

Approved as Recommended
and so Ordered
December 9, 1999

s/Maureen O. Helmer
Commissioner

Issued & Effective December 10, 1999

STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE

December 9, 1999

TO: THE COMMISSION

FROM: OFFICE OF ELECTRICITY AND ENVIRONMENT
RATES AND TARIFFS

SUBJECT: CASE 96-E-0897 - In the Matter of Consolidated Edison Company of New York, Inc.'s plans for (1) electric rate/restructuring pursuant to Opinion No. 96-12; and (2) the formation of a holding company pursuant to PSL, Section 70, Section 108, and Section 110, and certain related transactions.

Petition by Con Edison to revise the company's Fuel Adjustment Clause upon establishment of an Independent System Operator

SUMMARY OF

RECOMMENDATION: Accept, on a interim basis, subject to modifications.

SUMMARY

On September 17, 1999, Consolidated Edison Company of New York, Inc. (Con Edison or the company) filed a petition, in accordance with its Rate/Restructuring Order,^{1/} to revise the company's Fuel Adjustment Clause (FAC) and its incentive mechanism to reflect the spot market purchase price

^{1/} Cases 96-E-0897 and 96-E-0916, Order Adopting Terms of Settlement Subject to Conditions and Understandings (issued September 23, 1997); Confirming Order (issued October 1, 1997); and Opinion No. 97-16 (issued November 3, 1997).

and other applicable costs upon the establishment of an Independent System Operator (ISO). The petition includes an annotated version of the company's current FAC tariff provisions which sets forth the manner in which the company proposes to administer the FAC after the establishment of the ISO. Con Edison states that the annotated version of its currently-effective FAC tariff leaves will be amended from time-to-time to incorporate actual ISO operations.

The company proposes to implement the operating procedure upon commencement of the ISO and to reconcile cost and revenues, as necessary and appropriate, to reflect any modifications to the operating procedure that the Commission requires.

Staff reviewed the filing, considered the comments submitted by the parties, and recommends that the company's submission, except for the capacity cost reconciliation noted below, be accepted for filing as a interim operating procedure. Not later than 60 days after the ISO began its energy-market operations, the company should submit revised tariff leaves, to be effective not later than April 1, 2000, which conform the tariff to the proposed procedures, taking into account any modifications that are necessary after the ISO begins operation.

In addition, Staff recommends that the company's proposal to true-up capacity costs be rejected at this time. The petition should be considered and evaluated further in the context of the collaborative proceedings that began December 1, 1999 to consider the company's proposals for (1) ratemaking and accounting with respect to the proceeds resulting from the divestiture of the company's electric generation facilities,^{1/} and (2) proposed changes to the company's Retail Access Implementation Plan and Operating Procedure applicable to

^{1/} Case 96-E-0897, Con Edison letter dated October 18, 1999, Concerning Proceeds of Divestiture.

CASE 96-E-0897

Phase 3 of the Retail Choice Program.^{1/}

^{1/} Case 96-E-0897, Con Edison letter dated October 22, 1999, Concerning Phase 3 of Retail Access Program.

BACKGROUND

The Settlement terms adopted by the Commission state that,

... when the ISO assumes control of energy dispatch in the state, the parties will cooperate in revising the framework of the fuel adjustment and its incentive mechanism as may be necessary to reflect the spot market purchase price and other applicable costs resulting from the establishment of the ISO

... Con Edison will submit a proposed revised framework within 180 days after the point at which the ISO assumes control of energy dispatch in the state.^{1/}

The assumption had been that ISO operations would precede divestiture. However, the divestiture process was completed relatively quickly and the implementation of ISO operations was delayed. The Commission's order (Divestiture Order) approving the transfer of generating facilities, therefore, modified the above requirement.

Because the auctions and sales proceeded relatively quickly, while implementation of the NYISO has been delayed, the time for submitting proposed modifications to the FAC may be reasonably adjusted.^{2/}

Accordingly, the company made its September 17, 1999 filing to revise the FAC to accommodate the anticipated start up of the ISO. Start up of the ISO began on November 18, 1999.

^{1/} Settlement, p. 32.

^{2/} Case 96-E-0897, Comprehensive Order Approving Transfers of Generating Facilities and Making Other Findings, (issued June 17, 1999) p. 33; and Order Approving Transfer of Generating Facilities and Making Other Findings, (issued July 28, 1999) p. 22.

Related Filings

In addition to the instant FAC filing, the company has made three other filings which are related. These filings concern capacity costs, Phase 3 of retail access, and the disposition of the divestiture proceeds.

1. Con Edison filed a petition on July 30, 1999 requesting the Commission allow deferral of certain capacity costs associated with the divestiture of its generating plants. The costs are for over and under recoveries that result from the differences between the embedded costs and the capacity payments required to be made to the new owners under the Transition Capacity Agreements (Case 99-E-1020).
2. Phase 3 of Con Edison's retail access program begins on May 1, 2000. On October 22, 1999, the company made a filing with proposed changes for Phase 3.
3. On October 18, 1999, Con Edison filed a proposal to address various ratemaking and accounting issues related to the proceeds received from the divestiture of its generating facilities.

CON EDISON'S FAC FILING

The basic operation of the FAC would continue, except that it would take into account the changes in the electric marketplace and the company's operations. The company states that in order to address the rate treatment of ISO related charges and credits, it is important to identify the details of the related charges and credits, and to present the incentive methodology for post-ISO operations. To that end, the company submitted an annotated version of its current FAC tariff leaves which describes how the company intends to administer its current FAC under the post-ISO conditions.

The proposal addresses the following: targets for fuel cost incentives which are based on Load-Weighted, Locational Based Marginal Pricing (LBMP), the cost of

purchased energy, incremental costs, other related transmission costs, and modification of the FAC in the form of an operating agreement. The company's position on these issues is summarized below.

Fuel Cost Incentive

The basic elements of the FAC incentive would be similar to those before the ISO began operation, including the 30%/70% sharing (company/customer) of deviations from the fuel target. However, an ISO-based target would replace the PROMOD^{1/} based target in the post-ISO environment. The company proposes that the target for the fuel cost be based on the LBMP that is set by the ISO market. By using bi-lateral purchases and hedging contracts, Con Edison would have the opportunity to beat the LBMP price for its bundled service customers, and thus share the difference.

The monthly and annual cap applicable to operations at Indian Point No. 2 (IP2) would continue, except that the cost to replace generation for IP2 would be based on the load-weighted (with respect to time) LBMP at the IP2 generator bus.

The company would file its forecasted IP2 monthly generation levels applicable to each rate year by November 15 preceding each rate year.^{2/}

Purchased Energy

The cost of purchased energy and the net benefits from sales to others would reflect ISO transmission-related costs such as Transmission Service Charges (TSCs), Transmission Usage Charges (TUCs), and Transmission Congestion Contracts (TCCs)^{3/}. The TSCs, TUCs, and TCCs are not limited

^{1/} A computer simulation program used for production modeling (PROMOD) of fuel costs.

^{2/} By letter dated November 15, 1999, the company made its IP2 filing for 2000.

^{3/} Transmission Service Charges (TSCs) produce a residual amount of money that must be collected to meet the embedded costs of the owners of the transmission system after they

to in-state transmission costs.

Other Related Transmission Costs

Another charge that would be included in the calculation of the FAC is the NYPA Transmission Adjustment Charge (NTAC). When a NYPA customer leaves NYPA to purchase power directly from the ISO, NYPA's lost revenues are recovered through the NTAC as a surcharge on the energy charges of all load serving entities.

The cost of the ISO ancillary services (net of the cost of ancillary services embedded in Con Edison's rates) is also included in the calculation of the FAC.

Incremental Costs

Con Edison states that the currently-effective FAC provides for recovery of any incremental costs incurred by the company resulting from divestiture. The company cites its Generation Divestiture Plan, which was conditionally approved by the Commission's Divestiture Order that authorized the auctioning of generation plant. The company states that, consistent with the Rate and Restructuring Order, its Generation Divestiture Plan sets forth the manner in which the company will, once an ISO capacity market is established, primarily rely on the competitive market to obtain additional capacity needed to meet its service obligations and flow the competitive market costs through the FAC. The company proposes that the differences between the ISO capacity market prices and the capacity costs that are currently reflected and recovered in rates be flowed through the FAC.

receive revenues from TCCs, and wheeling.

Transmission Usage Charges (TUCs) are charged to the users for marginal losses (actually are implicit in the LBMP) and the congestion costs (both for day-ahead and real-time contracts).

Transmission Congestion Contracts (TCCs) are pre-purchased contracts that can be used at a later time to cover the costs of congestion in the real-time market.

The company states that the Divestiture Order allows any incremental costs incurred by the company in acquiring short-term capacity to meet its provider of the last resort obligations, and from implementation of its Retail Choice Program (such as unavoidable fuel costs), to be reflected in the post-ISO FAC.

Operating Procedure

Finally, the company proposes to modify the FAC in the form of an operating procedure, which would be amended as necessary from time to time to reflect actual ISO operations.

Con Edison relates that it is likely that additional changes will be needed to the FAC; therefore, modifying the FAC through an operating procedure is appropriate. Con Edison plans to submit conforming tariff amendments, along with other scheduled tariff changes which must be made, effective upon the start of the fourth rate year, i.e., April 1, 2000.

COMMENTS RECEIVED

In response to the Commission's notice soliciting comments issued September 29, 1999, comments were received from New York State Consumer Protection Board (CPB), City of New York (NYC or the City), County of Westchester (Westchester or the County) and the Urac Corporation (Urac). The comments are summarized in an Appendix.

STATE ADMINISTRATIVE PROCEDURE ACT

The proposed filing has been noticed under the provisions of the State Administrative Procedures Act (SAPA).

Publication in the State Register was on October 20, 1999, resulting in a 45-day comment period which expired on December 4, 1999. No additional comments were received in response to the SAPA notice.

DISCUSSION

The important features of Con Edison's filing to be addressed now are:

1. Review Process: How best can the review of the instant FAC filing be coordinated with the other interrelated filings that the Commission has received recently from Con Edison?
2. Deferral of pre-ISO Capacity Costs: Should certain capacity costs associated with the divestiture of the

company's generating plants be deferred for later consideration?

3. Capacity Cost Recovery Through the FAC: Is it appropriate to recover generation capacity costs through the FAC?
4. Modifying the FAC Tariff as an Operating Procedure: Should the proposed modifications be accomplished by means of an operating procedure?

These issues are discussed below.

Review Process

The City states, among other things, that the FAC proposal should be negotiated in a proceeding that will consider the net gains that were realized from the divestiture. Westchester asks, in addition to its other comments, that the FAC proposal be thoroughly examined during the Phase 3 retail access review. CPB states that the deferral of pre-ISO capacity costs should not further enhance the company's already excess earnings.

Staff finds that the City's, Westchester's, and CPB's comments have considerable merit. The issues involved in the filings for the (1) post-ISO FAC, (2) divestiture proceeds, (3) Phase 3 retail access and (4) deferral of pre-ISO capacity costs are interrelated. Staff believes that there are potential synergistic effects in resolving them together. Therefore, it is advantageous to address all the issues in a collaborative effort through meeting(s) of interested parties. The first such meeting was held on December 1, 1999, with another scheduled for December 14, 1999. The collective resolution of the filings will probably result in an overall superior solution than would an attempt to achieve distinct separate resolutions for each filing.

Staff, therefore, recommends that a final decision on the company's post-ISO FAC filing not be made until after the outcome of collaborative meetings to address all filings

in a holistic manner. Con Edison should be directed to fully cooperate in responding to the parties' questions during the collaborative meetings. In the interim, the company's instant filing can serve as a interim operating procedure which will provide regulatory stability during the transition to an operational ISO. All ISO-related charges and credits will be subject to review by staff.

Deferral of pre-ISO Capacity Costs

On July 30, 1999, the company filed a petition requesting authorization to defer certain pre-ISO capacity costs. Con Edison is also seeking the Commission's decision on the manner in which these costs should be reflected for ratemaking purposes. The company prefers that the net differences in pre-ISO capacity costs be recovered or credited to the net proceeds of the company's generating asset sales. CPB opposes the company's petition because: the specific ratemaking treatment for Transaction Power Agreements (TPAs) costs resulting from the sales of the company's generating facilities was not pre-approved; the level of excess earnings will continue to increase, which puts Con Edison in a less risky financial position; and accordingly, the cost of debt has not increased since the Commission issued Opinion No. 97-16 on November 3, 1997.

Staff recommends that these issues be developed through the collaborative meetings.

Capacity Cost Recovery Through the FAC

CPB opposes modification of the FAC to allow the flow through of the differences between capacity costs at market rates and capacity costs currently reflected in rates, Westchester notes a concern that capacity costs have not been previously included in the FAC. The County notes that the company's capacity purchases are for the purpose of solving the City's load pocket problems and that Westchester does not have load pockets. The County, therefore, asks that capacity

costs be excluded from any FAC that may be applicable to Westchester.

Staff agrees that inclusion of capacity costs into the FAC raises serious concerns, and recommends that the company be prohibited from including its capacity costs in the FAC. This matter should be explored further in the collaborative sessions.

FAC Tariff Modifications
As an Operating Procedure

Con Edison has made its proposal in the form of an "operating procedure" rather than a formal revision to its electric tariff, i.e., P.S.C. No. 9 - Electricity. The company states that it

anticipates working with Staff and interested parties to monitor post-ISO experience with actual ISO charges and credits so that necessary adjustments to the operating procedure reflective of actual ISO operations can be made on a timely basis. (p. 2)

Staff finds this proposal to be excessively open-ended and recommends that the company be ordered to submit revised tariff leaves that provide the basis for the FAC mechanism not later than 60 days after the ISO began its energy-market operations, with an effective date of not later than April 1, 2000. In the interim, prior to April 1, 2000, Con Edison should be permitted to use its operating procedure as it is approved here, but should be directed not to modify the procedure without the Commission's approval.

CONCLUSION AND RECOMMENDATIONS

For the reasons stated above, staff concludes that the Commission should accept Con Edison's petition subject to the following:

1. The issues and questions raised by CPB, the City, and Westchester be addressed during the

collaborative meetings.

2. The inclusion of capacity costs in the FAC raises serious concerns and should be prohibited. This matter should be explored further in the collaborative meetings.
3. The company be prepared to present its estimate of the impacts of its FAC proposal on ratepayers.
4. ISO-related charges and credits reflected in the FAC should be subject to review by staff.

It is recommended that:

1. A final decision on Consolidated Edison Company of New York, Inc.'s (the company or Con Edison) post-ISO FAC filing not be made until after the outcome of the collaborative meetings. In the interim, the company's filing, subject to the limitation set forth in paragraph 2 below, should be adopted as an interim operating procedure to provide regulatory stability during the transition to an operational ISO. Charges and credits reflected in the operating procedure should be reviewed by staff.
2. The company be prohibited from including its capacity costs in the FAC pending the outcome of the company's proposal for (1) ratemaking and accounting with respect to the proceeds resulting from the divestiture of the company's electric generation facilities, (2) proposed changes to the company's Retail Access Implementation Plan and Operating Procedure applicable to Phase 3 of the Retail Choice Program.
3. The company submit revised tariff leaves that provide the basis for the FAC mechanism not later than 60 days after the ISO began its energy-market operations, with an effective date of not later than April 1, 2000.

4. Con Edison be directed to cooperate fully in responding to the parties questions during the collaborative meetings.

Respectively Submitted,

FRED HAAG
Principal Engineer

REVIEWED BY:

RICHARD C. KING
Managing Attorney
Office Of General Counsel

APPROVED BY:

HARVEY ARNETT
Chief, Rates & Tariffs
Office Of Electricity & Environment

Consolidated Edison of New York, Inc.

SUMMARY OF COMMENTS RECEIVED

A Notice Soliciting Comments on Con Edison's post-ISO FAC filing was issued September 29, 1999. Comments were received from the New York State Consumer Protection Board (CPB), City of New York (NYC or City), County of Westchester (Westchester or County), and the Urac Corporation (Urac).

New York State Consumer Protection Board

CPB opposes the company's proposal to modify the FAC to allow for the flow through of the differences between ISO capacity costs at market prices and capacity costs currently reflected in rates. CPB rejects Con Edison's automatic recovery or pass through to recover incremental short-term capacity costs that the company may incur to satisfy its Provider of Last Resort (POLR) responsibilities.

CPB reasons that the Commission must retain the authority for an annual review of these costs. The adoption of an automatic recovery and pass-through FAC would deny the Commission the opportunity to make a fair determination about over- and under-recoveries of capacity costs after they occur.

CPB recognizes that it may be unduly burdensome for the Commission to rule on de minimis recoveries, and therefore, recommends that the Commission establish a \$10 million band around the embedded cost estimate included in rates. If the company's capacity costs fall within the \$10 million band, then that amount would be flowed through or recovered through the FAC. If the amount is larger than \$10 million, then it would be subject to the Commission's discretion. However, should the company's earnings decline significantly and its realized return approximate or fall below the Commission's estimate of Con Edison's required return, then CPB states the Commission should consider allowing the company to recover some or all of the cost

deficiencies related to the acceleration of the divestiture of its power plants. CPB believes this approach would ensure that both Con Edison shareholders and ratepayers are treated fairly.

City of New York

The City states that the FAC proposal should be negotiated in the proceeding where the net gains from the divestiture will be considered. It refers to the Commission's order that authorized the process for divestiture.

Con Edison must propose a new framework for the FAC within 180 days of the time that the ISO assumes control of energy dispatch.^{1/} At that time there may be a re-evaluation of how market results are shared between stockholders and ratepayers.^{2/}

A re-evaluation is clearly appropriate, the City states, because the divestiture of the company's in-City generation plants has been completed. NYC recommends that the Commission defer any final evaluation of Con Edison's FAC proposal to the Commission's proceeding addressing the net gains from the divestiture of Con Edison's in-City electric generation plants. In addition, the City asks the Commission to order Con Edison "to make a proposal concerning the rate impacts of its FAC Proposal."

The City also asks several questions about the proposed FAC language:

1. There does not appear to be any incentive/sharing mechanism for the new FAC. While the company states that the key elements of the currently-effective FAC will continue to operate, including the 30/70 company/customer sharing ratio between the actual and targeted fuel costs, there does not appear to be any incentive mechanism for ISO-related costs.
2. There are multiple references to flow-through of transmission costs, with no explanation as to why Con

^{1/} Settlement, Section II, Paragraph 32 (viii), p. 32.

^{2/} Divestiture order, p. 30.

Edison does not already recover these costs in its transmission rates.

3. The proposed FAC operating procedure would allow Con Edison to recover "any incremental costs incurred by the Company resulting from the divestiture of its electric generation facilities." It is not at all clear that Con Edison has the right to recover these costs, especially without an incentive mechanism.
4. The proposed operating procedure states that the fuel costs shall be net other [ISO] related charges, including the cost of ISO ancillary services, "net of the cost of ancillary services embedded in Con Edison's rates," The company should state now which ancillary services are already embedded in its rates, so that there will be no dispute in the future.
5. With regard to the Item (3) under the subtractions under Factor of Adjustment, what is the explanation for the item, "net other NYISO-related credits," where it says that "wholesale TSCs received for wheeling power within, into, and out of the New York Control Area will not be flowed through."

County of Westchester

Westchester County recommends that the Commission thoroughly examine the petition during the Phase 3 review of the Settlement. To facilitate the review, the County asks that Con Edison be required, after the ISO has taken responsibility for dispatching the system, to maintain detailed pro-forma accounting records for each transaction as recorded hour-by-hour which would be used in determining FAC contributions to rates. Westchester recommends that those details be presented by Con Edison in technical sessions and be available for examination by all parties.

The County relates that when the transition to competitive pricing of generation is completed, the FAC becomes irrelevant; the market will set the price for generation, which will include the cost of fuel. When the Settlement expires, and the transition is complete, the County cautions that the post-ISO FAC should not be used as a catchall for costs that might extend its use beyond the Settlement

Agreement, or extend its purpose beyond its original intent.

The County states that the issues surrounding the modification of the FAC after the ISO has been established are complicated by:

1. The need for the FAC to be consistent with the terms of the Settlement and subsequent orders.
2. Con Edison has divested its conventional generation under contracts which include price controls for energy, unit commitment, capacity, and reserves. The company has also purchased capacity and energy from those units to assure that capacity and energy is available within NYC.
3. Con Edison proposes the difference between the market price of capacity and price in the contracts with the divested generation be flowed through the FAC. Capacity costs have not been included before in the FAC.

The capacity purchases are related exclusively to the NYC load pockets. Because Westchester does not have load pockets, and for the market to work as a truly competitive market, capacity costs should be excluded from the FAC for Westchester sales.

4. Changing from a PROMOD-based method to an LBMP-based method for setting the target fuel cost is a radical revision. The results should be carefully examined to see if the new method is appropriate.

Also, having changed the methodology for determining the target fuel cost, the sharing between the stockholders and the customers should be reexamined.

5. Using LBMP as a target would facilitate assigning individual FACs to each LBMP area.

In addition, assigning individual FAC to each LBMP area would be consistent with local competitive markets, and would provide pricing signals for siting new generation facilities and expanding transmission line capacity.

6. Some ISO-related charges and transmission charges that are proposed to be recovered through the FAC may be already embedded in the Settlement rates, and should not be recovered again. In addition, some of these charges may be paid directly by the ESCOs, therefore, the sharing between Con Edison's full service and retail access customers is not clear.

Urac Corporation

Urac addresses Con Edison's proposal to modify the FAC in the form of an operating procedure. It is unsure as to the meaning of "modifying the FAC in the form of an operating procedure." If the company intentions are to establish FACs at various time intervals and publish them in the operating procedures in lieu of filing statements with the Commission, then Urac Corporation objects to Con Edison's proposal. However, if this is not the case, then Urac requests that its comments be ignored.

Urac argues that if the filing of FAC statements are to be discontinued, the information will not be readily available and consumers will be at the mercy of the company should they need them. Urac's experience is that Con Edison does not provide the information on a timely basis. Urac comments that in this de-regulated era where savings are important to consumers, it is imperative that consumers have the opportunity to compare the rates offered by Con Edison and the ESCOs. It would obstruct the consumer's decision to choose without knowing all of the related charges on the consumer's bill, i.e., increase in rates and charges, fuel adjustment charges, etc.