or LRAC). In New York, that obligation was reinforced by a statute (repealed in 1992) that required the purchase price to be at least 6 cents. Because the State's LRAC estimates (like those of the utilities) tended during the 1980's to overestimate mid-90's fuel prices and electricity demand while underestimating the number of independent power plants that would be built, the resulting contracts often call for payments well above utility generating costs. Investors in these independent units, like investors in utility plants, claim a good faith right -- as well as legal rights -- to have their expectations realized. To the extent that they are not, a portion of the loss will take the form of tax write-offs and will therefore come from federal and state treasuries.

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[1] This assurance, however, has never been absolute. The Nine Mile II cap (Cases 29327 et al., Niagara Mohawk Power Corporation - Nine Mile 2 Issues Settlement, Opinion No. 89-37(C), issued March 14, 1991) and the flexible pricing tariffs (Case 93-M-0229, Opinion No. 94-15 (issued July 11, 1994), mimeo page 16, footnote 1, citing Cases 93-E-0208 et al., Niagara Mohawk Power Corporation - Tariff Filing for S.C. No. 10, Cases 93-E-0672 and 93-E-0405, Rochester Gas and Electric Corporation - Individually Negotiated Rates and Case 94-E-0007, New York State Electric & Gas Corporation Tariff Filing for S.C. No. 13 - Individually Negotiated Service Agreements) are two examples of unrecoverable investment (agreed to by the respective utilities) without any finding of imprudence.

Rough estimates of the costs of these contracts above today's market price range between zero and $6 billion or more over time.[1]

Environmental and Other Social Obligations

New York utilities have undertaken or deferred commitments of several sorts in response to state policies. These include renewable resource purchases, demand side management (DSM) deferrals, and low income assistance. Although small in relation to the three items above, these expenditures are of considerable social and/or environmental significance.

* * *

The average price of a kilowatt-hour in New York in 1993 was about 11.5 cents. The average price nationally was about 6.9 cents. The difference is largely made up of the items set forth above, coupled with higher than average New York utility operation, maintenance and labor costs.

* * *

B. FIRST PRINCIPLE

The economic and environmental well-being of New York State is of paramount concern here. That is the primary principle, the one that cannot be compromised to accommodate the others.

In the context of electric utility regulation, the Commission has found this to mean that all New Yorkers should have access to reliable and reasonably priced utility services, provided safely, cleanly and efficiently. The concept of "reasonably priced utility services" must also mean that the New

[1] This figure does not, of course, reflect the costs that utilities would have incurred had they built plants based on their own load forecasts.

York economy not continue to be at a long-term competitive disadvantage due to high electricity prices.[1]

The Public Service Commission can only implement the principle within the context of its own powers and responsibilities. We cannot change taxes, and we cannot deploy the resources of the New York Power Authority. However, these resources and capabilities urgently need to be coordinated with the transition to competition. Otherwise, any substantial near term reduction in prices and/or bills for some customers will largely come at the expense of increased prices to others, or out of lower prices paid to suppliers (primarily independent power producers), or out of earnings. The amounts to be saved from increased productivity, while important, cannot close the gap by themselves. Only a strategy coordinated across government can do that without producing major dislocation among those now involved in the supply of New York's expensive electricity.

The following proposed principles reflect these considerations as well as the parties' suggestions. Because there are changes between this version and the proposed principles the parties already commented on, these revised principles will be issued for further comment. This will allow the parties a final opportunity to articulate their interests and supplement the record in this proceeding before final adoption of any principles.

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[1] The State Energy Plan finds that, "New York should initiate and encourage actions that reduce by 50 percent the amount by which current New York State prices and/or bills exceed the national average by the end of the planning period." In fact, the planning period (until 2012) is too remote a target for the attainment of this goal. Without major progress over the next few years, especially in the highest cost service areas, a piece-meal process of retail bypass, lost economic activity and municipalization will achieve unevenly distributed reductions of unpredictable magnitude with greater economic dislocation to all of the interests listed above.

C. PROPOSED PRINCIPLES

In accordance with the Commission's mandate that all New Yorkers must have access to reliable and reasonably priced electric service provided safely, cleanly and efficiently, the following guiding principles apply in the transition to a more competitive electric industry:

1. Competition in the electric power industry, at least at the wholesale level, will further the economic and environmental well-being of New York State. The basic objective of moving to a more competitive structure is to satisfy all consumers' interests at minimum resource cost. Prices should therefore accurately reflect resource costs, and all consumers should have a reasonable opportunity to realize savings and other benefits from competition.
2. The Commission should strive to minimize "bill shock" for any class of customers. A basic level of reasonably affordable service must be maintained, especially for people living in poverty.
3. Either market-based means or public programs to preserve research, environmental protections, cost effective energy efficiency and fuel diversity must be developed.
4. The integrity, safety, reliability, and quality of the bulk electric system should not be jeopardized. Customer service quality cannot be compromised without customer consent.
5. Any new electric industry structure should provide: (a) increased consumer choice of service and pricing options; (b) a suitable forum for promptly resolving consumer concerns and complaints; (c) strong incentives to improve transmission and distribution technology and efficiency; and (d) leeway for approaches that reflect the differences that exist among New York electric utilities.
6. With more competition should come less regulation, although the transition requires vigorous fair trade safeguards and heightened awareness of the need for forward-looking labor-management interaction. All market participants should be

subject to fair and consistent laws, rules, and regulations. Mechanisms should exist to identify and correct anticompetitive behavior. Where monopoly remains, performance based regulation is preferable to traditional rate cases.

7. The current industry structure, in which most power plants are vertically integrated with natural monopoly transmission and distribution, is incompatible with effective wholesale or retail competition.
8. Utilities should have a reasonable opportunity to recover prudent and verifiable expenditures and commitments made pursuant to their legal obligations, as long as they are cooperating in furthering all of these principles. Similar cooperation by independent power producers should result in respect for the reasonable expectations of IPP investors. Utilities should be responsible for taking all practicable measures to mitigate transition costs. The transition should balance order, deliberation, and speed.
9. Pro-competitive policies should further economic development (defined as "activities tending to enlarge the average disposable personal income of New Yorkers") in New York State.

ISSUES TO BE ADDRESSED NEXT

In comments submitted October 26, 1994, many parties offered their opinions as to whether the next part of this proceeding should address issues related to wholesale competition only, or consideration of both retail and wholesale competition. Most notably, Multiple Intervenors argued strongly that retail competition issues should be addressed expeditiously and proposed a process that would commence consideration of retail competition

on November 15, 1994 and conclude it on June 30, 1995.[1] Other parties argued that issues related to the establishment of a fully efficient wholesale market should be examined first, primarily basing their arguments on the order instituting phase II of this proceeding.[2]

The order instituting phase II of this proceeding states:

> The parties should also examine issues related to the establishment of a fully efficient wholesale market for electricity and any pricing reforms necessary to reflect those market efficiencies in retail customer rates. Such a market appears to offer considerable potential to benefit consumers. Parties should explore the advantages and disadvantages of different market structure changes and work collaboratively to identify the most efficient structure for wholesale competition among electric providers. Creative approaches are encouraged to address questions raised by the transition, especially whether divestiture of generating assets by the provider of transmission and distribution services would enhance the transition to a competitive wholesale market. It is also important to consider ways to reflect wholesale price fluctuations in retail rates, in order to be sure that all classes of customers get the benefits of a more responsive wholesale market.[3]

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[1] May Department Stores, Suffolk County, Nassau/Suffolk Water Commissioners Association, and Columbia University/New York Energy Buyers Forum agreed that issues related to wholesale and retail competition should be considered together and soon. Independent Power Producers of New York, Inc. and Adirondack Hydro Development Corporation stated that no structural reforms should be precluded from consideration and retail competition proposals should be discussed early in the process, although it would be premature to move to retail competition before correcting wholesale market deficiencies.

[2] New York Power Authority, Municipal Electric Utilities Association of New York State, Public Interest Intervenors and New York City Economic Policy and Marketing Group agreed that issues about wholesale competition should be addressed first.

[3] Case 93-M-0229, Order Instituting Phase II of Proceeding, pp. 3-4, footnotes omitted.

In order to expedite a conclusion of this investigation, parties should address issues related to both wholesale and retail competition in the next part of this proceeding, striving for consistency with the principles in both instances.

With respect to retail competition, the New York State Energy Plan states that proponents need to address some fundamental issues, such as how such a structure will treat all customer classes fairly, how the structure will support energy efficiency and renewables, and how it will deal with transition costs.[1] Only models of retail competition consistent with the principles will be considered. Such an approach would be consistent with this order and the State Energy Plan.

CONCLUSION

The above proposed principles to guide the transition to competition for electric service are issued for comment, and in the next part of this proceeding, parties should examine issues related to wholesale and retail competition expeditiously and consistent with this opinion.

The Commission orders:

1. The proposed principles stated herein shall be issued for comment in accordance with a schedule to be established by the Secretary.

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[1] "Retail competition should occur when fair treatment of all customer classes, of competitors, of energy efficiency and renewables, and of capital committed in prudent response to past government mandates is reasonably assured. In the absence of utility cooperation in the development of a fully competitive wholesale market, retail competition should perhaps be considered sooner." New York State Energy Plan, (October 1994), Volume I: Summary Report, page 26.

2. This proceeding is continued.

By the Commission,

(SIGNED) JOHN J. KELLIHER
Secretary

APPENDICES

List of 25 Parties Filing Comments on Draft Principles
Electric Competitive Opportunities Proceeding
(October 26, 1994)

Columbia University/New York Energy Buyers Forum (Columbia)
Energy Association of New York State (Energy Association)
Enron Gas Services Group (Enron)
Independent Power Producers of New York, Inc. and Adirondack Hydro Development Corporation (IPPNY)
Interested Lenders
Joint Supporters for Local Generation and DSM (Joint Supporters)
May Department Stores Company (May)
Multiple Intervenors/American Forest & Paper Association (MI)
Municipal Electric Utilities Association of New York State (MEUA)
Nassau/Suffolk Water Commissioners Association
New York City Comptroller (NYC Comptroller)
New York City Economic Policy and Marketing Group (NYC EPM)
New York City Public Utility Service (NYCPUS)
New York Power Authority (NYPA)
NYS Consumer Protection Board (CPB)
NYS Department of Economic Development (DED)
NYS Department of Public Service Staff (staff)
NYS Energy Office/Department of Environmental Conservation/ Energy Research and Development Authority (SEO)
Owners Committee on Electric Rates (Owners Committee)
Public Interest Intervenors and Attorney General G. Oliver Koppell (PII)
Public Utility Law Project of New York, Inc. (PULP)
Suffolk County
US Department of Energy and US Environmental Protection Agency (DOE-EPA)
Utility Workers Union of America, Local 1-2 (Utility Workers Union)
Wheeled Electric Power Company (WEPCO)

SUMMARY OF COMMENTS

(Minor wording changes are not included in this summary)

General

Columbia University/ New York Energy Buyers Forum (Columbia)

- Four overarching considerations that should guide Commission:

  1. basic objective - reduce price to consumers

  2. competition in both wholesale and retail markets is necessary to assure development of a fully competitive marketplace

  3. competitive market controls should replace regulation where marketplace is competitive

  4. competitive market exists today for end-user electricity commodity products and services in both wholesale and retail markets.

NYS Consumer Protection Board (CPB)

- Not enough focus on need to reduce rates for all consumers and to fully protect captive customers.

US Department of Energy and US Environmental Protection Agency (DOE-EPA)

- Strongly support principles but offer possible refinements.

Energy Association of New York State (Energy Association)

- Would like two principles added:

  1. Commission should approach proceeding with open mind and no bias for or against particular industry structure.

  2. All reasonable steps must be taken to reduce all costs related to production and delivery of electric service.

- Must view comments in context of entire group of proposed principles.

- Essential that a full record be developed.

Enron Gas Services Group (Enron)

- Retain language encouraging reliance on market forces and supporting increased access into market by new competitors.

- Three points:

  1. Efficiency of power market is critically important to public interest (should say "An efficient cash and forward market must be allowed to develop.").

  2. Timing is not a "process issue" (Restructuring must be implemented quickly and benefits to consumers must be captured early on).

  3. Sanctity of contracts is critical.

Independent Power Producers of New York, Inc. and Adirondack Hydro Development Corporation (IPPNY)

- Urges Commission to adopt with minor changes proposed principles (if substantive changes are needed, Commission should issue for comments with deadlines of 2-3 weeks and replies 1-2 weeks later); replace "shall" with "should" and "customer" with "consumer" (not all consumers are actual direct utility customers); would add a principle highlighting expected coordination between this case and State Energy Plan (see comments under proposed principle 9).

Multiple Intervenors/American Forest & Paper Association (MI)

- Considers proposals to be a package which should not be adopted; disagrees with #1, 2, 5, 6 and 8; agrees with #3, 4, 7 and 9.

New York City Comptroller (NYC Comptroller)

- Supports framework except for #8.

New York City Economic Policy and Marketing Group (NYC EPM)

- Would flip order for greater clarity (#7 become #8, and #6 goes in between becoming #7).

New York City Public Utility Service (NYCPUS)

- Reasonable framework with three exceptions (#1, 6 and 8); Commission should be consistent and not worsen competitive position and investments of existing competitors to utilities.

New York Power Authority (NYPA)

- In general agreement with proposed principles; replace mandatory verbs (shall) with permissive (should); replace "customer" with "consumer;" add a principle stating that the State Energy Plan provides policy guidance.

Owners Committee on Electric Rates (Owners Committee)

- Package is acceptable; but principles shouldn't embody absolutes (shouldn't limit flexibility); also Commission should look to solutions regarding interstate and international competition for business and jobs.

Public Interest Intervenors and Attorney General G. Oliver Koppell (PII)

- Add a tenth principle to make transition compatible with policy goals embraced in State Energy Plan.

Public Utility Law Project of New York, Inc. (PULP)

- Add preface to make clear that Commission's mandate ("to ensure that all New Yorkers enjoy universally available and reasonably affordable, environmentally sound, efficient, safe and reliable electric service") remains same as competition increases; and principles should be construed consistent with this mandate.

NYS Department of Public Service Staff (staff)

- All imperatives should instead say "should"; "customer" should say "consumer" (many consumers are not bill payers).

NYS Energy Office/Department of Environmental Conservation/Energy Research and Development Authority (SEO)

- Would add as tenth principle:

  "The New York State Energy Plan findings and recommendations should provide policy guidance for the move to greater competition."

  (1994 plan expected to be released within days.)

Suffolk County

- Need principles to provide certainty; uncertainty imposes transactional costs that may tilt the competitive balance.

Utility Workers Union of America, Local 1-2 (Utility Workers Union)

- Underlying assumption hasn't been tested (that increased competition will increase efficiency); existing electric markets are not competitive; true competition may not develop; some principles could apply to current regulatory practice; Commission should first determine if a further transition is appropriate.

Proposed Principle 1

The basic objective of moving to a more competitive structure[1] shall be an increase in economic efficiency.

An explanation of the term "economic efficiency," which was generally accepted by the parties, is as follows:

Economic efficiency generally means that the wants of consumers are satisfied at minimum resource cost. It has two components: efficiency in production (which includes electric generation, transmission and distribution) and efficiency in consumption. In the context of the market for electricity in New York State, these two components apply as follows. First, in the production of electricity, the costs to be incurred by the New York electric system should be minimized. This means combining inputs, including such items as fuel, capital, labor, and environmental costs, in a least cost manner to satisfy the energy service needs of consumers. Second is the final retail price of electricity in New York, and the extent to which it reflects marginal costs. Significant deviations between prices and costs can lead to inefficient consumption decisions, such as the loss of industry and jobs to other states when electricity prices are too high.

Columbia

- Basic objective "shall be to minimize the price paid for electricity by all wholesale and retail consumers;" and would add as 1A: "Competition in both the wholesale and retail electricity markets is necessary to ensure the development of a fully competitive marketplace."

CPB

- Would add "thereby reducing rates for all consumers."

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[1] One option for this principle, preferred by some parties, is as follows:

> The basic objective of moving to a more competitive structure shall be to minimize the overall cost to consumers.

A second option for this principle is the following:

> The basic objective of moving to a more competitive structure shall be an increase in economic efficiency to minimize the overall cost of meeting energy service requirements rather than shifting costs.

DOE-EPA

- Either as proposed or second option but would add "life-cycle" and omit "rather than shifting costs."

Energy Association

- Need full discussion of economic efficiency and its application in subsequent phases of this proceeding.

Enron

- Definition is silent on market structure; should be broadened to encompass concept of market efficiency.

IPPNY

- Would add "to minimize the overall life-cycle cost of meeting energy service requirements." (The implementation of any efficiency principle must recognize both static and dynamic forms of efficiency.)

Interested Lenders

- Generally agrees; would add "taking into consideration the effect of change on the operation of relevant markets;" (to gain benefits of economic efficiency, markets must have confidence in the stability of law, regulatory policy and contractual agreements).

Joint Supporters for Local Generation and DSM (Joint Supporters)

- Trickle down benefits to end-users potentially too slow and too removed; highly efficient dispersed generation should be encouraged.

MI

- Disagrees; basic objective should be to minimize retail prices paid by consumers (lower costs don't necessarily result in lower retail prices.)

Nassau/Suffolk Water Commissioners

- Would add at end "provided overall charges for electric service are reduced;" definition acceptable and should be supported by references to economic texts.

NYC Economic Policy and Marketing Group (NYC EPM)

- Rephrase to incorporate explanation of "economic efficiency" in text.

NYCPUS

- Objective should be minimization of final rates to consumers; definition of economic efficiency basically does move prices toward marginal costs (could add that market prices for power should be the touchstone).

NYPA

- Prefers second option and omission of definition of "economic efficiency."

Public Interest Intervenors/Department of Law (PII)

- Prefers second option with insertion of word "life-cycle" before "cost;" if definition of economic efficiency is included, must be changed to acknowledge that cost-effective investments in end-use conservation by energy service companies, utilities, or consumers adds to economic efficiency.

PULP

- Agrees with objective being economic efficiency, but definition (if needed) should be shortened to first sentence.

Staff

- Re: economic efficiency definition - Replace last two sentences with:

  Second, consumption decisions of electricity consumers need to be efficient. Consumption choices between electricity and its substitutes (such as a conservation measure) are efficient to the extent prices reflect marginal costs and consumers make decisions that maximize their welfare. For example, significant deviations between prices and costs can lead to inefficient consumption decisions, such as the loss of industry and jobs to other states when electricity prices are too high.

SEO/DEC/ERDA (SEO)

- Would add "to minimize overall cost of meeting energy service requirements;" prefers no definition needed.

Suffolk County

- Agrees if designed to reflect policies analogous to policies underlying the 1992 Energy Policy Act (shouldn't be used for anti-competitive reasons); shouldn't be limited to NYS (should be a function of markets, not maps); electric rates are higher than neighbors.

Utility Workers Union

- Should say "The basic objective of the Commission is to maximize economic efficiency to the extent possible, while assuring that the utilities provide safe and adequate service."

- Disagrees with definition of economic efficiency (doesn't explicitly recognize costs arising from inadequate and unsafe service).

Wheeled Electric Power Company (WEPCO)

- Disagrees; would prefer "The basic objective of moving to a more competitive structure shall be to promote economic and market efficiency."

Proposed Principle 2

The Commission shall strive to achieve the economic benefits of competition, consistent with the obligation:

A. to minimize significant adverse impacts of rates, bills, and service quality, especially during the move to competition; and

B. to meet short term and long term public policy goals and commitments, including the minimization of long-term resource costs,[1] environmental protection, fuel and technological diversity, renewable resources, research and development, energy efficiency, and the equal consideration of cost effective supply and demand options, using marketplace mechanisms to the maximum extent feasible.

Columbia

- Principle should separately address those parts of electric service that are competitive and those that should continue to be provided on a regulated monopoly basis.

- Most of areas of concern in 2B are attainable through market mechanisms (except arguably environmental protections, which should be met through laws and regulations).

CPB

- A - should say "minimize rates and bills and maintain service quality (shouldn't assume an adverse effect).

NYS Department of Economic Development (DED)

- 2B: Need greater elaboration as in footnote (can't overlook short-term considerations).

DOE-EPA

- Would elaborate on reference to environmental protection, as follows:

  EPA and DOE (or "Some parties") urge the Commission to interpret this principle as providing assurance that New York's environmental quality and progress toward environmental goals are not adversely affected by the transition to more competitive electricity markets.

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[1] Some parties preferred greater elaboration such as "minimization of the present value of resource costs (recognizing short and long-term considerations)."

They note that State environmental regulators have committed to a 75-percent reduction in nitrogen oxide emissions from major electric generator boilers in the State's most severe ozone non-attainment areas by 2003.

- The term "energy efficiency" might be modified to include efficiency in the production, delivery, and use of energy.

Energy Association

- Would substitute "objective" for "obligation;" would delete "long-term" before resource costs in 2B.

Interested Lenders

- Would add at end of 2B "taking into account the effects that risk and the perception of risk have on each of these goals and commitments." (Cost of capital is significant factor affecting long-term resource costs; any change could affect financial institutions' perception of financial risk, which could affect capital costs.)

Joint Supporters

- 2B is strengthened by existing statutory framework in Public Service Law 66-i.

May Department Stores Company

- B - would add after word including: "goals and commitments for" (as written, it pre-supposes well-defined goals and commitments, or indicates the topics in themselves are goals and commitments); would change last phrase to read "allowing market mechanisms to meet these goals and commitments to the maximum extent feasible."

MI

- Disagrees; obligations in B are inconsistent with competition (market should decide and if needed, legislature should decide utilities should pursue certain social initiatives, which should be funded by taxpayers).

Nassau/Suffolk Water Commissioners Association

- Move reliance on marketplace mechanisms to beginning of principle to ensure priority; omit "to maximum extent feasible" since it is too broad.

NYC EPM

- Deals indirectly with equity; Rephrase to say "The new electricity industry structural and regulatory framework shall strive to maximize the economic benefits of competition consistent with the Commission's obligations to..."

PII

- Would delete "especially" in 2A

- In 2B, would like it explicitly to state that "environmental protection" means that NY's environmental quality and progress toward environmental goals will not be adversely affected by the transition to more competitive electricity markets.

- Would substitute "treatment" for "consideration" and no need for footnote.

PULP

- 2A Would omit "service quality" since no balancing needed; should be absolute that service quality goals be maintained.

  Would add provision allowing utilities opportunity recover costs here, to show balancing needed.

Staff

- A - "of" should be "on"

- B - prefers language in footnote

Suffolk County

- Disagrees with implication that economic benefits of competition are inconsistent with minimizing adverse impacts of rates and meeting environmental and other public policy goals.

Utility Workers Union

- First need study to determine if there are economic benefits from competition; subparts reflect inappropriate balancing of important concepts.

Proposed Principle 3

The integrity, safety, reliability, and quality of the bulk electric system should not be jeopardized as the industry evolves to a more competitive structure.

Columbia

- Should define "bulk electric system"

DED

- Supports principle; should recognize existing standards may change over time.

DOE-EPA/IPPNY/NYPA/PII/Staff/SEO/Utility Workers Union

- Delete last phrase; should not only be applicable during transition period.

Energy Association

- Agrees, pointing out that reliability standards may evolve over time, and public safety and the safety of people working in the electric industry must not be jeopardized.

PULP - Agrees

Suffolk County

- Reliability and competition go together; shouldn't imply that competition inherently jeopardizes safety, reliability, etc. (competition spurs quality).

Proposed Principle 4

Any new industry structure must provide: (a) increased customer choice of service and pricing options; (b) a basic level of reasonably affordable service to all customers including low income customers; (c) a suitable forum for promptly resolving customer concerns and complaints; and (d) adequate service quality, safety, and reliability for all customers.

Columbia

- First clause should be modified so only applies to "non-monopoly, competitively provided end-user electricity products and services."

DED

- Change "customers" to "consumers" to be consistent with definition of economic efficiency and to recognize import of needs and concerns of ultimate end users.

Energy Association

- Must read "affordable" in 4b with the first proposed principle establishing economic efficiency as the basic goal.

Joint Supporters

- Valid as presented; rush to wholesale competition without parallel consideration of retail competition will cause disputes which will need resolution.

May Department Stores Company

- Would insert "electric" before industry to clarify and limit the principle.

NYC EPM

- Should substitute "regulatory framework" for "structure"

PII/SEO

- Delete word "adequate" from 4(d)

PULP

- Omit 4A which requires increased customer choice (not necessary but would be normal consequence).

Suffolk County

- Agrees; these goals are the "hallmarks of competition."

Utility Workers Union

- Would change to apply to any electric industry structure; would add "high levels of safety for utility employees, customers and the public" as 4(e).

Proposed Principle 5

As competition increases, regulation of the pricing and provision of electric service should decrease. The Commission should determine a reasonable balance between a competitive market where price and service levels, and risks and rewards to service providers are governed by market forces, and areas where continued regulation is necessary.

Columbia

- Should clearly delineate the areas in which market forces will be relied on and those that still need regulation (transmission and distribution services, whose prices should be set no higher than cost and there should be assurance of open and non-discriminatory access, and prices should be unbundled from charges for competitive end-user products).

CPB

- To remove ambiguity, would add as first sentence "The transmission and distribution system should continue to be regulated."

- Suggests a definition of effective competition (when it operates over time to protect consumers from exploitation by sellers).

DED

- Insert "non-monopoly" before electric service; may need also to indicate a need for evaluation to determine whether the optimal market structure has evolved; transition may not always be orderly (stresses need for regulatory guidance).

DOE-EPA/PII/Staff

- Add "non-monopoly" before electric service (monopolies should still be regulated) (DOE-EPA has wording suggestions; change "determine" to "seek").

Energy Association

- In first sentence, would insert word "correspondingly" after word decrease; Commission must review and reconsider its role as competition increases (incentives must allow utilities great flexibility and Commission must review existing regulatory mandates to determine whether benefits warrant costs).

IPPNY

- Would insert "competitive" before electric service in first sentence to clarify.

Interested Lenders

- Would add to end of first sentence "within the bounds established by law." (And the law generally requires a respect for the sanctity of contracts-see comments under proposed principle 6).

Joint Supporters

- Decrease in regulation should permit market pricing of stand-by services for end-users.

MI

- Doesn't distinguish adequately between type of regulation for competitive parts of markets and monopolies; until there is full retail competition, still need regulation of pricing and provision of generation; natural monopolies (transmission and distribution) still need regulation; no need for "reasonable balance" in second sentence.

Nassau/Suffolk Water Commissioners

- For second sentence would add as rebuttable presumption that marketplace determines a reasonable balance; only where market not working, Commission should assert its regulatory power.

Owners Committee

- The only "areas where continued regulation is necessary" should be "those aspects of electric service which remain monopolistic in character" (reduced role for regulation in one area shouldn't be basis for expanded role in others where market forces are working satisfactorily).

PULP

- Can live with it

Utility Workers Union

- Should be stated in the hypothetical sense (If it is determined competition should change, then...)

Proposed Principle 6

The Commission should encourage a level playing field for all market participants where all providers of energy services are subject to fair and consistent laws, rules, and regulations.[1] Existing contract obligations should be acknowledged.

Columbia

- Basically agrees, but many laws, rules and regulations are outside the Commission's jurisdiction; last sentence should be stricken (should be consistent with established legal authority); desire to achieve this goal shouldn't delay progress.

CPB

- Would omit last sentence (efforts should be made to reduce costs).

DED

- No need to include second sentence; add footnote about equal and open access.

DOE-EPA

- Would add "Monopoly services should be available to all competitive market players on consistent terms and conditions."

Energy Association

- It is critical that all cost burdens should be reduced; In first sentence should substitute "ensure" for "encourage" and add as second sentence: "Costs should be borne by consumers in a way that puts no participant at a competitive disadvantage."

Enron

- Substitute "respected" rather than "acknowledged" (sanctity of contracts is critical).

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[1] Some parties suggested the term "level playing field" needs a definition. In addition, there was a suggestion that something like the following should be added: "To the extent that access to the market is provided, such access should be equal and open."

Interested Lenders

- Would add to end of last sentence "and the integrity of such contracts should be preserved. The transition to competition must fulfill the reasonable expectations of consumers, investors and lenders, taking into account the views of affected utility consumers." (Contracts must be respected and integrity preserved, or there would be an increase in the perception of risk, which would increase cost of capital.) Order instituting phase II stated that the transition "must fulfill reasonable expectations of ...investors." (These are all investors in both IPPs and utilities.)

IPPNY

- Would insert "to the extent access to transmission or other monopoly services is provided, it should be available to all competitive market participants on fair and consistent terms and considerations. Further, transactions between and among market participants should take place on an arm's-length basis."

  Also, very important that Commission not merely "acknowledge" contracts but respect them.

Joint Supporters

- Principle is well articulated.

May Department Stores Company

- Would add that laws, rules and regulations should be non-discriminatory; second sentence is superfluous.

Municipal Electric Utilities Association of New York State

- Must be revised to reflect that not all energy providers are participants in the same market, nor are they all under the Commission's jurisdiction, nor should they be subject to same laws, rules and regulations (Rather than promote level playing field, principle should say "Commission should take action, to the extent of its jurisdiction and authority, to eliminate barriers to entry in defined markets to encourage nondiscriminatory access by competitors.) (Implication in proposed principle is that existing laws, rules and regulations are unfair and inconsistent. Existing laws are not the major barrier to a more competitive bulk power market.) (Need coordination with other regulatory agencies.)

MI

- Disagrees; no definition of "level playing field;" will be encouraged by removing existing regulatory burdens and social programs; second sentence is not appropriate (implies incorrectly that resolution of such issues is within Commission's jurisdiction).

Nassau/Suffolk Water Commissioners

- Level playing field concept is extremely important, would add "All legal, regulatory and technical impediments to marketplace access should be systematically removed to the greatest extent practical."

NYC EPM

- Existing contract obligations should move to #8.

NYCPUS

- "Level playing field" is undefined and should be dropped.

NYPA

- Level playing field is one where barriers to entry are removed; should say "All users of the electric transmission grid using comparable services should pay comparable rates."

PULP

- Would omit sentence about acknowledging existing contract obligations (vague; no clear meaning of "acknowledged;" issue of whether existing contracts should be binding is independent of whether there is competition.)

- Would combine proposed principles 6 and 7 since part of same concept (level playing field).

SEO

- At end of first sentence, would add "and other governmental requirements. Transactions between and among participants should take place on an arms-length basis. Access to transmission, or other monopoly services to the extent provided, should be available to all competitive market participants on fair and consistent terms and conditions."

- Would move second sentence to proposed principle 8.

Staff

- After "providers," add "and consumers" (level playing field and open access also important as applied to consumers).

Suffolk County

- First sentence needs to be fleshed out to be meaningful and focus on Commission's jurisdiction

- Second sentence is problematic (if it is only restating legal axiom, no need; if makes economic efficiency meaningless, disagrees)

Utility Workers Union

- Supports concept of "level playing field;" objects to last sentence as unclear and would omit.

WEPCO

- Would add "where all providers of energy services, utilities and others alike, are equally subject to fair and consistent laws, rules, and regulations."

Proposed Principle 7

As the industry moves toward competition, mechanisms should exist to identify and correct anti-competitive behavior.

Columbia

- Basically agrees

DED

- Would prefer it said mechanisms should exist to assure that market forces are not impaired by any market participant.

DOE-EPA/IPPNY/NYPA/PII/Staff/SEO/Utility Workers Union

- Delete first phrase; should not only apply during transition period.

PULP

- Would combine proposed principles 7 and 6 (level playing field concept).

Proposed Principle 8

Utilities should have a reasonable opportunity to recover past investments and expenditures made pursuant to their obligation to provide service to the public.[1] Utilities are responsible for taking all practicable measures to mitigate transition costs, and creative ways should be developed to reduce these costs to the greatest possible extent. Such costs should be legitimate and verifiable. The transition itself should be orderly, deliberate, and proceed as rapidly as attainment of these principles will allow.

Columbia

- First sentence should be deleted since appears to be restatement of Public Service Law and no need for second sentence.
- Transition costs should be equitably shared among shareholders, market participants, customers and taxpayers.
- Shouldn't be reason for delaying progress.

CPB

- Would delete last two sentences and add language saying that where payments to the alternative supplier exceed the utility's marginal cost, the alternative supplier should bear primary responsibility for funding transition costs; in other cases, there should be equitable sharing
- Would define transition costs as "any costs reflected in rates which exceed the marginal cost of service or the competitive price, whichever is higher, for a specified period of transition."

DED

- Generally supports first and second sentence; third sentence should say "such costs should be legitimate and reasonably verifiable in the manner, and to the extent, that they are presently required to be verified;" last sentence should indicate that the Commission should proceed with care in the transition and only after conducting a thorough evaluation of all options and, to the extent possible, a computer analysis. (The

[1] This provision is extremely controversial. A separate option, preferred by many parties, is to require equitable sharing. Additionally, the suggestion was made to have a clear definition of "transition costs."

evaluation and analysis should carefully weigh increases in price and cost on the economy, so that best option would be selected for implementation); should also take into account comparative price gap between NY and other states.

DOE-EPA/IPPNY/NYPA/PII

- Only prudent past investments should be included.

Energy Association

- Any conclusion regarding the nature and extent of "transition costs" is premature and totally unwarranted.

- In first sentence, would substitute "must" for "should" and add reference to the necessity for all responsible parties, not simply utilities, to take all practical steps to mitigate electricity prices; also add that a transition plan should be well defined and have clearly established rules and responsibilities.

Interested Lenders

- Would add at end of first sentence "or in accordance with the requirements of State and federal law." (Recovery must include all prudently incurred costs associated with IPP contracts.)

- Would add at end of second sentence "without directly or indirectly encouraging the abrogation of contracts." (Commission shouldn't micromanage in hindsight.)

Joint Supporters

- Issue of recovery of past utility investments needs careful attention.

May Department Stores Company

- Disagrees; would prefer no principle be presented and lack of consensus be presented instead.

MI

- Objects to first and last sentences; does not object to second and third sentences; transition costs can't be dealt with generically; where they are legitimate and verifiable, they should be recovered from all stakeholders.

Municipal Electric Utilities Association of New York State

- Would omit first sentence (shouldn't suggest utilities have substantive right, rather than procedural due process right, to recover stranded investment costs; and shouldn't be recovered from public at large, rather from specific customers for which the costs were incurred.) (cites Cajun Electric Power v. FERC)

Nassau/Suffolk Water Commissioners

- Should be tempered to realign the legitimate expectations of shareholders in view of the acceptance of risk, while simultaneously restoring the balance inherent in a properly functioning marketplace, regulated or competitive, to avoid continuing economic harm to ratepayers.

NYC Comptroller

- Strongly opposes; denies proposed principles 1 and 7 and makes the principles internally inconsistent; creates uneconomic market distortions by forcing prices for captive customers away from marginal prices (contrary to #1) and by protecting high-cost utilities from high costs (contrary to #7); results in grave inequities for captive ratepayers.

- Should require equitable sharing.

NYCPUS

- Not sufficiently inclusive to stand as transition cost principle (ignores transition benefits and ignores legal rights of players other than utilities); transition cost principles are not comprehensive; issue should be tabled (could be examined in detail in next stage).

PULP

- Omit first sentence and move to proposed principle 2.

SEO

- Would re-arrange order and add: "Transition costs should be allocated equitably among all affected parties."

- Would replace first sentence with "Utilities should have a fair opportunity to recover capital committed in prudent response to past government mandates."

- Would add that existing contract obligations should be respected (moving this from proposed principle 6).

Staff

- Disagrees with first sentence; would replace with:

  "The Commission should give due regard to the fact that investors seek a reasonable rate of return on capital actually expended pursuant to the utilities' obligation to provide service to the public."

- Would prefer to eliminate third sentence (concerned that Commission may need to establish a policy on transition costs when it can only estimate their level).

Suffolk County

- Need clear delineation of recoverable transition costs; transition to competitive markets shouldn't be treated as a special case.

Utility Workers Union

- Would omit first sentence entirely (shouldn't assume competition will increase or that there will be a transition).

WEPCO

- Would add after reasonable opportunity "consistent with the prudent expectations of investors" and would omit "and expenditures."

Proposed Principle 9

The Commission should consider the effect on economic development in New York State as the electric industry moves toward a more competitive environment.[1]

DED

- Fully supports principle and definition; reiterates position that principle should stand by itself.

IPPNY

- Would omit and replace with: "The Findings, Recommendations, and Action Steps of the New York State Energy Plan should provide policy guidance for the move to greater competition."

Interested Lenders

- Would insert after phrase economic development in New York State "and the availability of capital needed to support such development."

Nassau/Suffolk Water Commissioners

- Agrees with principle and definition.

PULP

- Can live with it as long as not with DED's definition (far too broad and all encompassing; need optimal balance between extremes for blindly using limited resources for economic development and denying any legitimate role in achieving economic development goals that serve the public interest; sees no need to define term).

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[1] One definition offered for economic development is as follows:

> Any activity that involves the increase or enhancement of the economy's capacity for the production of goods and services and the creation or retention of employment opportunities, including but not limited to the establishment or expansion of businesses, investment in the expansion or modernization of business facilities and actions that improve the competitiveness of businesses or groups of businesses.

This definition was not discussed by the parties.

Suffolk County

- Strongly endorses this provision (end-users seek economically efficient suppliers; industry and jobs can be retained when utilities' prices are competitive.)

Utility Workers Union

- Would state "The Commission should consider the effect of its policies on economic development in NYS."