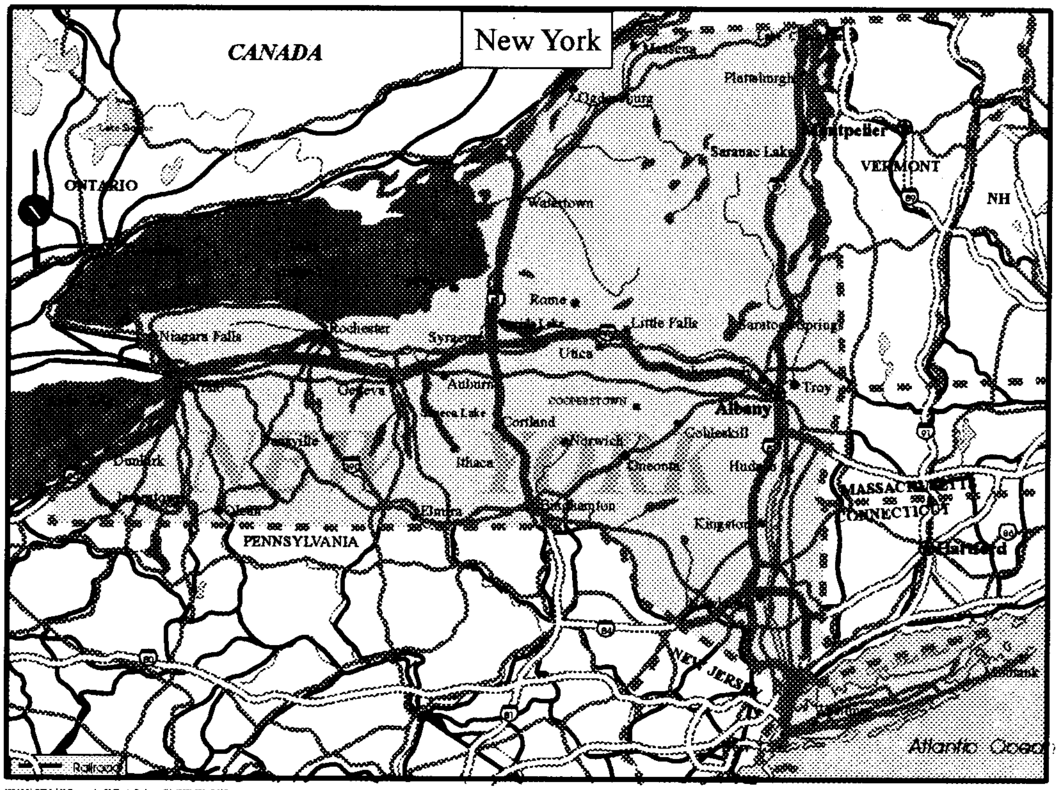
New York State

Public Service Commission

Department of Public Service



1995 - 1996

Annual Report

George E. Pataki, Governor
John F. O'Mara, Chairman

About the New York Public Service Commission and Department of Public Service

The New York State Public Service Commission was established in 1907, one year after a New York City lawyer, Charles Evans Hughes, was elected Governor of the state. Hughes had earned a reputation as a crusader while heading an investigation of gas and electric services in New York City; a major plank of his campaign was the creation of an independent government agency that would regulate private utilities. His opponent in the 1906 election, William Randolph Hearst, advocated municipal ownership of utilities.

As one of his first official acts, Governor Hughes succeeded in obtaining passage of legislation that created the Public Service Commission, the first such regulatory body in the country. The Commission was given authority to investigate the quality of service provided by utilities and the reasonableness of their rates. Its stated duties also included evaluating utility operations, prescribing accounting methods, and supervising the issuance of securities.

The Chairman of the Public Service Commission also serves as Chairman of the Department of Public Service, which represents the public interest in matters before the Public Service Commission and makes recommendations on utility-related matters.

The Department was officially created in 1926 when a constitutional reorganization of New York's state government took place. Since then it has experienced many changes and reorganizations, such as the transfer of some regulatory functions to the Department of Transportation in 1970, the creation of a Consumer Services Division in 1981, and the addition of cable television industry regulation in 1996.

The Commission and Department staff remain committed to serving all the people of the state, as evidenced by its Mission Statement, adopted in 1996:

Our purpose is to ensure that New Yorkers have access to competitively priced, high quality utility services provided safely, cleanly, and with maximum customer choice.

We will be innovative, fair, and responsive in balancing the needs of customers, service providers, and all others.

1995 - 96 Administrative Initiatives

Department Reorganization

In 1995, the Energy and Water Division split into two divisions -- the Electric Division and the Gas and Water Division, to increase the focus on electric and gas utility competition issues. The Department also incorporated functions of the Commission on Cable Television on January 1, 1996. The 48 former Cable Television employees joined the Department's Communications Division, Consumer Services Division, Office of General Counsel, and Office of the Secretary.

Electronic Tariff System

In a collaborative effort by participating utilities and the Department, the Department implemented the electronic tariff system (ETS) in December 1996. ETS allows public access to tariffs (a compilation of utility rates and rules governing relations with customers), via the Commission's web page, within 24 hours of filing.

Streamlining Reporting Requirements

The Department has participated in a program to reduce the rules and reporting requirements for the utilities it regulates. As part of that program, the Office of Accounting and Finance has substantially revised the Commission's annual report and other reports that electric, gas and telephone companies are required to file with the Commission. These actions are intended to reduce administrative burdens and facilitate more cost-effective regulation.

As a result of these efforts, the Department eliminated or revised numerous schedules in the annual reports, and reduced the information required in the reports by approximately one-third. To eliminate duplicative reporting, electric and gas companies can now substitute schedules from the Federal Energy Regulatory Commission's annual report in place of the Commission schedules when those schedules contain similar information. The revisions do not materially affect the quality of information reported to the Commission. The Commission also streamlined the computerized version of the annual report to more fully automate the report and use advanced electronic spreadsheet capabilities. These changes provide staff with better access to selected financial and operating data and make it easier for companies to complete the annual report.

Accounting and Finance also eliminated or streamlined other reporting requirements, including: telephone company quarterly financial reports, quarterly joint cost and jurisdictional separation reports, and the requirement for telephone companies to file an annual independent auditor's report on the annual joint cost data report. For the electric and gas companies, the requirement to file a fourth quarter Commission report was eliminated because this data is already provided in the Commission's annual report. The Department also streamlined the Commission quarterly report by eliminating several schedules that were not used and/or were duplicative.

Competition in the Electric Industry

In 1993, the Commission established the Competitive Opportunities Case (COB for Competitive Opportunities/ Bypass) to allow collaborative review of the numerous complex issues associated with a transition to competition.

Between April and July of 1995, the Department participated in numerous symposia where invited experts gave presentations to the parties in the competitive opportunities case. These widely-attended sessions proved invaluable in providing a common knowledge base for the numerous parties (more than 90 parties representing diverse interests participated in the case) that would later have to work together to determine the best approach for restructuring New York's electric industry.

On June 7, 1995, the Commission adopted principles to guide the transition to competition. The parties continued to work collaboratively on the issues and set forth proposals for restructuring the industry, outlining the potential benefits and risks. The final draft report, titled ***Restructuring New York's Electric Industry: Alternative Models and Approaches - Final Phase II Report***, issued in September 1995, reflected all of the parties' comments.

On December 21, 1995, Administrative Law Judge Judith A. Lee and former Deputy Director of the Energy & Water Division, Ronald J. Liberty, issued a recommended decision in the Competitive Opportunities Case which called for a continuing collaborative process to restructure New York's electric industry. It presented a preferred competitive model, and recommended the establishment of an independent system operator (ISO) to ensure the reliable operation of the system.

On May 20, 1996, the Commission issued a landmark decision that established a framework for developing a competitive electric industry in New York state. The Commission's decision called for a competitive wholesale power market in early 1997 and the introduction of retail access for all classes of electric customers in early 1998. The Commission's policy direction and vision for the future of the electric industry included the following goals:

- lowering rates for consumers;
- increasing customer choice;
- continuing reliability of service;
- continuing environmental and public policy programs;
- allaying concerns about market power; and
- continuing customer protections and the obligation to serve.

To implement its policies, the Commission directed each of the utilities to file restructuring proposals and rate plans by October 1, 1996. The filing requirement did not immediately apply to Long Island Lighting Company (LILCO) or Niagara Mohawk Power Corporation (NiMo). NiMo had already submitted its PowerChoice restructuring proposal prior to the Commission decision and, at the time, the Commission was investigating LILCO's rates and the Long Island Power Authority was negotiating a new structure for the company.

The five remaining utilities, Consolidated Edison Company of New York, Inc., Central Hudson Gas & Electric Corporation, New York State Electric & Gas, Orange & Rockland Utilities, Inc., and Rochester Gas and Electric Corporation, filed plans on October 1, 1996, for introducing competition into the electric industry. All parties in the competitive opportunities proceeding were permitted to review and comment on each filing. Utility-specific staff teams were organized to review these filings and aid in negotiations. The Commission also directed that Department staff, utilities and other parties work collaboratively to resolve technical issues.

Supreme Court Upholds PSC Authority

The Supreme Court of New York rejected a petition filed by the Energy Association (EA) and its member electric corporations, and another petition filed by the Public Utility Law Project (PULP), challenging the Commission's order in the COB proceeding.

In rejecting the petitions, the Court reached four conclusions.

- Public Service Law empowered the Commission to require the utilities to file restructuring plans.
- The Commission's authority to order these actions was not justiciable.
- EA's argument that utilities are entitled to recover all costs that will become uneconomic or stranded in a competitive market was rejected.
- Arguments that the Commission issued its order in violation of the State Administrative Procedure Act were rejected.

Role of the Energy Service Companies

The Commission described a vision of the future of the electric industry that included increased consumer choice of energy service companies (ESCOs). ESCOs may offer electric customers a variety of service packages that include innovative pricing alternatives, information services, energy efficiency measures, maintenance of equipment, and financing programs. However, the provision of electricity and related services in a multi-provider environment raises many complex issues. A multi-party ESCO working group was formed to address these concerns.

On October 1, 1996, the parties filed a draft report on ESCO issues.The Commission issued an order on May 19, 1997, in which it made decisions regarding the establishment of regulatory policies for the provision of retail energy services.

Independent System Operator

In order to have competitive generation services, open access to the transmission system is required. An independent system operator (ISO) could control daily operations on the power grid, plan for and respond to system upsets and emergency situations, and provide a supply of spot energy and ancillary services.

Department staff, along with other parties, participated in an evaluation of issues related to the establishment of an ISO for New York state's bulk power operations, issuing a report, titled ***Restructuring New York's Electric Industry: An Interim Report on an Independent System Operator for New York State***, in April 1996. The report identified areas of general agreement and apparent disagreement. The major topics covered by the report included: role and responsibilities of an ISO, operational considerations, governance, dispute resolution, and planning. Also included in the report were extensive appendices in which various parties provided their own viewpoints on the issues that had not yet been resolved.

Market Power

Department staff, in collaboration with the utilities and interveners, headed up a major effort in the analysis of load pockets and market power which yielded two valuable reports to guide the Commission and other interested parties in analysis of these issues for New York State. They issued ***Report on Load Pockets: Identification and Description*** in February 1996 and ***Analysis of Load Pockets and Market***

Power in New York State: Final Report in October 1996.

Outreach and Education

Public involvement in the competitive opportunities case proved to be essential in educating the public and receiving views regarding the future of the electric industry. To ensure integration of the public's concerns, the Department held 25 educational forums and public statement hearings from December 1995 through February 1996. Reports were submitted to the Commission and comments were considered in the Commission's May 1996 decision.

A survey aimed at learning about people's awareness level of competition in the electric and gas industries indicated that 85 percent of the 1,800 respondents were in favor of customer choice in the energy marketplace. The PSC Website allowed consumers to learn more about competition and comment via the Website's Consumer Comment Forum.

Department staff also created a toll-free Opinion Line, allowing consumers to express opinions on competition and other proceedings. A toll-free English and Spanish language information line on competition was also implemented, giving consumers the opportunity to hear or request written information on competition.

The results of a survey distributed to the members of the Business Council of New York indicated that business people rely heavily on the Internet for information and favor the Commission providing information on electric restructuring on the Internet. The Commission is developing a link for business on the Department's website.

System Benefits Charge

In its Competitive Opportunities decision, the Commission called for the creation of a non-bypassable system benefits charge (SBC) to support conservation efforts and public policy initiatives beyond what competitive markets would provide during the transition to competition.

Demand Side Management (DSM)

With the implementation of a competitive market and projected lower energy costs, there is concern that consumers' interest in energy saving techniques may decrease. In 1995, the Commission ordered a study to evaluate the cost-effectiveness of the utilities' DSM programs. Completed in early 1996, the report reviewed DSM evaluation efforts previously conducted, measurement criteria, and DSM evaluation studies.

The Commission, in its May 16, 1996, decision, foresaw a much different environment for DSM by 1998 or 1999, calling for movement toward full retail electric competition, with independent ESCOs providing many of the DSM services formerly offered almost exclusively by the state's seven major electric utilities. The Commission determined that during the transition to competition, the SBC would be needed to support some of the programs.

COB - SEQRA Analysis and Final Generic Environmental Statement

On February 14, 1996, the Commission issued a positive declaration of potential environmental impact under the State Environmental Quality Review Act (SEQRA) and directed the preparation of a Draft Generic Environmental Impact Statement (DGEIS) in Phase II of the Competitive Opportunities proceeding, which it issued for comment on March 7, 1996. On May 3, 1996, the Commission issued a Final Generic Environmental Impact Statement (FGEIS) which addressed the environmental impacts of a policy supporting increased competition in electric markets. In its opinion, issued May 20, 1996, the Commission determined that the likely environmental effects of a shift to a more competitive market for electricity are not fully predictable but that the proposed action will have environmental impacts that are modest or not distinguishable from those of alternative actions, including the no-action alternative. The FGEIS identified several areas of concern and implemented mitigation measures to reduce adverse impacts.

The Commission required each utility to file an Environmental Assessment Form and a recommendation on further environmental review to be considered along with each restructuring plan.

Related Electric Competition Proposals

Niagara Mohawk PowerChoice Proposal

On October 6, 1995, Niagara Mohawk Power Corporation (NiMo) filed its PowerChoice proposal. Under the proposal, NiMo would form two separate companies, one that would own its power generating plants, and another that would provide service as a regulated transmission and distribution utility. The company's largest industrial customers would initially deal directly with competitive power suppliers. Similar direct retail access would be phased in over three years for other classes of customers. The proposal also included a provision to freeze customer rates for five years. A major amendment to the PowerChoice proposal reflected an agreement with major independent power producers (IPPs).

Orange & Rockland Utilities, Inc. Retail Access Pilot Program

In May of 1996 the Commission approved the implementation of Orange & Rockland Utilities, Inc.'s (O&R) retail access pilot program (PowerPick), designed to allow program participants access to providers of electricity other than O&R. The pilot program is the first in New York to provide customer access to a retail competitive environment. PowerPick is being carried out in two phases. Phase I, intended for larger industrial customers, went into effect on July 1, 1996, and allowed O&R's largest industrial customers the option of buying their energy from O&R or any alternative supplier. During this phase of the program, 18 of O&R's largest customers purchased over 70,000 mWh from suppliers other than O&R, which resulted in a savings to those customers of approximately $207,000. Phase II of the pilot, which is designed for residential and smaller commercial and industrial customers, begins in early 1997.

Competitive Opportunities and the Federal Energy Regulatory Commission

The Federal Energy Regulatory Commission (FERC) expanded its competitive philosophy by pursuing policies and rulemakings on stranded cost recovery, mergers, and wholesale competition through open-access transmission. Department staff submitted comments in the FERC proceedings and made presentations at four technical conferences within these proceedings. Since both New York and FERC are interested in fostering the rapid development of a competitive wholesale market, the majority of comments to FERC focused on the smooth advancement of competition.

In March 1995, FERC issued proposals for recovery of uneconomic costs and investments of electric corporations stranded in a competitive market and for open access to the nation's electric system. The Department filed comments that supported the promotion of open access and wholesale competition.

FERC Order 888, released on April 24, 1996, established open-access transmission service through a system of uniform unbundled tariff price structures, terms and conditions; set forth the proposed treatment of stranded costs; reserved FERC jurisdiction over all wholesale and retail-turned-wholesale stranded costs; established indicators and functional tests for determining what facilities are transmission versus local distribution; established a real-time information network for the availability of transmission services; and established guiding principles for the development of ISOs.

In response to the open-access provisions of Order 888, each New York utility filed an open-access tariff with FERC that unbundled transmission service from wholesale power sales and unbundled transmission service into a basic service and six ancillary services. Six of the seven tariffs had pricing issues set for hearings.

FERC proposed replacing the open access transmission tariffs filed by the utilities with new tariffs. The new capacity reservation transmission tariffs (CRT) would reserve transmission capacity between points of receipt and delivery for all wholesale and retail transactions. The Department opposed the proposal because it would limit the states' flexibility in implementing retail competition, intrude on state authority, and threaten system reliability. In response to significant opposition, FERC withdrew the proposal.

FERC also held in Order 888 that once a utility established its open-access transmission tariff, the utility's market power over generation would likely be mitigated. As a result, most of the New York utilities have petitioned FERC to become power marketers with the ability to sell power from existing generation resources at market based rates. The Department has been very active in these proceedings to ensure that retail ratepayers are not harmed by these activities and that appropriate benefits flow back to the ratepayers.

The Department successfully defended a challenge of a New York law by Niagara Mohawk Power Corporation (NiMo) at FERC. NiMo challenged the law, enacted in 1991, which requires utility reimbursement of certain gas import tax payments that a qualifying facility (QF) is obligated to pay on gas used to produce electricity to sell to the electric utility. NiMo maintained that the payments are in excess of avoided costs based on the Commission's cost-of-service methodology for setting rates utilities must pay to QFs. New York intervened and filed a motion to dismiss, based on FERC's lack of jurisdiction over the issue. FERC agreed and denied NiMo's petition, maintaining that it was a tax collection issue and not an avoided cost issue.

Actions on Electric Utility Issues

Consolidated Edison Company Of New York, Inc.

Three-Year Rate Plan

On March 29, 1995, the Commission approved a three-year rate plan for Consolidated Edison Company of New York, Inc. (Con Edison) which froze base electric rates for the first year of the agreement, and allowed limited possible adjustments for certain specified costs in the second and third years. The rate agreement took effect on April 1, 1995, and will end on March 31, 1998.

The agreement caps Con Edison's revenues to encourage cost control and provides incentives for customer retention and for attracting new customers since shareholders' losses or gains are dependent on the number of customers rather than on the amount of electricity sold. The agreement also includes performance incentives designed to ensure reliability, improve service quality, and continue energy conservation efforts. It requires sharing between customers and shareholders should the company realize revenues beyond the projected level.

Long Island Lighting Company, Inc.

Complete Rate Case Ordered

On April 25, 1996, the Commission instituted a comprehensive examination of Long Island Lighting Company, Inc.'s (LILCO) electric rates and financial situation by directing LILCO to file a complete rate case proposing an immediate rate reduction and also a comprehensive rate plan through 1999. The Commission's decision expanded an earlier order directing the company to show cause why certain measures should not be implemented to reduce electric rates as soon as possible. In that earlier decision, the Commission had identified measures that held potential for reducing rates.

On September 27, 1996, LILCO filed its permanent rate case which proposed to freeze base rates through November 30, 1999. Although base rates are proposed to be frozen, LILCO anticipates there would be minimal overall bill impacts.

Niagara Mohawk Power Corporation

1995 Rate Increase

By order issued April 21, 1995, the Commission authorized Niagara Mohawk Power Corporation (NiMo) to increase its electric rates, effective April 27, 1995, by an amount designed to produce about a 1.1% increase in 1995 revenues over those received in the year 1994. On February 12, 1996, the company filed a request for a $325 million permanent rate increase to take effect on January 1, 1997. This permanent case was filed apparently as a safeguard against prolonged delays in the resolution of issues and implementation of its previously filed PowerChoice proposal. The company requested $137.5 million of its permanent request on an immediate temporary basis (subject to refund) in order to avert a serious financial crisis and associated potential service problems in 1996. On May 2, 1996, the Commission denied NiMo's request for an increase on the basis that the public interest would not be served by granting such an increase.

Department staff participating in the case won an $8.4 million rate base adjustment disallowing expenses associated with the company's relocation of its Collections Operations. The Commission also ordered the company to reduce its uncollectible expense by $1.2 million in return for allowing it to increase and speed up enrollment from 2,000 to 5,000 customers in its Low Income Customer Assistance Program. Staff proposed, and the Commission adopted, a penalty-only service quality program for 1995.

NiMo and Alcan Corporation

The Commission issued a certificate to Sithe Energies, Inc. to operate as an electric corporation and to sell electricity generated at its Independence Power Plant to Alcan Aluminum Corporation. NiMo, the provider of energy to Alcan, filed a petition challenging the Commission's decision. The Appellate Division confirmed the Commission action.

New York State Electric & Gas Corporation

Electric Rate Filing Suspended

In August 1996, the Commission suspended an electric rate filing by New York State Electric and Gas (NYSEG) which would have provided NYSEG with a 2.8% rate increase for the second year of a previously approved three-year rate plan. NYSEG sought a rehearing of the Commission's suspension, claiming it had a contractual right to receive the second-year rate increase.

Orange and Rockland Utilities, Inc.

Ethics Investigation and $8.5 Million Refund

On October 4, 1993, the Commission instituted a prudence investigation of Orange and Rockland Utilities, Inc. (O&R) after the arrest of the vice president of its Corporate Communications and External Affairs Department. The Commission directed O&R to prepare a detailed analysis of the company's own internal investigation into improprieties, including estimates of ratepayer impacts. On November 10, 1994, the company filed testimony which addressed electric and gas rate impacts and proposed a $3.8 million refund to gas and electric customers.

On July 6, 1995, the Commission released a Department staff report which found that "while the [proposed] $3.8 million is a reasonable estimate of inappropriate invoices and expense accounts, this estimate falls far short of quantifying the total ratepayer costs" because it did not include reimbursement to ratepayers for excess costs in the areas of: (1) senior management compensation, (2) the Internal Audit Department, and (3) the Corporate Communications and External Affairs Department. After settlement conferences, the company, staff, and other parties agreed to an $8.5 million settlement. The Commission adopted this settlement and also approved a three-year rate plan which reduced annual electric rates by $7.75 million and froze rates through April 30, 1999. The rate reduction is in addition to a $6.1 million rate reduction ordered in 1995.

After the investigation, eight of the eleven senior managers either were terminated or retired. The company replaced its external auditing firm, terminated the head of internal auditing, and improved internal controls for the Board of Directors Audit Committee. O&R also agreed to hire an inspector general and ethics officer responsible for administering and enforcing an ethics program.

Rochester Gas and Electric Corporation

Three-Year Settlement Agreement

In June 1996, the Commission approved, with modifications, a three-year settlement agreement with Rochester Gas and Electric Corporation. The settlement provided for a $7.1 million (1.0%) base rate decrease in the first year, and $3.5 million (0.5%) base rate decreases in each of the succeeding two years. A further reduction for the first year was effected through incorporating a projected negative Fuel Cost Adjustment into base rates (reflecting a court determination reducing payments to an IPP below contractual prices). First year revenues were projected to be reduced by 2.5% for residential and 4.5% for non-residential customers.

Other Electric Utility Issues

Load Shed Events

Department staff investigated two load shedding events during 1996. The first incident, which occurred on May 21, was in part the result of Consolidated Edison Company of New York, Inc.'s (Con Edison) equipment failures. Con Edison has implemented staff recommendations aimed at ensuring that similar failures do not occur in the future.

The second incident, which occurred on August 26, was caused by a relay failure at a critical location on New York State's bulk power transmission system. Staff identified a number of areas where improvements have been made, including a requirement for increased operating reserves in the critical southeast region, and a joint agreement with the Pennsylvania, New Jersey, and Maryland power pool to better control transmission flow between the pools that can aggravate transmission overloads. Other issues related to this event are being addressed in conjunction with the ISO development efforts.

Reliability Standards and Penalties

The Commission, based on Department staff's recommendations, adopted revisions to its Electric Service Standards, which had been in place since 1991. Staff also recommended changes to reduce the filing burden on the electric utilities. The standards have effectively increased utility focus on service reliability and power quality. They have been used in conjunction with penalty mechanisms created to ensure that service does not deteriorate as utilities strive to reduce costs.

Municipalization

Towns, cities, and counties throughout upstate New York and parts of Long Island are looking closely at setting up their own municipal electric utilities. Due to this interest, Department staff made presentations to numerous localities considering municipalization. The presentations focused on the advantages and risks involved and discussed competition as an alternative to municipalization.

Nuclear Waste

The federal government has collected billions of dollars from electric ratepayers to establish a storage site and accept nuclear waste by January 1, 1998. However, the federal Department of Energy decided that it would not be able to meet the deadline for acceptance of nuclear waste and, in the absence of the selection of a permanent repository, it had no duty to designate a site by the deadline or to provide for interim storage. The Department of Public Service joined several electric corporations and regulatory agencies to challenge that decision. On July 23, 1996, the D.C. Circuit Court of Appeals held that the Department of Energy has a statutory responsibility to meet the January 1, 1998, deadline.

Deregulation of the Natural Gas Industry

On March 28, 1996, the Commission issued its ***Order Concerning Compliance Filings*** in its gas restructuring proceeding. The Commission required open access to the gas distribution system in New York State, allowing all customers to choose alternate gas (commodity) suppliers. Previously, only large gas users could transport their own gas.

In the Commission's proceeding, the Public Utility Law Project (PULP) claimed that gas marketers must comply with the Home Energy Fair Practices Act (HEFPA), which governs disconnection of residential services and requires consumer protections in the local distribution companies' (LDCs') tariffs for residential and commercial customers choosing marketers. The Commission rejected PULP's claim and defended its decision in the state Supreme Court, stating that the marketers could not connect or disconnect gas service, and that consumers would continue to have HEFPA protections available through the LDCs. Marketers supported the Commission, asserting that compliance with HEFPA would make it difficult for them to serve the residential market.

Certification Program

Staff initiated a compliance program to review standard contracts filed by the marketers to comply with Commission orders regarding consumer protections.

As of the end of 1996, there were more than 50 marketers serving more than 4,000 small customers under the gas aggregation program. It is expected that this number will grow more rapidly as the start-up problems are solved and customers become more aware of the opportunity to purchase gas from competitors.

Outreach and Education

The Department held numerous public hearings and forums to gain consumer input on the move toward deregulation in the natural gas industry and submitted reports and comments to the Commission. The largest of these gatherings, the State Fair, dealt with the issue of the emerging gas competition by developing an interactive "Informed Energy Choices" exhibit that approximately 75,000 consumers visited.

Through the use of toll-free telephone lines, the Commission provides consumers easy access to information. Dialing 1-888-ASK-PSC 1 (1-888-275-7721) connects in-state callers to an automated phone system of recorded messages on gas and electric competition. The toll-free line allows consumers access to information regarding the Commission's March 28, 1996, order approving plans to provide residential, small commercial and business customers the option to buy natural gas supplies from non-utility service companies. In-state consumers can also submit comments by calling the Commission's toll-free Opinion Line at 1-800-335-2120; writing to John C. Crary, Secretary to the Commission, 3 Empire State Plaza, Albany, New York 12223-1350; or visiting the Consumer Comment Forum and Hot News Section on the Commission's website:

(http://www.dps.state.ny.us).

State Intervention at the Federal Level

The Federal Energy Regulatory Commission (FERC) continues with its industry-wide restructuring of the interstate natural gas pipeline network. FERC's goal is to create a nationwide pipeline grid, and it has been addressing topics that include both pipeline rate and capacity-related issues. FERC is issuing generic policy statements and conducting rulemaking forums as well as setting policy in individual, company-specific proceedings.

In May of 1995, FERC issued a pricing policy for new and existing facilities constructed by interstate pipelines. Under the policy statement, rolled-in rates (rolling-in the expansion costs with existing facilities) would apply when rate increases to existing customers from rolling in the cost of new facilities are 5% or less and when the pipeline makes a showing of system-wide benefits. This policy affects a number of expansion projects in New York State.

FERC approved straight fixed variable (SFV) rate design for interstate pipelines as part of its Order 636. Under SFV, all fixed costs are recovered through fixed monthly demand charges. The Commission continues to advocate the elimination of SFV. New York submitted testimony opposing SFV in a number of FERC rate proceedings involving pipelines serving New York.

New York State natural gas customers use gas produced in many areas of the country. National pipeline companies transport this gas to New York over interstate pipelines. The FERC has jurisdiction over the rates charged by the companies, and the Department actively participates in FERC natural gas pipeline rate cases to protect the interest of New York state consumers. In 1995, Transcontinental Gas Pipeline Corporation, Tennessee, and Columbia Gas Transmission corporation filed requests for rate increases. The Department sponsored testimony, participated in hearings and filed documents in these cases opposing recovery of all or a portion of the rate increase requests.

Iroquois Gas Transmission System L.P.

The Commission initiated a penalty action against Iroquois for violations of New York State law associated with the construction of the New York portion of a new pipeline. Iroquois and the Department entered into a settlement to resolve the action. The settlement included a $4 million payment by Iroquois to the state of New York, conditioned upon the approval of federal consent decrees which were executed in September 1996.

Gas Utility Issues

Trends in the Cost of Natural Gas

Most of the natural gas purchased by gas utilities is tied to monthly price indices. Beginning in late 1996, those indices developed both an upward trend and an increased volatility. This was troubling because the commodity cost of gas can equate to approximately 35% of a customer's annual bill. Moreover, as the industry moves toward a more competitive gas market, the Commission is considering the use of more price caps and elimination of the gas adjustment clause, a mechanism that allows a utility to recover from (or return to) customers variations in the cost of gas above or below those contained in base rates. This change becomes more difficult if the increased price and volatility are anything more than an isolated occurrence. Department staff has undertaken a further review of operations of these price indices to determine if gas utilities can make prices less susceptible to these factors.

1995-96 Winter Gas Supply

The winter of 1995-96 was particularly severe throughout the eastern and mid-western portions of the United States. Department staff reviewed the performance of each local distribution company (LDC) and found that they generally did a good job of managing gas supply in a tough winter. Service to all firm customers was maintained and no major supply problems developed.

Pipeline Risk Management

Department staff, the Federal Joint Risk Management Quality Team, state pipeline safety agencies, oil and gas companies, and the public have developed a national standard for applying risk management principles to pipeline operations. A demonstration program will allow selected interstate pipeline companies to operate under approved risk management programs in lieu of complying with minimum mandated safety code requirements. Pipeline operators are provided the flexibility to identify risks and approaches to address those risks at less cost than under existing safety codes.

Safety

The Commission issued a Notice of Proposed Rulemaking in April 1996 to adopt rules that require excavators to inform operators of underground facilities of their intent to dig by contacting a one-call notification system. The one-call system transmits the notice to its members. All operators of underground facilities are required to participate in one-call systems.

Brooklyn Union Gas Company

Corporate Restructuring and Rate Plan

On September 11, 1996, the Commission approved a plan to reorganize Brooklyn Union Gas Company (BUG) and its subsidiaries into a holding company and to stabilize rates over the next six years.

The new structure will provide BUG the organizational flexibility needed to take advantage of new business opportunities and expand its existing lines of business in gas distribution, exploration and production, power generation, storage, and pipeline operations. Investments in non-utility ventures will be allowed to increase from 15% to 50% of capitalization.

The rate plan decreased overall rates by $3.5 million on October 1, 1996, and freezes them for the following five years. The company will also continue to redesign rates initiated in the last rate plan to better reflect the cost of serving customer groups and help the gas distribution company compete in the future market place.

The plan includes a customer service quality performance plan and a rate for low-income customers. The plan provides BUG with the incentive to maintain service at existing levels or incur penalties.

Management and Operations Audit

In July 1995, Department staff completed a Management and Operations Audit of BUG. The audit report presented a number of recommendations for improvement in: gas purchasing, computer information systems, marketing programs, corporate perspective, EEO/AA, ethics and internal controls, and construction program planning. By implementing those recommendations, BUG could reduce costs and produce an organization which is more responsive to the competitive marketplace, with lower customer rates, and higher returns for shareholders.

Central Hudson Gas & Electric Corporation

Service Quality Incentive Mechanism

Department staff established the first service quality performance incentive mechanism for Central Hudson Gas & Electric Corporation (Central Hudson) in its gas rate case (95-G-1034). Under the mechanism, the utility will incur a financial penalty if customer satisfaction with service falls below acceptable levels, as measured by an annual survey. The company will also compensate the individual customers affected if it fails to keep service appointments.

Consolidated Edison Company of New York, Inc.

Rate Case -- Third Stage

On June 17, 1996, Consolidated Edison Company of New York, Inc. (Con Edison) filed proposed gas rates to implement the third, and final, stage of a gas rate settlement approved by the Commission in 1994. Con Edison sought a gas rate increase of $36.1 million (4.1%).

On October 4, 1996, staff and Con Edison reached a settlement, in principle, to freeze gas rates through September 30, 2000, and include incentives to maintain system reliability and customer service.

National Fuel Gas Distribution Corporation

Two-Year Settlement

On November 2, 1995, National Fuel Gas Distribution Corporation (NFG) filed rates designed to increase annual revenues by $28.9 million (5.2%) for the rate year ending September 30, 1997. In its previous two opinions in NFG rate cases, the Commission noted a steady rise in the company's non-gas costs and frequent rate filings, and encouraged the company to discuss a multi-year rate-making approach, together with performance-based incentives. The resulting two-year settlement plan includes:

- performance-based incentive provisions for gas purchasing;
- a mechanism for use of refunds and credits to offset uncontrollable costs;
- a sharing mechanism for any earnings that exceed a target;
- steps to further the process of rate restructuring by moving transportation rates closer to their underlying costs;
- provisions to limit the impacts on residential customers to only nominal increases in monthly minimum charges;
- a customer service performance incentive program to ensure customer service levels do not deteriorate;
- extension of a low-income residential assistance program; and
- a company commitment to develop a transportation aggregation program for customers who receive benefits from the Department of Social Services (DSS).

As a result of the settlement, rate increases have been set at fixed levels of $7.2 million (1.1%) for each of the two years covered by the settlement.

N.E.A. Cross of New York, Inc.

On May 16, 1996, the Commission issued a Certificate of Public Convenience and Necessity to N.E.A. Cross of New York, Inc., (NEA) to construct a natural gas distribution system and to exercise gas franchises granted by the Towns of French Creek and Mina.

This new gas company began service on November 6, 1996. It expects to have a total of approximately 1,000 residential and commercial customers on-line by the end of 1999.

New York State Electric & Gas Corporation

Gas Rate Settlement

At its December 13, 1995, session, the Commission approved a multi-year gas rate plan for New York State Electric & Gas Corporation (NYSEG) customers. Under the plan, residential rates are frozen at the base tariff rates plus the gas adjustment clause (GAC) that was effective on October 31, 1995. This "hard price cap" is the first ever approved in this state. Other plan highlights include:

- non-residential rates subject to either an index-price option (IPO) or a fixed-price option

(FPO);

- the IPO would float monthly with the average price of 12 commodity indices, while the FPO would allow the customer to lock in the price of gas for varying periods up to the full 32 months of the agreement;
- GAC and weather normalization clauses were eliminated;
- service quality standards were established;
- the rate disparity between NYSEG's seven rate areas was reduced by shifting revenues out of the high-priced areas into lower-priced areas;
- an affordable energy program was begun for approximately 11,375 eligible residential customers.

Seneca Lake Gas Storage Project

NYSEG proposed and developed this major gas storage and transmission project to accommodate anticipated growth in Southern Tier and Central New York market areas. The project involved two transmission pipelines, a compressor station in the Town of Reading, and an underground storage cavern in a salt dome formation. Interested parties and the public were involved in the early planning and evaluation of alternative routes and mitigation measures.

Construction of the West Pipeline began in April 1996, with the main line completed in mid-May. No major problems or incidents occurred during construction.

The East Pipeline consists of 37.4 miles of pipe extending from the CNG pipeline in the Town of Danby to NYSEG's distribution facilities in the Binghamton area. Construction of the eastern leg of this line required many minor changes to accommodate conditions and landowner concerns. Construction went smoothly with effective Department-utility cooperation. All environmental protection requirements were met, with the project brought into operation by December 1996.

A proposed third phase will augment the compression and storage capacity of the facility at Watkins Glen. Since NYSEG's rates are frozen, the $57 million project will not affect rates at this time .

Gas Franchises

Four applications for natural gas franchises were reviewed and filed with the required SEQRA (State Environmental Quality Review Act) notices following Commission action. NYSEG filed three of the applications, including one involving a new crossing of the Saranac River near the City of Plattsburgh. The Commission ordered NYSEG to seek alternative crossings to protect this scenic and recreational resource. An alternate location was found, and the pipeline was successfully constructed before the winter heating season on an existing pedestrian bridge owned by the City of Plattsburgh Board of Education.

Niagara Mohawk Power Corporation

Gas Rates

On November 27, 1995, Niagara Mohawk Power Corporation (NiMo) filed for a gas rate increase of $35.3 million, or 5.8%. After the recommended decision was issued, Department staff, NiMo, and Multiple Interveners agreed to a three-year rate plan to settle the case, including:

- a $30 million rate decrease achieved through a $10 million (1.6%) base rate reduction for the first year and base rate freezes in the two following years;
- replacement of the gas adjustment clause (GAC) with a commodity cost index, covering gas commodity costs only;
- rate design changes that reflect a better align-

ment of rates with cost;

- a service quality performance incentive mechanism that will impose up to $1 million in penalties if basic customer service goals are not met;
- an affordability plan for low income customers;
- a contingency reserve account to reduce the need for deferrals in the future; and
- an incentive for development of a gas aggregation program in conjunction with the Department of Social Services.

The settlement was approved by the Commission, subject to conditions, on December 19, 1996.

Rochester Gas & Electric Corporation

Gas Prudence Investigation

As a result of many complaints from Rochester Gas & Electric Corporation (RG&E) gas customers, due to abnormally high winter bills experienced in January 1995, the Commission instituted a series of investigations into RG&E's gas purchasing and billing practices.

Department staff found that RG&E had acquired excess pipeline capacity and the cost of that excess capacity was the most significant factor contributing to the high bills; gas procurement activities were deficient in several areas; meter reading and bill estimates were inaccurate; and the company's communications with its customers were ineffective and/or inaccurate.

These investigations culminated with a three-year settlement, approved by the Commission and effective November 1, 1995. It makes RG&E solely responsible for surplus pipeline capacity contracted for from various upstream pipelines, and requires the company to implement staff recommendations concerning its gas purchasing practices and billing process. The company is also prohibited from increasing base rates for a three-year period.

Competition II Proceeding

In February 1994, the Commission instituted a proceeding to develop a framework for an orderly transition to a competitive local exchange market. Previously, a few companies had been authorized to provide local exchange services on a competitive basis. As more competitors appeared, the Commission saw the need for a focused, systematic examination of the fundamental issues concerning local exchange competition.

The following principles applied:

- the Commission's goal of ensuring the provision of adequate telecommunications services at reasonable rates is primary;
- competition is a tool by which this primary goal may be achieved;
- regulation should reflect market conditions; and
- providers in similar circumstances should be subject to similar regulations.

The parties developed a regulatory framework that provides extensive opportunities for local exchange competition to develop in all areas of the state, while preserving universal service and other necessary consumer protections during the transition to fully competitive markets. Under this framework, carriers, new entrants, and incumbents are given wide latitude to choose where they wish to offer service, subject to a common carrier obligation within any service territory they elect to define. They are also free to offer any service package they deem appropriate, subject only to requirements that residence packages include, at a minimum, some basic elements and that they provide an acceptable quality of service overall.

New York Telephone Company (NYT), Rochester Telephone Corporation (RTC), and Taconic Telephone Corporation, have entered regulatory arrangements that provide customer benefits while allowing the companies to recover their investments and enhance their earnings by improving efficiency, offering new services, and pricing competitively. The remaining incumbents are encouraged to enter similar regulatory agreements.

Resale Provisions

The framework allows competitors to purchase incumbents' services at wholesale and resell them to retail customers. The Commission initiated a case in 1995 to establish rules and prices for resale of New York Telephone Company's (NYT) local services. Later, the case was expanded to set resale prices for Rochester Telephone Corporation's (RTC) local services. The Telecommunications Act of 1996 and Federal Communications Commission (FCC) rules further prescribed the services that may be resold, the general method for setting a wholesale discount, and a detailed pricing methodology.

In November 1996, the Commission established a wholesale discount of 19.1 % on NYT's retail pricing for resellers using the company's operator services and 21.7% for resellers who do not. The corresponding wholesale discounts established for RTC are 17.0% and 19.6%.

Unbundling Network Elements

An "element" is a facility or function used in the provision of a telecommunications service. "Unbundling" the telecommunications network into discrete elements allows potential competitors to use only those parts of the existing network they need to provide services to customers. The Commission instituted a proceeding in 1995 to examine the resale of local services, including examination of the pricing of certain unbundled network elements, primarily the "local loop." The Telecommunications Act of 1996 and the FCC's rules enacted in August 1996 defined additional elements to be unbundled by incumbent carriers. In 1996, the scope of this proceeding was expanded to include examination of other unbundled elements the FCC had identified.

Number Portability

Number portability is the ability of a customer to keep his/ her telephone number when changing local service providers. It is a key element in creating a level playing field for telephone competitors.

In September 1995, the Commission issued an order authorizing a trial of number portability in Manhattan which began on February 1, 1996, with six telephone companies participating. The trial concluded that number portability is technically feasible and that careful coordination of intercompany operations is essential. One of the major contributions of the trial was the development of a test plan, which has been used as the foundation of nationwide testing.

Until long-term portability is available, the Commission has required all carriers, including new local service providers, to offer interim number portability to customers using existing telephone service offerings, such as remote call forwarding.

New Carriers Certified

Until recently, New Yorkers were served by one of 40 local exchange carriers with unique franchised service territories. Now, in addition to the incumbent local exchange carriers, there are approximately 600 companies certified to provide telecommunications service within the state, including other common carriers (OCCs), resellers, and competitive local exchange carriers (CLECs). OCCs or interexchange carriers provide and manage their own facilities for the transmission of toll calls and typically have significant capital investments in their networks. Resellers specialize in resale of OCC or local exchange carrier services. CLECs are competitive local exchange carriers providing local exchange services (local dial tone) to customers in competition with the incumbent local exchange carriers. These companies typically own their own central office switches, but the service can also be provided through resale arrangements.

The Commission granted 300 Certificates of Public Convenience and Necessity during 1995/1996 as follows:

COMPANIES	1995	1996
OCCs	5	5
RESELLERS	130	125
CLECs	15	20

Reforming Service Quality Controls

In the Competition II proceeding, the Commission adopted a new framework for service quality standards which reduces many companies' reporting requirements. Only the largest companies will have to report on all of the performance indicators specified in the Commission's service quality standards. Companies may obtain a waiver from some of the reporting requirements upon earning a commendation from the Commission for providing consistently good service.

Telecom Act of 1996

The 1996 Telecommunications Act established as national policy, opening of all telecommunications markets to competition while ensuring universal service. Following its enactment, the FCC issued a number of proposed rules designed to promote the development of competition. The Department submitted comments on several of the proposed rules.

In 1996, the FCC issued rules governing prices for interconnection, resale, and specific unbundled services under the Act. New York joined more than 25 states to challenge the order. The Eighth Circuit Court of Appeals stayed the FCC's pricing provisions, pending the Court's decision after oral argument, and consideration of legal documents filed in the case.

The Act requires the FCC to develop universal service regulations intended to promote universal service for the needy, those in high cost areas, and for schools, libraries, and rural health care providers. A Federal-State Joint Board proposed universal service policies for schools and libraries and suggested significant changes to the high-cost area and lifeline programs for low-income customers. The Board proposed that the FCC meet its universal service obligations by requiring the use of intrastate revenues to fund the federal program. The Department filed comments contesting the Board's funding proposal, arguing that the Act does not require a massive shift in universal service policy.

In September 1996, the FCC lifted the limitations on charges for local calls from pay phones and detariffed and deregulated the provision of coin telephone by local exchange companies, beginning in 1997. In New York, performance regulatory plans adopted by the Commission limit local coin rates to 25 cents for both New York Telephone Corporation and Rochester Telephone Corporation. The FCC contends that it has the authority to preempt any state regulation of coin rates for local calling under the Act. The Department opposed the FCC's decision.

1995-96 Commission Actions in the Telecommunications Industry

New York Telephone Company

In June 1995, the Commission approved an innovative Performance-based Regulatory Plan for New York Telephone Company (NYT) to enhance competition, protect consumers during the transition to a more competitive telecommunications industry, and provide the company with the flexibility needed to deal with an increasingly competitive environment. The plan began in September 1995, runs through September 2000, and may be continued for an additional two years.

Some of the major aspects of the plan include rate reductions and a stringent Service Quality Plan. The company agreed to $2 billion in cumulative rate reductions over the term of the plan. To date, the company has reduced the flat rate service charge for approximately half of its residential customers, eliminated touch-tone charges for both residential and business customers, reduced the charges for regional toll calls by introducing four low priced optional calling plans, reduced the charges some business customers pay for local calls by offering discounts to high volume users, and reduced the charges long distance companies pay to use NYT's network. Further, the plan caps basic rates for the plan's entire term.

In order to provide incentives to the company to improve its service quality throughout the plan's term, the Commission established a number of increasingly stringent monthly, quarterly, and annual service quality targets for each of NYT's three market regions (Manhattan, Greater Metro and State) and specified graduated penalties for missing those targets. During the first full year of the Performance Regulatory Plan the company's service quality did not improve to targeted levels, resulting in the following penalties:

Service Category	*Penalty Incurred*
% Customer Trouble Report Rate Measurements at Objective Level	**$40.0 Million**
PSC Complaints	**$10.0 Million**
Aggregate of "Other Measures"	**$10.0 Million**
Missed Repair Appointments	**$3.4 Million**
Out-of-Service Over 24 Hours	**$9.4 Million**
Customer Trouble Report Rate 3 out of 5 Months at Weakspot	**$0.1 Million**
Total Penalties Incurred for Plan Year 1	**$72.9 Million**
Penalties Waived (due to abnormal circumstances)	**$0.6 Million**
Total Penalties Assessed	**$72.3 Million**

Some other critical features of the plan are:

- the plan may be terminated at any time if the company's service fails to improve substantially;
- penalties can be doubled if the company does not improve service to specified levels;
- a three-year checkpoint to monitor progress on opening the network to competition, and the Commission may take steps to further competition as needed;

- if the company does not meet its competition-related obligations under the plan, it can be terminated; the plan will continue for a sixth and seventh year only if the company outperforms its peers in reducing its prices and service improves;
- the plan substantially deregulates the company's earnings, freeing it from traditional profit constraints, and allows it flexibility in pricing new competitive services; and
- the plan will require New York Telephone to pay for the cost of implementing intraLATA presubscription, which will allow customers greater choice in the selection of intrastate toll carriers.

Rochester Telephone Corporation

On January 1, 1995, Rochester Telephone Corporation (RTC) began operating under the Open Market Incentive Plan. The plan was the result of a settlement agreement signed in May 1994 by Department staff, RTC, and five other parties and approved by the Commission subject to clarification and conditions on November 10, 1994. The plan extends for a seven-year period, through December 31, 2001, and includes $17 million in rate reductions.

The Open Market Plan was designed to facilitate development of competition in the Rochester market, while protecting those customers who remained with the regulated telephone company from any adverse impacts of emerging competition. Basic rates are frozen for the entire term of the plan. In addition, rates for touch-tone service are eliminated for residential customers and phased out over a three-year period for business customers. Local usage charges are also reduced over the term of the plan.

The plan establishes annual service quality targets. The company met the targets in 1995 but incurred a penalty of about $1.0 million for 1996.

To open the Rochester market to competition, all of RTC's services were offered to competitors at a 5% wholesale discount. This discount was subsequently increased to 17% in the Commission's resale proceeding. The access charges that long distance companies and facilities-based local service providers pay to RTC are reduced significantly over the seven years of the plan. These actions have enabled a number of resellers and facilities-based providers to offer local exchange service in Rochester, in direct competition with the incumbent. In exchange for opening its market to competition, RTC will operate with no cap on its earnings for the duration of the Open Market Plan.

On January 6, 1993, the Department concluded many years of analysis of RTC's dealings with its affiliates. The Commission adjusted RTC's future rates to reflect revenues that the company should have recovered from affiliates for the use of utility assets and to offset costs that affiliation imposed on RTC and its ratepayers. It also placed other utilities with affiliates on notice that the Commission would impute affiliate revenues in its calculation of revenue requirements in rate cases. RTC challenged the Commission's authority to issue the order. By a unanimous opinion dated October 31, 1995, the Court of Appeals confirmed the Commission's decision.

Taconic Telephone Corporation

On May 30, 1995, the Taconic Telephone Corporation (Taconic) filed a proposed incentive regulation plan (IRP), called the Quality Assurance Plan. Taconic, Department staff, and other interested parties entered into lengthy negotiations which culminated in a settlement agreement in June 1996. The agreement, which is significantly modified from the original proposal, was developed based in part on the Rochester Telephone Open Market Plan and New York Telephone Performance Regulation Plan. Taconic's is the first plan tailored to a small, independent telephone company. On August 29, 1996, the Commission approved the IRP contained in the settlement, with certain enhancements and clarifications.

Taconic's IRP provisions include:

- a five-year term, subject to a gateway review after three years;
- no increases in basic rates during the plan, except to recover (or refund) changes in access and billing and collection revenues, Extended Areas Service (EAS) settlements, direct revenue effects of the Telecommunications Act of 1996, and legislated changes in the gross receipts tax;
- immediate elimination of charges for touch-tone service and locality charges over three years;
- the opening of Taconic's territory to local competition through the immediate wholesale offering of bundled local service to resellers and the prompt future offering of unbundled links and ports, number portability, and intraLATA presubscription according to Commission rulings;
- downward rate flexibility for nonbasic services, within limits;
- no cap on Taconic's earnings; and
- safeguards to assure the company will exit the plan in good financial condition.

In addition, the parties developed the first-ever customer incentive program for a small telephone company. Under the plan, Taconic will be assessed penalties if it fails to meet preset goals in the areas of complaints, customer satisfaction, and life line service enrollment. The Commission developed an outreach and education plan, incorporated privacy principles, and established various reporting requirements.

Interconnection Agreements

The Telecommunications Act of 1996 encourages competing carriers to negotiate mutual interconnection agreements. In the event carriers are unable to reach a negotiated agreement, the Act provides for issues to be brought to the state commission for arbitration.

Five companies asked the Commission to arbitrate their interconnection agreements with NYNEX. The Commission completed these arbitrations, generally specifying the services and functions that NYNEX must make available and the timeframes for doing so. The Commission set most arbitrated prices on a temporary basis subject to refund pending completion of cost analysis. It also established performance standards and penalties as well as a dispute resolution process for future disagreements.

The chart below shows Commission actions as of December 31, 1996.

Telecommunications Act Implementation - State Proceedings
Interconnection *Agreements*

Case Number	*Parties*	*Type*	*Action*
96-C-0608	NYNEX & MFS	Agreement	Approved
96-C-0655	NYNEX & United Telemanagement Services	Agreement	Approved
96-C-0656	NYNEX & Frontier	Agreement	Approved
96-C-0724	NYNEX & AT&T	Arbitration	Completed
96-C-0781	NYNEX & Teleport	Agreement	Approved
96-C-0782	NYNEX & Winstar	Agreement	Approved
96-C-1164	NYNEX & Manhattan Telecom	Agreement	Pending
96-C-0783	NYNEX & Manhattan Telecom	Arbitration	Completed
96-C-0787	NYNEX & MCI	Arbitration	Completed
96-C-0890	NYNEX & C-TEC	Agreement	Approved
96-C-1012	Ogden & Time Warner AxS	Agreement	Pending

Relay Service

During 1996, the New York State Telecommunications Association (NYSTA) contract with AT&T for the provision of telecommunication relay service expired. Department staff explored alternate means of providing relay service, including investigating proposals to allow multiple vendors to provide the service to New York relay users. On Staff's recommendation, the Commission directed NYSTA to invite vendors to bid for the service under a variety of scenarios.

NYNEX/Bell Atlantic Merger

In April 1996, NYNEX and Bell Atlantic announced their intention to merge. Subsequently, to facilitate such a merger and simplify the regulatory procedures, it was announced that Bell Atlantic would acquire NYNEX. In July 1996, Bell Atlantic and NYNEX filed a petition with the Commission for a disclaimer of jurisdiction or approval of the acquisition.

This was the largest proposed merger/acquisition ever to come before the Commission. When announced, the proposed merger would have been the second largest in history, smaller only than RJR Nabisco. The proposed merger would create the nation's second largest telecommunications company (after AT&T) and the largest local telephone company, with 133,000 employees, revenues of $27.8 billion, and earnings of $3.1 billion (1995). The new Bell Atlantic, headquartered in New York City, would serve 26 million customers in 13 states and the District of Columbia.

By order issued August 9, 1996, the Commission asserted its jurisdiction to investigate the proposed transaction and instituted a proceeding to do so. Most of the parties, including the two companies and Department staff, presented testimony before the Commission on December 16, 1996.

To inform the public of the proposed merger, Department staff developed and implemented a public involvement plan, prepared informational material, and facilitated 13 statewide public forums in November and December 1996.

Slamming

Slamming occurs when a customer's carrier is changed without his/her knowledge or consent. Typically, rates of companies that slam are significantly higher than those of the customer's chosen carrier. Because of billing delays, consumers often do not realize they have been slammed until significant charges have accumulated.

In October 1995, the Commission issued proposed anti-slamming regulations for comment. Subsequently, the federal Telecommunications Act of 1996 was enacted, prohibiting slamming and requiring the FCC to adapt its rules to implement the law. The Department's efforts to promulgate rules were delayed, pending development of new federal rules. However, by late 1996 it became apparent that the FCC revisions would be delayed, and consumer unrest over slamming was continuing to grow. Therefore, in December 1996 the Commission issued for comment a second set of proposed state rules.

In 1995, the Commission issued an order suspending the Certificate of Public Convenience and Necessity of Sonic Communications, Inc, which had been engaged in slamming, and instituting hearings. Sonic is now out of business in New York state.

Telephone Corporation Audits

The state enacted a law to eliminate the mandatory five-year cycle for telephone corporation audits. The Commission will have the authority to direct the timing and focus of audits, as required to improve specific company operations. This law recognizes changes in the telecommunications industry.

Customer-Owned Currency-Operated Telephones (COCOTS)

Department staff conducted 1,200 inspections on payphones. As a result of the inspections, there were 363 citations. Department staff worked to update the COCOT regulations. Part 650 regulations were renewed and proposed revisions were suspended pending the outcome of the federal Telecommunications Act of 1996.

Streamlined Certification Process

On July 31, 1996, Governor Pataki signed into law an amendment to the Public Service Law. The law establishes an automatic 90-day approval process for certification of new telephone companies planning to offer services in New York. Certificates of Public Convenience and Necessity are deemed granted by the Commission 90 days after a telephone company applies for certification unless there is reason to extend the investigation and require a Commission order.

The Water Industry

At the end of 1996, there were about 400 private water companies in New York State serving a residential and business population of approximately 750,000. These companies are faced with many challenges, including increased taxes, need for infrastructure replacement, and stringent environmental regulations.

Currently, there are six major water companies in New York that serve between 4,000 and 74,000 customers each; 315 other systems serve fewer than 100 customers each.

For some small water systems the viability of day-to-day operations is in question, and the viability of future operations is questionable for many more.

Consolidation is a growing issue. Many municipalities, faced with rising budgets, are looking into whether they can sell assets, such as water systems, to large private companies, or allow private companies to operate their systems for a concession fee. Conversely, some small private water systems are having difficulty maintaining operations and proposed their acquisition by municipal entities.

Long Range Strategic Plans of Water Companies

At the Commission's December 18, 1996, session, Department staff presented its review of the major companies' 1996 long range plans. Total revenues were projected to increase 53% in the next 10 years compared to projected inflation of 28% for the period, and average residential bills are expected to increase 49%, from approximately $400 in 1996 to $586 in 2005. Staffs review found that taxes, inflation, and construction would drive the revenue increases.

The Commission's goal is to have the major water companies develop a comprehensive planning process to report on individual utility and industry developments. Department staff proposed that the Commission investigate whether the frequency of plan filings should be reduced, and whether companies should seek customer opinions on their long range plans and modify them based on consumer input. On December 31, 1996, the Commission issued an order soliciting comments on these issues.

Water Company Database

During 1996, Department staff developed a computerized database to monitor owner/operator changes for more than 400 water systems. The system has the capability of geographically plotting location of water systems. It also tracks company expenses to test the reasonableness of future rate increase requests. It highlights expense areas that appear to be out of line with average values for similar systems.

Reauthorization of the Safe Drinking Water Act

The federal government passed the Safe Drinking Water Act (SDWA) in 1974 and over the next 20 years water standards under the law have become more comprehensive and stringent. The New York State Department of Health estimated that the capital cost of complying with these rules could be $450 million a year for the next 20 years for New York State. The cost of filtering surface water sources could entail $250 million a year, not including the sources for New York City.

The reauthorization of the SDWA in 1996 provides greater emphasis on prevention approaches, improved consumer information, regulations based on cost/benefit analysis, monitoring based on the types of contamination likely to be found in particular states, and funding for public and private water systems through state revolving funds.

State Revolving Fund

The SDWA of 1996 provides money to the states to set up State Revolving Funds (SRF) to aid the country's water systems through low interest loans and grants. New York's share of the federal money is about $60 million over two years. The state must add matching funds of 20%, bringing New York's total to about $72 million. The Department of Health (DOH) and the Environmental Facilities Corporation will administer the program. DOH developed criteria for allocating the funds to the various water suppliers in the state and has proposed to give priority to systems with the most serious health risks, followed by those with chronic or longer term health risks, and then to infrastructure replacement.

Most of the 400 private systems regulated by the Commission are very small and cannot access capital markets. Department staff, in comments to the DOH, proposed that a larger percent of funds should be allocated to small systems (20% to systems serving fewer than 1,500 and 15% to systems serving 1,500 to 10,000). Staff also recommended that the inability to finance should be a primary criterion for receiving SRF money.

Repeal of Tax on Customer Contribution

Before January 1, 1987, the Internal Revenue Code treated Contribution in Aid of Construction (CIAC) received by regulated electric, gas, water and sewer utilities as a non-taxable capital contribution. This was changed by the Tax Reform Act of 1986 (TRA-86) which required that CIAC be considered income subject to federal income tax, adding a significant up-front cost that sometimes exceeded 50% of the amount required for the construction itself.

The National Association of Water Companies (NAWC) and the entire investor-owned water industry fought to repeal this tax as unfair and onerous. On August 20, 1996, President Clinton signed the repeal of the tax on CIAC received by water and sewer utilities after June 12, 1996.

Jamaica Water Supply Company

In 1994, Jamaica Water Supply Company's (JWS) parent, EMCOR Group, Inc. initiated a voluntary Chapter 11 bankruptcy proceeding. In February 1996, JWS announced that the EMCOR Group had entered into two separate agreements to sell the JWS assets, with the Queens assets going to New York City and Nassau County assets going to the Water Authority of Western Nassau County for a total of $178,500,000. Since both the acquisitions were made by municipal entities, the PSC will no longer regulate these systems. The closing took place in May 1996.

Sea Cliff Water Company

On February 29, 1996, the Aquarion Company, one of the 10 largest investor-owned water utilities in the United States , announced that it would acquire Sea Cliff for approximately $2.6 million in cash. The closing took place in May 1996.

Staatsburg Water Company

For many years Staatsburg Water's service had been very poor. Over the years the company had been cited by the Dutchess County Health Department for failing to comply with the health code.

On August 8, 1996, the Commission directed Staatsburg to show cause why its rates should not be made temporary, held in escrow, and subject to refund pending the outcome of a penalty action. The company filed a response, but this became moot on September 13, 1996, when Dutchess County took possession of the company through a tax enforcement proceeding. Department staff and the company reached a settlement that provided that customers would not be billed for the last three months of service under company ownership.

United Water New Rochelle

On December 19, 1995, United Water New Rochelle (UWNR) filed for a $2.5 million (15%) increase in rates for a one-year period or a three-year plan with annual rate increases of 18.2%, 8.9%, and 9.8%. On October 31, 1996, the Commission approved a three-year settlement plan which provides for annual rate increases of 2.95% for each of three years.

United Water New York, Inc.

On June 21, 1994, United Water New York (then known as Spring Valley Water Company, Inc.) proposed to increase annual water revenues by approximately $2.4 million, or 6.1%. The filing was later updated to request an annual increase of $3.12 million, or 7.9%.

On August 7, 1995, the Commission approved a three-year settlement plan granting annual base rate increases of $622,000 (1.54%) in year one; $723,000 (1.75%) in year two; and $743,000 (1.75%) in year three.

The state transferred authority over cable television companies from the Commission on Cable Television (CTC) to the Public Service Commission, effective January 1, 1996. The law directed the Department to prepare a study of the cable television industry and the state's cable television regulatory structure, including recommendations for statutory and regulatory changes. Representatives from the cable television industry and other telecommunications industries, consumer groups, municipal officials, access organizations, and other interested parties were consulted during the study's preparation.

"Cable Regulation in New York State: A Proposed Framework For A Changing Marketplace" was accepted by the Commission in December 1996. It was the first major study of the industry and the state's regulatory environment since 1972.

Among its chief recommendations, the final report suggested that the Commission conform state regulations to those on the federal level, streamline existing regulations to afford easy entry of new service providers into municipal markets, provide for timely completion of franchise renewals, and retain dual state/municipal regulatory roles during the transition to greater competition in the cable television marketplace.

Merger of US West with Continental Cablevision, Inc.

The Commission approved the merger of US West, a regional Bell operating company, with Continental Cablevision, Inc., the nations's third largest cable company. Approval of this merger increases the likelihood of the integration of existing communication services and new services. It also opens the door to further telephone service competition.

Revised Rebuild Policy

In the past, the CTC established and administered a policy whereby cable television companies were required to commit to system upgrades and rebuilds, using fiber optic technology as a condition of securing required approval of long-term franchise renewals.

In July 1996 the Commission accepted staff's recommendation that Department policy on cable system upgrades be aligned with its approach toward such matters in the telephone field. The new policy recognizes that some plant upgrades are not economically feasible. Recognition was also given to the increased competition from alternative video broadband providers such as Direct Broadcast Satellite (DBS). Therefore, flexibility will be given to cable companies, permitting them to determine when a system upgrade is most appropriate.

Reaching Out to the Community

Consumer Assistance

An Automated Response Unit was connected to the Commission's HELPLINE (1-800-342-3377), HOTLINE (1-800-342-3355) and Cable Television complaint line (1-800-342-3330). The response unit assists callers by providing the telephone numbers of most of the major utilities in New York State, allowing callers to leave a comment on an opinion line, automatically faxing a complaint form to a caller with faxing capability, or allowing the caller to leave a message requesting that a complaint form be mailed to the caller, and permitting Department staff to automatically direct callers to other agencies if necessary.

Customer Service Performance Mechanisms

To ensure that gas and electric utilities provide adequate service quality, staff has relied on service quality performance mechanisms to monitor customer service. If service quality deteriorates, the utilities are subject to a penalty. Customer satisfaction and PSC complaints provide the foundation for each of the service quality performance mechanisms. The major gas, electric, and water companies also report monthly on mutually agreed-upon customer service performance indicators.

Business Advocacy

Many upstate businesses have availed themselves of the Department's Business Advocacy program, which expanded in 1996 to some downstate corporations. The Commission also recently established a Business Advocate position within the Department's Consumer Services Division to work with the business community on energy rate issues and other matters regarding the utilities under Commission jurisdiction.

The Department Web Site

Since the Public Service Commission Home Page was unveiled in February of 1996, it has been accessed by more than 30,000 users. The Commission placed the latest consumer information on the site to educate utility customers on utility issues like competition, slamming, new options for local toll calls and tips on lowering utility bills. Providing public access to information in a quick and efficient manner strengthens ongoing efforts to inform and educate consumers, obtain valuable consumer input to assist in Commission deliberations on various utility issues, and increase public access in a cost-effective manner.

The Web Site Address is:
http://www.dps.state.ny.us