

NEW YORK STATE PUBLIC SERVICE COMMISSION

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In the Matter of New York State Electric :
& Gas Corporation's Plans for Electric :
Rate/Restructuring Pursuant to : Case 96-E-0891
Opinion No. 96-12 - RETAIL ACCESS :
CREDIT PHASE :
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INITIAL BRIEF
SUBMITTED ON BEHALF OF
NEW YORK STATE ELECTRIC & GAS CORPORATION

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PRELIMINARY STATEMENT

For the past seven months, parties to this proceeding have been examining whether the fixed retail access credit ("RAC") of New York State Electric & Gas Corporation ("NYSEG" or the "Company") should be modified. To resolve that issue, the focus of the inquiry has been on the relationship between the fixed RAC and the level of market prices. That examination has been complicated by the anomalous pricing results of the NYISO.

While the market price/backout comparison conducted by the Commission last spring led to no change in the backout, more recent results suggest that market prices have increased and now exceed the backout for the most recent 12 months as well as for projections of the next year. Although there is some question whether the most recent results constitute a sustainable trend, NYSEG proposes in this brief to move beyond that issue and institute a market-based RAC. The Company recommends that the

market-based RAC remain in effect at least until the Commission concludes that the problems with the NYISO have been corrected, at which point the level of market prices would determine if the 3.56 cents/kWh fixed RAC or the market-based RAC should continue for the remainder of NYSEG's Price Cap Period.

While the Company is proposing to change the retail access credit to reflect market prices, NYSEG will demonstrate that Staff's recommendation of a market-based RAC with a floor of 3.56 cents/kWh could result in a backout that exceeds the market price, and cannot be implemented with the Company's current customer information system ("CIS"). NYSEG will also show that proponents of an increment (or "adder") to the market price have failed to sustain their burden of proof, and that such an adder is unwarranted. Finally, NYSEG will show that Energetix, one of the ESCOs participating in this case, has failed to recognize that the treatment of line losses is different between the pre-NYISO environment and that which exists after the NYISO commenced operations. As a result, Energetix is not entitled to recover marginal line losses from NYSEG.

BACKGROUND

The Retail Access Credit Phase of NYSEG's Rate/Restructuring Proceeding was instituted in an Order Denying Motion and Instituting Further Proceedings, issued May 26, 2000 (the "May 26 Order"), of the New York State Public Service Commission ("PSC" or the "Commission"). The focus of the Retail Access Credit Phase has been whether changes should be made to NYSEG's current RAC of 3.56 cents/kWh (exclusive of the Gross Receipts Tax) in accordance with NYSEG's electric restructuring agreement, dated October 9, 1997 and subsequent Commission determinations modifying that agreement.¹

Pursuant to the May 26 Order, Administrative Law Judge ("ALJ") Gerald L. Lynch was appointed as the mediation judge and held a mediation conference in Albany on July 13, 2000. On July 21, 2000, the Commission issued its Order Continuing Proceedings and Providing Clarification (the "July 21 Order") in which the PSC provided guidance on the scope of the proceeding. ALJ William Bouteiller, who had been appointed the litigation judge in this case, issued his Ruling Establishing Litigation Schedule on August 14, 2000. NYSEG then filed a Petition for Rehearing

¹ See Case 96-E-0891, et al., Order Accepting Terms of Settlement Subject to Modifications and Conditions (issued January 27, 1998), mimeo p. 5; Case 96-E-0891 et al., Opinion and Order Accepting Terms of Settlement Subject to Modifications and Conditions, Opinion No. 98-6 (issued March 5, 1998), mimeo pp. 24-27; and Case 96-E-0891, et al., Order Clarifying and Modifying Rate and Restructuring Plan (issued December 3, 1998).

of the July 21 Order on August 17, 2000. The Commission suspended the litigation schedule on September 11, 2000 pending its consideration of NYSEG's Petition for Rehearing.

The Commission issued its Order Denying Rehearing on September 22, 2000. On the same day, ALJ Bouteiller released his Ruling Resuming Litigation Schedule (the "Ruling"). Consistent with the Ruling, NYSEG filed its direct testimony on October 4, 2000. On October 18, 2000, responsive testimony was submitted by the following parties: Auburn Steel of New York ("Auburn Steel"), Energetix, Leveraged Energy Purchasing Corp. ("LepCorp"), Multiple Intervenors ("MI"), National Energy Marketers Association ("NEMA"), Staff of the Department of Public Service ("Staff"), and Strategic Power Management, Inc. ("SPM"). NYSEG filed its rebuttal testimony on October 30, 2000.

Accompanying that rebuttal testimony was a separate letter in which NYSEG sought a suspension of the litigation schedule so that the parties could attempt to resolve their differences through further mediation. Thereafter, the litigation schedule was suspended and mediation conferences were held in Albany on November 8, 2000 and November 15, 2000. In addition to those parties that had submitted testimony, participants at these two mediation conferences included Advantage Energy, Agway, National Energy Service Providers

Association ("NESPA"), the New York State Attorney General, the New York State Consumer Protection Board (the "CPB") and NYSEG Solutions. With no agreement reached during a conference call on November 17, 2000, the litigation track was resumed and hearings were held in Albany on November 29 and 30, 2000. ALJ Bouteiller circulated a letter dated December 8, 2000 which memorialized the briefing schedule and related matters agreed to at the hearing of November 30, 2000.

ARGUMENT

I. The NYISO Is Fundamentally Flawed And, As A Result, Market Prices Are Distorted

The record in this proceeding demonstrates that the NYISO is fundamentally flawed. Indeed, that conclusion remains uncontroverted. Not only did NYSEG present evidence describing the nature of the NYISO's flaws, but the Company also demonstrated that market participants and regulators concur that such deficiencies exist.² As a result of the flaws in the NYISO, market prices have become distorted.

The NYISO suffers from transition and implementation problems related to software and market design as well as possible exercises of market power (SM³ 5321-22). The market flaws identified by NYSEG can be grouped into two categories: those that directly impact prices statewide, and flaws that wrongly spread the relatively high prices in southeast New York to all zones across the state (SM 5342).

² Mindful of the ALJ's admonition against merely repeating arguments raised in pre-filed testimony, together with the lack of any challenge to NYSEG's position on the issue addressed in this section, the Company will only provide an overview of the implementation problems associated with the NYISO. Also, this section will only summarize the decisions of the PSC and the FERC confirming that such flaws in the NYISO exist. For a more detailed explanation, as well as the citations of the regulatory opinions, the reader should review the transcript references.

³ SM = Stenographer's Minutes.

Turning to the first set of flaws, the Balancing Market Evaluation ("BME"), which is performed before the hour in which a dispatch occurs, incorrectly rejects economic bids in the Hour-Ahead Market ("HAM") and curtails bilateral transactions (SM 5342-43). This results in the NYISO improperly curtailing import transactions, thereby increasing Locational Based Marginal Prices ("LBMPs") (SM 5342-43).

The second category of flaws, spreading high southeast energy prices statewide, results from incorrect pricing associated with fixed block units and local reliability rules (SM 5344-45). In the case of the fixed block unit, the problem arises as a result of the NYISO bringing on a fixed block resource to meet load in a congested (higher cost) zone in an amount above the immediate requirement, thereby artificially and uneconomically relieving congestion between a lower cost zone and the higher cost zone (SM 5344). Consequently, the LBMP for the lower cost zone is erroneously set at the same level as the LBMP for the higher cost zone (SM 5344).

Local reliability rules may also contribute to erroneously high energy prices. Such rules may encourage the NYISO to bring on resources in a way that artificially relieves congestion (SM 5345).

NYSEG does not stand alone in recognizing the deficiencies of the NYISO. The Commission is on record that the

NYISO has encountered a number of obstacles (SM 5321). The Commission also has taken the unprecedented step of placing representatives on site at the NYISO (SM 5322). Moreover, Chairman Helmer directed the formation of Staff teams to investigate the operation of the NYISO (SM 5322).

The Federal Energy Regulatory Commission ("FERC") also has taken steps to address NYISO deficiencies. In various orders, FERC approved extraordinary measures designed to correct prices resulting from NYISO software errors (SM 5322). In an effort to implement a solution to a "significant market problem, namely the absence of price responsive demand," FERC imposed a bid cap of \$1,000 per MWH (SM 5323). To date, this cap remains in place, thereby confirming that FERC does not yet believe the market flaws have been remedied and that the market is not fully competitive.

As further support for the proposition that the NYISO is not functioning properly, NYSEG identified a number of market participants (including the NYISO President and CEO) sharing NYSEG's view (SM 5323-26). For example, Enron Power Marketing likened the NYISO markets to a "foundering ship" (SM 5325). Con Ed raised market design problems, concluding that the "market is far from successful." SM 5326. Clearly there is ample support for NYSEG's position.

No party challenged NYSEG's assessment of the implementation problems of the NYISO. In fact, with the exception of MI (SM 5864) and Staff (SM 5603), no other party even addressed the flawed NYISO. MI did not refute NYSEG's allegations concerning the operation of the NYISO. Indeed, MI acknowledged the need for a well functioning Regional Transmission Organization and discussed the NYISO's problems as a hypothetical (SM 5864).⁴ Staff merely noted NYSEG's position, but did not challenge it.

II. Tainted by Deficiencies in the NYISO, Market Prices are Exceeding NYSEG's Fixed Backout Credit

There can be no doubt that the market price of energy and capacity (on both an historic and a forecast basis) has increased since this past August to the present. Moreover, the record demonstrates that on both an historic and forecast basis market prices presently exceed NYSEG's fixed backout of 3.56 cents/kWh.

⁴ Counsel for MI commented: "I don't think there would be much dispute in the room that the ISO has had some problems. . . ." SM 5538. Subsequently, counsel for MI appeared to backtrack somewhat when he stated: "So I guess I'm not willing to concede that it's [i.e., the NYISO] functioning improperly at the moment." SM 5692-93. Whatever the opinion of MI counsel may be on this issue, neither MI's witness nor any other witness offered any evidence to undermine the testimony of Mr. Tedesco on the NYISO's flaws.

On an historic basis, the NERA panel⁵ agreed that for its first full year of operation (mid-November 1999 - mid-November 2000) the NYISO weighted average market price for energy and capacity was 3.6 cents/kWh (SM 5484). There are several figures in the record attempting to quantify forecast market prices and each of them exceeds NYSEG's fixed backout of 3.56 cents/kWh. The NERA panel stated in their direct testimony that the forecast of market prices for the period October 2000 through September 2001 was 3.77 cents/kWh (SM 5457, 5485). NERA's update of that figure one month later was 4.49 cents/kWh (SM 5528). Finally, using a slightly different forecast period, the Natsource projection for calendar year 2001 presented in Exhibit R-8 was \$39.54 per MWh (SM 5748), or 3.95 cents/kWh.⁶

Two arguments can be raised to undermine the credibility of all of these figures. First, as noted in the previous section, NYISO market prices are flawed. Moving to a market-based backout would be premature until the problems with the NYISO are rectified (SM 5337). Second, there is insufficient data to establish whether the recently-observed increase in market prices constitutes a trend that can be

⁵ Testifying on behalf of NYSEG, the NERA panel included Dr. Kenneth Gordon and Dr. David Kathan.

⁶ Dr. Rosenberg presented several Natsource-based market prices ranging between 4.31 cents/kWh and 4.38 cents/kWh (SM 5851). The record contains no explanation of how those estimates can be reconciled to Exhibit R-8.

sustained (SM 5386). The issue raised under this second argument is whether the recent activity in the market is only a short-term aberration that should be permitted to run its course without any change in the fixed backout credit.⁷

NYSEG will not rely on either of those two arguments in this case. Instead, the Company is proposing to take the initiative by moving to a market-based backout under the conditions set forth in the following section of this brief.

III. The Commission Should Adopt NYSEG's Offer of a Market-Based Backout Credit At Least Until the Deficiencies in the NYISO are Remedied

NYSEG strongly supports the retail access initiatives of the Commission. The Company has an excellent record of encouraging customers to switch to alternate suppliers, as evidenced by the testimony of Mr. Tedesco, NYSEG's President (SM 5403). With that level of commitment, it is not surprising to find that NYSEG's retail access program is one of the most successful in the country.⁸

Nevertheless, NYSEG recognizes that market prices are above the backout and that the flawed nature of those prices may

⁷ Mr. Schnitzer testified that 20 trading days (or the passage of a full month) was needed to obtain one data point (SM 5803, 5811). Market prices have exceeded NYSEG's fixed backout only through observations made over the past three months.

⁸ See generally the discussion at SM 5338-41, and 5388-89. See also, Exhibit R-1.

take some period of time to remedy.⁹ NYSEG is also keenly aware that the flaws in the market do not discriminate in favor of one market participant over another. Those flaws impact both NYSEG and the ESCOs (SM 5539). Under these circumstances, the Company is seizing the initiative, responding to the ALJ's request for innovative solutions and proposing to move to a market-based backout at least until the problems with the NYISO's prices are resolved. The details of the proposal follow.

- Energy Component - The energy component of the market-based RAC for a customer's billing period would reflect a weighted average market value of energy applicable to the customer's region, load shape, and individual usage, as described in the Special Provisions section for the customer's applicable Service Classification. The weighted average market value of energy would be derived from the day ahead NYISO posted Locational Based Marginal Prices of electricity in Zone C for customers west of the Total East ISO Interface ("West Region") and Zone G for customers located East of the Total East ISO Interface ("East Region").

- Capacity Component - The capacity component of the market-based RAC would reflect the pro rata portion of the

⁹ Mr. Tedesco commented that he has seen nothing that would cause him to conclude that the NYISO could correct "its difficulties in the very near term." SM 5413.

November 2000 - April 2001 Winter Capability Period NYISO six month installed capacity auction, stated on a cents per kWh basis.

- Transmission Congestion Costs - With the implementation of the market-based RAC, NYSEG would cease to reimburse suppliers for transmission congestion costs.
- Ancillary Services, Line Losses and Installed Capacity - There would be no change in the treatment of ancillary services, line losses, installed capacity and installed capacity reserve from the Commission's determination in the Unbundling Phase of NYSEG's Electric Rate/Restructuring Proceeding, Opinion No. 99-7, issued July 15, 1999.
- Incentives - Along with its willingness to move to a market-based RAC at least until the NYISO's flaws are corrected, the Company continues to stand by its proposal to place in effect the incentive program outlined in the direct testimony of Mr. Tedesco as a further inducement to have customers switch to a retail access supplier (SM 5328-31). Under that proposal, an incentive of \$75 would be paid to the retail access supplier for each non-demand billed customer that enters the Customer Advantage Program for the first time, up to a cap of 35,000 eligible recipients. An incentive of \$115 would

be paid to the retail access supplier of demand billed customers with demands of less than 500 kW that enters the Customer Advantage Program, with the eligibility cap set at 3,000 customers. In addition, a separate incentive of \$115 would be paid to each such customer in this group. Finally, an incentive of \$2,250 would be paid to the retail access supplier of customers with demands equal to or exceeding 500 kW that switches for the first time, with an eligibility cap of 100 customers. A separate incentive of the same amount would be paid to each customer in this group that switches.¹⁰

- Minimum Energy Delivery Rate Component of the Bill - If the RAC that is calculated in accordance with the description above exceeds the energy delivery rate, the energy delivery rate would be set at zero. This protection is necessary so that the retail access customer would not receive a credit for the energy component of the bill.¹¹ NYSEG would place an annual cap of 50,000 MWH relating to load that would receive a negative energy delivery bill but for the zero energy bill limitation. If the 50,000 MWH cap is reached, no new retail

¹⁰ Customers participating in NYSEG's Farm and Food Processor Pilot ("F&FP") would be eligible for the incentive if they select the Customer Advantage Program after their participation in F&FP is concluded (SM 5329). All switching rules currently in effect would apply. The incentive program would be open to customers through the earlier of December 31, 2001 or when the program is fully subscribed.

¹¹ The problems with a negative bill are described by Mrs. Stratakos at SM 5664-66.

access customers would be added until the reasons for the negative energy delivery bill are examined and corrective measures put in place. During the remainder of the Price Cap Period, NYSEG would have the discretion to file for PSC approval of a minimum delivery rate.

- Cost Recovery - NYSEG would not recover from customers any of the costs associated with moving to a market-based RAC or implementation costs associated with moving to a market-based RAC.¹² In addition, NYSEG would not recover from customers the cost of its incentive program.¹³

- Duration - NYSEG's proposal to move to a market-based RAC is an interim solution to a problem that the Company believes has been caused by the well-documented problems associated with the NYISO. To address that situation, NYSEG is offering to commit to a market-based RAC through May 31, 2001. Sometime prior to that date, the Company would seek a determination from the Commission whether the NYISO's problems have been corrected.¹⁴ If the Commission determines that

¹² While the record contains statements that moving to a market-based RAC would have an adverse financial impact on NYSEG (SM 5434, 5441), that impact was not quantified.

¹³ The cost of the fully-subscribed incentive program would be \$3.8 million (SM 5428).

¹⁴ The Commission's determination could be made either in the context of the instant proceeding or the PSC's pending investigation of the NYISO, i.e., Case 00-E-1380.

problems with the NYISO still persist, the market-based RAC as outlined above would continue in effect. If the Commission concludes on May 31, 2001 (or at some later date) that corrective measures have had the desired effect so that the NYISO prices are no longer flawed, NYSEG would either return to the settlement's fixed backout of 3.56 cents/kWh (if market prices are at or below that level) or continue with a market-based RAC (if the market price exceeds 3.56 cents/kWh) for the remainder of the Price Cap Period.¹⁵ The determination whether market prices exceed the 3.56 cents/kWh fixed backout at that time should be based on the Natsource forward prices, using the methodology relied upon by Mr. Schnitzer at SM 5761.

IV. The Commission Should Reject Staff's Proposed Market-Based Backout With a Floor of 3.56 Cents/kWh

The Staff Panel proposed a market-based backout with the further constraint that the current fixed RAC of 3.56 cents/kWh should serve as a floor (SM 5600). Staff also recommended that energy prices should be shaped to the individual customer load profile by the NYISO zone where the customer is located (SM 5608).

These are two reasons why the Commission should not adopt the Staff proposal. First, despite its claims to the

¹⁵ Returning to the fixed backout if market prices are at or below that level ensures that the terms of NYSEG's settlement are being adhered to.

contrary (SM 5605), Staff is not recommending a truly "market" backout credit. As Mr. Schnitzer alluded to at SM 5772-73, the introduction of a floor distorts the RAC so that it would likely exceed the market price on an average annual basis. Therefore, the institution of a market-based RAC with a floor is tantamount to a market-based RAC with an adder, which cannot be justified for the reasons explained in the next section.

Second, there are serious implementation issues that the Staff recommendation presents. As noted previously, Staff proposed that the RAC reflect market prices for the zone in which the customer is located. Due to the non-contiguous nature of its service territory, NYSEG provides service in seven different NYISO zones. Mrs. Stratakos testified that in order to calculate a RAC for each of those seven zones, extensive programming changes would have to be made to the Company's billing system (SM 5661).

Those programming changes would take seven to eleven months to complete (id.). Before NYSEG could even begin working on those extensive programming changes, however, the Company would have to make some personnel allocation decisions regarding the Single Bill Project and the Meter Upgrade Project, both of which are already in progress (SM 5622).¹⁶

¹⁶ NYSEG's programming staff is also working on other CIS changes, including a change that would provide industrial and manufacturing customers information about the amount of GRT credit to report on their

While reprogramming NYSEG's billing system to accommodate seven zones would present serious difficulties, Mrs. Stratakos testified that NYSEG currently has the ability to implement a market-based backout using two zones (SM 5705). For that reason, NYSEG's market-based RAC proposal described in the previous section is based on using two zones.

Another CIS constraint addressed by Mrs. Stratakos is that NYSEG does not have the ability to implement Staff's proposal of a market based backout with a floor. In other words, the Company's computer system cannot render a bill that would reflect the higher of a market price backout or a fixed floor backout for the same customer during a billing period (SM 5705-09; 5723-32). During the cross-examination on this point, the Company explained that Staff's proposal would require extensive modification to NYSEG's billing system, raising again the issue of assigning priorities to the numerous CIS reprogramming projects already underway.

V. The Commission Should Not Adopt An Adder to the Market-Based Backout Credit

Several parties suggested that a market-based RAC for NYSEG should be increased by some undefined amount. For instance, Mr. DiValentino on behalf of SPM proposed to increase

business tax returns, in accordance with recent tax law changes (SM 5663).

the backout "by using some of NYSEG's over earnings and/or merger savings." SM 5546. The statement of Mr. Goodman on behalf of NEMA recommended that the market-based RAC should be augmented by the "full commercial costs associated with serving retail NYSEG customers. . . ." SM 5875. MI witness Dr. Rosenberg testified about the need to maintain a "spread" between the market price and the backout credit (5862).

LepCorp witnesses Mastroianni and Penharlow advocated the use of a market-based backout (SM 5576, 5584), but it is clear from the testimony of Mr. Penharlow that LepCorp's definition of a market-based RAC would include more than just the market price of energy and capacity (SM 5588). Finally, the Staff Panel stated that it was considering filing additional testimony at some later point in time if, upon further analysis, the panelists believe "additional enhancements are needed." SM 5609.

Before delving into the particulars of each party's proposal with respect to an adder, it may be useful to recall that the Commission has already rejected the notion that retail access should be funded by subsidies (and that is what the adder amounts to). For instance, in an order issued last year in a case involving Niagara Mohawk Power Corp., the PSC stated that "[i]n regards to increasing the shopping credit, there should be no subsidization of the retail access program by full service

customers."¹⁷ A subsidy would occur when the utility is forced to pay suppliers more than the market price of energy and capacity but is unable to avoid those additional costs. With that guidance from the Commission serving to provide context, a review of the record in this case reveals that there is no support for increasing the market-based RAC by an adder because there has been no demonstration that NYSEG can avoid any costs besides the market price of energy and capacity.¹⁸ Similarly, there is no support for the magnitude of the adder proposed by the various parties.

Mr. DiValentino's analysis of what he characterized as "over earnings" ignores the earnings calculation methodology specified in the Commission's Order of December 3, 1998 modifying NYSEG's electric Rate/Restructuring Agreement, described extensively by Mrs. Stratakos at SM 5641-44. With respect to his claim that the adder be funded by merger savings, Mr. DiValentino incorrectly assumes that NYSEG was the acquiring entity (SM 5547). Since the acquisition of out-of-state utilities was made by NYSEG's parent, Energy East, rather than

¹⁷ Case 96-E-0897, Niagara Mohawk Power Corp. Order Approving Transfer of Generating Facilities and Making Other Findings, issued July 28, 1999 (mimeo, p. 27.

¹⁸ In the May 26 Order, the Commission rejected Advantage Energy's proposed adder of a 10% "levelizer" in the form of a floating credit. Mimeo, p. 10.

NYSEG, there are no synergy savings to be obtained from the regulated entity.¹⁹

At SM 5875-76, NEMA argued that the backout credit should recognize the following "full commercial costs" that NYSEG allegedly can avoid when a customer switches to retail access: load forecasting; negotiating and managing contracts; regulatory compliance and litigation; taxes; A&G; customer service; billing; bad debt; collections; environmental disclosure; marketing; and cost of capital.²⁰ The problem with the NEMA position is that it fails to recognize the purpose of the backout. As noted by Mr. Schnitzer at SM 5793, the backout credit is designed to identify those costs which NYSEG can avoid when a customer chooses an alternate supplier.

No showing has been made by NEMA on this record that NYSEG can avoid the types of commercial costs identified at SM 5875-76.²¹ Moreover, Mr. Schnitzer offered a number of reasons why there should be no presumption that a customer opting for

¹⁹ Even if NYSEG, rather than Energy East, had merged with or acquired another utility, Article VI, Paragraph 1, of NYSEG's electric restructuring agreement permits NYSEG to retain all related savings for a period of five years from the date of the closing up to the amount of the premium.

²⁰ NEMA acknowledged that the PSC has already initiated inquiries into the level of customer service and billing costs that may be avoided (Id.).

²¹ Once again, recognizing that the level of avoided customer service and billings costs are being examined by the PSC in a separate proceeding.

retail access will allow NYSEG to avoid some costs.²² For instance, Mr. Schnitzer noted that customers leaving the system are not obligated to disclose when, and if, they plan to return to NYSEG's bundled service (SM 5800). NYSEG's status as the Provider of Last Resort ("POLR") will require it to continue to incur costs so that it can render service if such a customer returns (SM 5815-16). As the POLR, NYSEG may not be able to shed any risk management, A&G and uncollectibles expense, Mr. Schnitzer concluded (SM 5820-22).²³

Dr. Rosenberg's testimony about the need to maintain a spread between the market price and the backout is hardly credible in light of his recommendations. Dr. Rosenberg proposed a fixed backout of 4.5 cents/kWh (SM 5852), which he characterized as being "consistent with my analysis of current market prices in New York." SM 5853. Actually, the most recent market price cited in his testimony is 4.38 cents/kWh (SM 5851), suggesting a spread of 1.2 mills. That differential should be

²² Citing another reason against the adoption of any adders, Mr. Schnitzer stated that the definition of market price in the retail access section of NYSEG's electric restructuring agreement was limited to energy and capacity (SM 5758). No mention is made in that agreement of including in any market price backout the extraneous cost elements identified by LepCorp and NEMA.

²³ The absence of the kind of proof on this point that would be required to support an adder was underscored by the distinction drawn by the ALJ between the "natural law" and "business science." SM 5823. In failing to deal with the "business science" of the avoided cost issue, proponents of an adder have neglected to offer any empirical support for their position and, therefore, have not sustained their burden of proof.

contrasted with his testimony at SM 5862 where he stated that the spread should be at least 5 mills.

LepCorp's presentation on this issue is equally devoid of substance. In responding to a question at SM 5588 in which he was asked whether "any additional components" should be reflected in the backout credit, Mr. Penharlow mentioned that the list should include "miscellaneous costs associated with NYSEG's avoided retail costs. . . ." Soon thereafter, the witness stated NYSEG did not include all of the applicable elements that "LepCorp feels are irrefutably part of any cost of participating in a retail access program. . . ." SM 5589.²⁴

Unfortunately, what may appear "irrefutable" to LepCorp amounts to nothing more than conclusory statements. No determination whether avoided costs exist can be substantiated on the basis of such remarks.

Finally, the Staff Panel's reference to "additional enhancements" should be treated as a nullity, since no further testimony was ever filed on this subject.

VI. There Is No Basis For Requiring NYSEG To Reimburse Energetix For Marginal Line Losses

Energetix argues that NYSEG should be responsible for "transmission losses [including NYISO marginal line losses]

²⁴ Mr. Penharlow would include in this category the cost of balancing and settlement, forecasting and settlement, cost of capital and gross receipts surcharge. Id.

associated with on-system bi-lateral transactions used to serve NYSEG retail consumers from ex-NYSEG generation assets. . . ."

Under this very limited circumstance, Energetix claims that NYSEG should reimburse Energetix for these marginal losses.

There are two reasons why the position taken by Energetix cannot be sustained. First, Energetix incorrectly assumes that the treatment of losses in the pre-NYISO environment is identical to the way losses are recognized after the NYISO began operations. (SM 5653). Second, Energetix fails to recognize that an ESCO can select generation resources that will result in no marginal loss charges or may actually result in a marginal loss credit (SM 5654-57).

Regarding the first point, there is, in fact, a fundamental difference in the way line losses are recognized before and after the NYISO began operating. In the pre-NYISO environment, the transmission customer had to increase its take at the generator to account for losses in an amount equal to the transmission provider's fixed, system average loss factor between the generator and the load (SM 5653-54). That factor, which is specified in the Open Access Transmission Tariff ("OATT") of the transmission provider, was always the same, regardless of the direction that the energy flowed. As a consequence, losses in the pre-NYISO period were always treated

as an expense, i.e., to compensate for the loss, the customer had to purchase an additional amount of electricity (SM 5656).

Since it began operations, however, the NYISO either charges or credits suppliers for the cost of the marginal losses associated with the transmission of power from the generator to the demarcation point of the system in which the load is located. Under this approach, if the transaction is in the direction of the prevailing flows of the system, the NYISO will charge the transmission customer for losses (SM 5655). Conversely, if the transaction is counter to the prevailing flows, the transmission customer will be paid by the NYISO, since that customer is, in effect, responsible for reducing losses on the system (SM 5655). In other words, losses under the NYISO are determined by a flow-based model (SM 5653) and the supplier's choice of generator location determines whether or not the supplier will receive a charge or a credit (SM 5655-5657).

With the NYISO now in operation, the transmission customer must also pay for losses from the demarcation point between the bulk and lower voltage transmission system to the distribution system (the "sub-transmission system") of the transmission provider where the load is located (SM 5655). NYSEG has recognized that it has the responsibility to pay for these losses and does so (SM 5656). However, since an ESCO can

pick generation that results in no marginal loss charges, NYSEG does not reimburse ESCOs for any marginal losses that are experienced on the bulk transmission system (SM 5656).²⁵ In other words, by purchasing generation that results in no charge for marginal losses, the ESCO is in the same financial position under the NYISO that it found itself before the NYISO commenced operation.

Accordingly, the ALJ should conclude that NYSEG need not reimburse Energetix for any past charges associated with losses. The ALJ should also find that no changes to NYSEG's method for reimbursing losses are warranted.

CONCLUSION

NYSEG's willingness to support a market-based RAC under the circumstances described in this brief represents a substantial departure from the litigation position described on the record of this case.²⁶ In part, that change was the result of increasing market prices. But the change is attributable more to the Company's willingness to overlook the severe problems with the NYISO's pricing mechanisms so that NYSEG's

²⁵ If NYSEG were to reimburse Energetix for marginal losses, the Company could be exposed to enormous costs, since ESCOs could select as their source of supply a distant generating unit, resulting in significant marginal loss charges.

²⁶ As noted previously, NYSEG's proposal also includes the incentives described by Mr. Tedesco.

retail access program can continue as one of the most successful in the country.

The Company's proposal to move to a market-based RAC should bring this case to a swift conclusion. In rendering its decision, the Commission should reject proposals to increase the RAC by an adder because of the absence of proof on this subject. Implementation of a market-based RAC with a floor is just an adder by another name and likewise should be rejected. Finally, the marginal line loss issue raised by Energetix is without merit and NYSEG's position should be sustained.

Respectfully submitted,

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