

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
Albany on February 9, 2005

COMMISSIONERS PRESENT:

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

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

STATEMENT OF POLICY ON RATE DESIGN ISSUES

(Issued and Effective February 14, 2005)

BY THE COMMISSION:

INTRODUCTION

On August 25, 2004, the Commission's Statement of Policy on Unbundling and Order Directing Tariff Filings (Unbundling Policy) was issued in which we sought the comments of the parties on a variety of rate design issues.¹ Our intent was "to review these comments to determine whether consistent policies regarding these [rate design] issues should be adopted."²

Initial comments were filed by Niagara Mohawk Power Corporation (Niagara Mohawk), Multiple Intervenors (MI), Central Hudson Gas & Electric Corporation (Central Hudson), the Small Customer Marketer Coalition (SCMC), Consolidated Edison Company of New York, Inc. (Con Edison), the National Energy Marketers Association (NEM), Constellation NewEnergy, Inc. (Constellation), National Fuel Gas Distribution Corporation

¹ Unbundling Policy, pp. 36-37.

² Id.

(NFGDC), and New York State Electric & Gas Corporation jointly with Rochester Gas and Electric Corporation (jointly NYSEG). Reply comments were filed by the New York State Consumer Protection Board (CPB).

In the Unbundling Policy, we set forth three specific questions for parties to address:

First, does the two-to-one ratio of current backout credits fairly account for the relative costs imposed by the residential and non-residential classes?

Second, should there be further division(s) within the non-residential classes (e.g., small commercial and large commercial/industrial)?

Finally, should consideration be given to establishing competitive rates partly on a per customer, fixed monthly charge basis?³

Set forth below is a summary of the comments received followed by our discussion of the issues.

Parties Comments

Con Edison's comments first suggest that unbundled rates be designed in accordance with the methods used to design full service rates. If that is not done, it contends, the full service rate would not equal the sum of the unbundled cost components. Regarding fixed versus variable rate designs, Con Edison provides examples showing that a two-part rate design for commodity supply (50% fixed, 50% variable) would benefit a 300 kWh/month residential customer (i.e., would increase by 13% the utility charges avoided by such a customer migrating to an ESCO for electric supply), whereas a non-residential customer using 1 million kWh/month would avoid only 50% of the utility charges that would be avoided under a purely volumetric design. While Con Edison makes no recommendations on these issues,⁴ it

³ Id.

⁴ Con Edison notes, however, that a two-part design is "arguably" more cost-based and, therefore, "is more likely to achieve a reasonable balance among all stakeholders." (Con Edison's Comments, p. 4.)

urges the consideration of the impacts of these proposals on our goal of encouraging customer migration at the least overall societal cost.

Central Hudson notes that a number of the costs to be recovered in unbundled rates do not vary by usage and collecting such costs on a usage basis distorts the allocation of service costs among the rate classes. Based on its own ratios of customers and kWhs between classes, Central Hudson concludes that a 2:1 ratio of backout credits is inappropriate.⁵ It also notes that the equity of a two-part competitive rate necessarily assumes that existing fixed customer charges are sufficient to cover all fixed costs, a situation it implies may not be the case.

NFGDC contends that it would be inappropriate to create a single rate for all classes, if the costs to serve each class are significantly different.⁶ It notes, however, that there is no need to further differentiate non-residential firm-sales customers because they all receive service under a single tariff, and the costs of servicing this class would not vary significantly by any sub-class of these customers. Regarding volumetric versus fixed rates, NFGDC argues that a volumetric approach is appropriate for the unbundled supply rate because the cost components allocated to that rate are predominantly variable rather than fixed. Finally, NFGDC contends that the primary consideration in changing the design or level of unbundled competitive service rates should be the impact of the change on end-use customers, a consideration best addressed in individual company rate proceedings.

NYSEG generally argues that considerations of cost causation should be a primary objective for designing rates for

⁵ Central Hudson has four backout credits, one each for SC 1, SC 2, SC 3, and SC 13. The ratio of those credits (8:6:4:1) is also inappropriate according to the company (Central Hudson's Comments, p. 3.)

⁶ Conversely, where costs do not vary from class to class, the unbundled rate should be the same for each (NFGDC's Comments, pp. 2-3.)

competitive services and that the Commission must avoid or lessen existing cost subsidies while minimizing undue impacts of rate changes on customers. It states that competitive rates should be designed to reflect any differences in costs imposed by different service classes, such that the ratio of residential and non-residential competitive rates would be a result of the functionalization, classification, and allocation of costs.⁷ Regarding the further segmentation of non-residential classes, NYSEG observes that such an approach could result in rates more closely reflecting actual costs, depending on the individual circumstances of the utility. Finally, NYSEG agrees with a number of other parties that competitive rates containing both a fixed and a variable charge may be appropriate where the costs recovered by that rate have both fixed and variable components.

Niagara Mohawk suggests that rates be designed on a per bill or volumetric basis depending on the classification of costs in the embedded cost of service (ECOS) studies. It also contends that rates for different classes of customers be set considering the allocation of costs in the ECOS studies. The company notes that the nature of its costs and services will change as the market develops, and it urges us to maintain sufficient flexibility in rate design practices to respond to these changes.

MI advocates that we adopt a number of positions, including: it is premature to reduce customer migration incentives; competitive supply rates should remain volumetric until individual utility ECOS studies are examined; additional divisions within non-residential classes (some of which already exist) are not warranted at this time; and the current disparity between residential and non-residential backout credits is unjustified and should be reduced to reflect the actual supply procurement-related cost disparity between small and large customers. MI and other parties also suggest that competition should not be subsidized on a long-term basis and that competitive rates should reflect the best available cost-of-

⁷ NYSEG's Comments, pp. 6-7.

service evidence.⁸ MI further states that any apparent intra-class inequity created by the use of a volumetric competitive supply rate would be offset in part by the largely volumetric recovery of utility net lost revenues.⁹

SCMC notes its agreement with the broad factors and specific issues identified in our Unbundling Policy as appropriate for consideration in establishing competitive rate designs, but it argues with most other parties that such issues are best determined in the context of individual rate proceedings. Constellation and NEM agree that it is important to set competitive rates based on utility embedded costs, and Constellation adds that the 2:1 ratio of existing residential to non-residential backout credits reflects a fair apportionment of the costs imposed by these two groups. Constellation believes that a further division of the non-residential classes is unnecessary, while NEM argues that creating additional classes could allow more targeted marketing thereby increasing competitiveness in the market. Both agree that recovering customer care costs on a fixed basis may provide the most accurate pricing signals to customers.

The reply comments of the CPB generally agreed with the other parties that rates should be cost-based, that additional subdivisions of non-residential customers may be advisable where there is a significant difference in the cost of serving those customers, and that any changes to the design of existing backout credits be undertaken in individual rate proceedings.

Discussion

It is our purpose here to provide the parties general guidance regarding rate design issues, not to predetermine the specific design of competitive rates for all utilities. We agree with those who have argued the need to maintain flexibility in designing rates to allow the consideration of utility specific factors (e.g., costs, market development,

⁸ MI's Comments, p. 7.

⁹ Id., p. 9.

customer impacts). As SCMC stated, "[i]t is most difficult and potentially counterproductive to establish categorical positions in the abstract without reflecting the real life conditions of a particular utility and its customer base."¹⁰

We also agree with the comments made by most parties that ". . . the overarching issue that should be considered in setting competitive rates is providing customers with proper and adequate embedded cost-based . . ." price signals.¹¹ The CPB is correct in observing that competitive rates set above such costs¹² would result in uneconomic migration and, ultimately, an unsustainable market; while rates set below utility costs would likely prevent economic competition from developing.¹³

Accordingly, we encourage the parties to design utility rates for competitive services that reflect, as accurately as reasonably possible, the utility's embedded costs of providing the service to each distinct class of customers. Based on the comments of the parties, we are reasonably convinced that the existing backout credits adequately reflect the costs to serve the classes of customers to which they are assigned and we accordingly see no immediate need to change

¹⁰ SCMC's Comments, p. 2.

¹¹ NEM's Comments, p. 4; CPB's Reply Comments, p. 2. NEM's additional suggestion that we consider the difference in reliability required by different classes in setting competitive rates would result in consumer-value-based rates rather than rates based on costs (NEM's Comments, p. 2.) As discussed below, we are concerned that rates which vary from actual utility costs, as value-based rates might do, would result in inefficient economic pricing signals to consumers. Such a result could impede the development of a sustainable and robust retail market.

¹² As we have previously noted, for these types of functions ". . . embedded cost-based rates and long-run marginal cost-based rates are generally reasonable proxies of each other . . ." (Case 00-M-0504, supra, Order Establishing Parameters for Lost Revenue Recovery and Incremental Cost Studies (issued March 21, 2002), p. 18; hereafter Order Establishing Parameters).

¹³ CPB Reply Comments, p. 3; Unbundling Policy, p. 13; Order Establishing Parameters, p. 17.

them. In future individual utility proceedings, however, we expect competitive service rates to continue to reflect the utility's cost to serve each distinct customer type as reflected in the utility's ECOS studies. As Niagara Mohawk suggests, differences in competitive rates between different classes of customers should reflect the results of the allocation of costs in the ECOS studies.

For similar reasons, we conclude that the need for additional subdivisions among non-residential customers (or within the residential customer class) would be justified only if the utility's ECOS studies reveal significant differences in the cost of serving different types or classes of customers and the costs of newly creating such classes are reasonable. Further, as MI notes, some utilities now have backout credits based on divisions within the non-residential customer class. In future proceedings, we expect the parties to examine whether there are cost justifications supporting the establishment of different competitive rates for different classes or sub-classes of customers.

Finally, we address the issue of designing competitive rates to recover fixed costs in a fixed charge and variable costs in a variable charge. We have previously addressed this issue regarding unbundled billing and metering rates, but the issue has not been addressed in the design of competitive commodity rates, which will now include a portion of fixed costs. We agree with those parties who noted that a cost recovery scheme that mirrors cost incurrence is the most economically efficient, and we therefore remain concerned that using a purely volumetric rate for commodity supply will provide an undue benefit (i.e., a greater avoided utility charge) to customers with above class-average usage, and a smaller than economically justified benefit to those with below class-average usage. As MI notes, however, this intra-class volumetric disparity regarding the current design of competitive commodity backout credits is partially offset by the largely volumetric recovery of the utility's net lost revenues associated with those rates, and, as others have noted, the magnitude of fixed

costs collected in the variable competitive commodity rate is relatively small.

Accordingly, we see no immediate need to change the design of existing commodity backout credits, but in future cases where unbundled competitive service rates are established we expect the parties to more fully explore this issue. To the extent reasonable and practical, competitive service rates should be designed to permit the equitable recovery of utility costs from each customer in accordance with the manner the costs were incurred so as to ameliorate the effects of over-recovering from higher use customers in a class or under-recovering from customers with a below-class-average usage.

By the Commission,

(SIGNED)

JACLYN A. BRILLING
Secretary