brief

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January 14, 2000

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Via Overnight Delivery

The Honorable Debra Renner, Acting Secretary
New York State Public Service Commission
Three Empire State Plaza
OAH – Swan S
Albany, New York 12223-1350

Re: **PSC Case No. 99-E-0681 – Transition Cost Obligation of the Village of Lakewood, New York Under Rule 52 of the PSC No. 207 Electricity – Initial Post-Hearing Brief of the Village of Lakewood, New York**

Dear Secretary Renner:

Enclosed, please find for filing 25 copies of the redacted version of the Reply Brief of the Village of Lakewood, New York ("Lakewood") in the above-referenced proceeding. Also enclosed are two copies for date-stamping and return to our office via U.S. Mail.

The original unredacted version of this filing has been sent to the Honorable Gerald L. Lynch. Lakewood is also providing both redacted and unredacted copies to NYPSC Staff Counsel and Counsel for Niagara Mohawk.

Please call if you have any questions.

Sincerely,

Kellie A. Donnelly

J. Cathy Fogel
Kellie A. Donnelly
Robin Remis Shichman
Attorneys for the Village of
Lakewood, New York

Enclosure
cc: All Parties

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Dear Judge Lynch:

In accordance with the procedural schedule in the above-referenced proceeding, the Village of Lakewood, New York ("Lakewood") is serving your Honor via electronic mail and overnight courier service with the original unredacted Reply Brief of Lakewood. We are also serving 25 copies of the redacted version of Lakewood's Reply Brief with the Office of the Secretary of the New York Public Service Commission ("NYPSC").

Lakewood is providing both redacted and unredacted copies to Counsel for Niagara Mohawk and to NYPSC Staff Counsel.

Please call if you have any questions.

Sincerely,

Kellie A. Donnelly

J. Cathy Fogel
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cc: All Parties

PUBLIC SERVICE COMMISSION
STATE OF NEW YORK

Petition of Niagara Mohawk Power Corporation for a Declaratory Order Approving Niagara Mohawk's Determination of the Village of Lakewood, New York's Transition Cost Obligation Under Rule 52 of P.S.C. No. 207 Electricity	)))))))	CASE No. 99-E-0681

REPLY BRIEF OF THE VILLAGE OF LAKEWOOD, NEW YORK

REDACTED VERSION

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VILLAGE OF LAKEWOOD, NEW YORK

January 14, 2000

PUBLIC SERVICE COMMISSION
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VILLAGE OF LAKEWOOD, NEW YORK

January 14, 2000

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Pursuant to Rule 4.8 of the New York Public Service Commission's ("NYPSC or "Commission"") Rules of Procedures, 16 N.Y.C.R.R. § 4.8, and the procedural schedule in this proceeding, the Village of Lakewood, New York ("Lakewood" or "Village") hereby submits this Reply Brief.

INTRODUCTION

As explained in detail in its Initial Brief, Lakewood plans to form its own municipal electric utility system so that its residential consumers may experience the benefits of a comprehensively restructured electric market in the State of New York. To date, despite the Commission's goals of providing meaningful retail choice to all New York customers, and notwithstanding the implementation of Niagara Mohawk Power Corporation's ("Niagara Mohawk" or "Company") PowerChoice Settlement Agreement ("PowerChoice" or "Settlement Agreement"), only industrial and large commercial consumers have enjoyed the substantial advantages of a deregulated electric market.

In this case of first impression, the calculation of Lakewood's exit fee will serve to determine whether or not the Village and, in turn, other communities served by Niagara Mohawk, can afford to bring competition to residential customers through the formation a municipal electric system. Continuation of existing subsidies and inclusion of transmission and distribution-related stranded costs, in addition to production-related stranded costs, in the Village's exit fee, would result in a prohibitively exorbitant amount. Niagara Mohawk's proposed bill of $18 million to Lakewood for the privilege of leaving the Company's system would effectively stifle competition — for Lakewood and others. This "chilling effect" is not unlike the situation of a car dealer and a lessor where hidden expenses and charges associated with an attempt to dissolve a car lease can be so excessive that it is often easier to simply renew the lease with the dealership.

Artificially imposed strandable costs, as sought by Niagara Mohawk here, send an improper price signal to customers and competitors alike. A properly allocated exit fee would allow economically efficient competition.

I. PUBLIC POLICY AND BACKGROUND: PowerChoice and Rule 52 Were Enacted in Furtherance of the Commission's Goal of Providing Retail Choice to All Customers and Should Be Viewed in That Context.

Since 1993, the NYPSC has sought to restructure comprehensively the electric industry in the State of New York so that, in addition to other policy goals, all consumers would have access to meaningful retail choice.[1] Niagara Mohawk's PowerChoice Settlement Agreement, along with its Rule 52 implementing retail tariff, were enacted by the Commission in furtherance of promoting electric competition in a deregulated environment.[2] Rule 52 provides for the recovery of stranded costs from

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[1] See Case 93-M-0229, Order Instituting Proceeding (Issued Mar. 19, 1993); Case 94-E-0952 et al., Opinion and Order Adopting Principles to Guide the Transition to Competition, Opinion No. 95-7, (Issued June 7, 1995); Case 94-E-0952 et al., Opinion and Order Regarding Competitive Opportunities for Electric Service, Opinion No. 96-12 (Issued May 20, 1996); and Initial Post-Hearing Brief of the Village of Lakewood, New York, at 3-4 (N.Y.P.S.C. Dec. 20, 1999) (No. 99-E-0681) ("Lakewood Initial Brief").

[2] See Case 94-E-0098 and 94-E-0099, Opinion and Order Adopting Terms of Settlement Agreement Subject to Modifications and Conditions, Opinion No. 98-8, (Issued Mar. 20, 1998); Case 94-E-0098 et al., Order Concerning Tariff Amendments Setting Rates for All Customer Classes and Implementing a Retail Access Program, (Issued Aug. 26, 1998).

customers that leave the Company's system upon forming a municipal utility system.[3] The stated purpose of Rule 52, which both Niagara Mohawk and NYPSC Staff evoke throughout their Initial Briefs, is as follows:

> *To discourage total bypass of the Company's retail distribution services and charges where such bypass is not economic from society's standpoint and to prevent the shifting of the Company's Transition Costs to other stakeholders that would occur in such circumstances.*[4]

The parties disagree as to the manner in which the Purpose section of Rule 52 applies in this case of first impression. Repeatedly referring to Rule 52's Purpose section, the Company, and even Staff, seem to imply that all current consumers should remain distribution and transmission customers of Niagara Mohawk, as anything short of that would constitute uneconomic bypass. That is, through their misapplied interpretation of that Section, Staff and Niagara Mohawk have set Rule 52 up to be a "no risk" insurance policy that will allow Niagara Mohawk to remain a transmission and distribution monopoly.

This result, however, would directly undermine one predominant reason that this Commission approved the PowerChoice settlement — "to foster and implement a competitive electric market."[5] A municipality seeking to provide electric service to its residents and small businesses should be allowed to participate in the competitive market rather than being excluded by a misinterpretation of a "purpose" clause.

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3 See Ex. 52 at 30-32.

4 See id., Section 52.1.

5 Case 94-E-0098 and 94-E-0099, Opinion and Order Denying Petitions for Rehearing, Opinion No. 98-12 (Issued June 5, 1998) at 5.

As Staff and the Commission recognized in considering Rule 52 prior to its enactment, the Purpose section of the tariff is merely a "brief description of the basis for the subsequent tariff provisions" and "it is the application of the entire Rule 52 tariff to individual circumstances, not the Purpose alone, which will provide the customer with guidance regarding the economics of an alternative electric service supplier."[6] As discussed in Lakewood's Initial Brief, the entire tariff must therefore be applied to the particular circumstances of the case at hand.[7]

A. In Forming its Own Municipal Utility System, Lakewood Is Not Entirely Bypassing Niagara Mohawk's System.

Upon the formation of Lakewood's municipal utility system, Niagara Mohawk's system will not be totally bypassed by the Village's consumers. Lakewood has made clear throughout this proceeding its intention to purchase the Company's distribution system, along with its plan to use Niagara Mohawk's transmission system.[8] In a situation such as this, in which the departing customers are purchasing the utility's distribution system and using the utility's transmission system, there is no uneconomic bypass.[9]

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6 Case 94-E-0098 and 94-E-0099, Order approving Staff recommendation, (issued June 30, 1998); Lakewood Initial Brief at 15.

7 See Lakewood Initial Brief at 12-15.

8 See id. at 18, 29-30 and Tr. at 537-538.

9 See Lakewood Initial Brief at 18-19 and 29-30. Tr. at 537.

B. A Fair Share Determination of Lakewood's Exit Fee, Along with Appropriate Compensation for the Utility's Distribution System and the Continued Use of the Company's Transmission Service, Will Not Result in Unfair Cost-Shifting to Remaining Customers.

Niagara Mohawk argues that it is the Commission's "intent to ensure, through provision for full strandable cost recovery, both the benefits of PowerChoice and equality of treatment between customers who municipalize and those who do not."[10] The Company particularly notes the remarks of Commission Chairman Maureen O. Helmer at the February 24, 1998 session meeting at which Opinion No. 98-8 was formally approved:

> Our decision today is not a decision against municipalization. Rather, it is an affirmation that one municipality should not have the benefit of going to competition without paying their fair share of these transition costs. A failure to recover these costs from one municipality would merely shift these costs to others. Allowing all forms of competition to begin with the same benefits AND RESPONSIBILITIES is a simple matter of fairness to all ratepayers.[11]

Lakewood agrees that, as a basic matter of fairness to New York ratepayers, all forms of competition must begin with the same benefits and responsibilities. As demonstrated throughout this process, Lakewood is not attempting to completely bypass Niagara Mohawk's system, nor is the Village trying to avoid its responsibility for paying its *fair share* of stranded costs. Instead, in the interest of fairness and "equality

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[10] Initial Post-Hearing Brief of Niagara Mohawk Power Corporation at 6-7 (N.Y.P.S.C. Dec. 20, 1999) (No. 99-E-0681) ("Niagara Mohawk Initial Brief").

[11] Id. at 6 (emphasis in the original).

of treatment," Lakewood is seeking to ensure that it pays what it owes — no more, no less. The issue of cost-shifting will be discussed in more detail infra.

C. The Commission's Goal of Promoting Effective Retail Competition Has Not Yet Been Realized by Residential Consumers.

Niagara Mohawk argues that "[t]he PowerChoice Settlement provided an array of public benefits, including most prominently rate reductions for all classes of customers; retail choice for all customers; promotion of competitive generation markets through divestiture of generation; protection of the social programs through a system Benefits Charge; and resolution of the bulk of Niagara Mohawk's above-market Qualifying Facility ("QF") power purchase obligations."[12] This statement, however, is nothing more than mere lip service with regard to effective retail competition. As discussed fully in Lakewood's Initial Brief, residential consumers have yet to realize the promised benefits of a newly restructured competitive market.[13] In fact, it is only after expending considerable time and resources in protracted litigation that the Village of Lakewood is poised to take advantage of retail choice through the formation of its own municipal utility system. However, a determination of excessive stranded costs will prevent Lakewood from leaving the Company's system and will serve as a warning to other communities interested in effectuating competition through the formation of a municipal electrical system.

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12 Id. at 4.

13 See Lakewood Initial Brief at 6-12.

Any competition contemplated by PowerChoice simply does not reach residential customers, as demonstrated by a recent Commission Order regarding Niagara Mohawk's customer service back-out credits ("CSBC").[14] There, this Commission decreased the CSBC that may be used by residential customers, because less than 2 percent of the allowed CSBC (i.e., approximately $80,000 of an allowed $5.6 million) had been used by residential customers obtaining access to competition.[15]

The fact that less than 2 percent of the CSBC has been used further demonstrates the point raised in Lakewood's Initial Brief — namely that in contrast to large industrial and commercial consumers, residential customers are not able to take advantage of competition except by such means as forming a municipal electric utility. Such formation should be encouraged, rather than dissuaded by making it uneconomical, as Niagara Mohawk proposes to do here. Lakewood agrees with the concerns voiced by the Consumer Protection Board ("CPB") during consideration of Niagara Mohawk's request to reduce residential back-out credits: "residential access

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14 See Case 94-E-0098 and 94-E-0099, Order approving Staff recommendation (Issued Dec. 15, 1999) at 3-4 ("Dec. 15, 1999 Order"). The CSBC mechanism is designed to provide a credit to consumers that select an alternative electrical supplier. The credit amount, which is based on service classification, is subject to yearly class-specific credit caps. In November 1999, the Company informed the Commission that the credit caps for S.C. No. 2 and S.C. No. 3 service classes had been reached because of high customer demand. See id. at 2. Niagara Mohawk requested that the credit cap for residential consumers, S.C. No. 1, be reduced by $2 million in years 2 and 3 in order to increase the credit cap for customers in S.C. No. 2 and S.C. No. 3. See id.

15 See id. at 3.

should be stimulated as a first priority from the funds previously allocated for that purpose."[16]

The December 15, 1999 Order, which increases the CSBC for large customers at the expense of the residential consumers, provides yet another example of how residential customers are overlooked and disregarded in the restructured competitive arena of New York. This immediate proceeding presents an opportunity for the Commission to encourage and actively facilitate competition for residential customers.

II. SUMMARY OF ARGUMENT

As explained fully in Lakewood's Initial Brief, Niagara Mohawk is seeking to collect from Lakewood an exorbitant exit fee, far exceeding the amount of costs that would actually be stranded in the event that the Village departs the Company's system and forms a municipal electric utility. Niagara Mohawk and Staff's overstated stranded cost estimates are based upon their misinterpretation of the Rule 52 stranded cost formula as well as their fallacious application of that formula.

As applied by Niagara Mohawk, the Rule 52 calculation will result in over-recovery of stranded costs by the Company. Contrary to the language of the PowerChoice Agreement and Rule 52 implementing that Agreement, the Company contends that it is entitled to recovery of transmission and distribution-related stranded costs notwithstanding the fact that such costs will be addressed separately. More specifically, there is no support for the view espoused by both Niagara Mohawk and

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[16] Id. at 4.

Staff that the provisions of PowerChoice and Rule 52 permit recovery of distribution or transmission-related stranded costs in a situation in which the departing customer condemns the distribution system and contracts with the Company for transmission services.

As Lakewood has made clear, it intends to acquire the distribution system and pay Niagara Mohawk the amount determined in the condemnation proceeding. In addition, the Village has informed the Company that it will use Niagara Mohawk's transmission facilities. Thus, Niagara Mohawk will be fairly compensated for both distribution and transmission-related costs. Such costs then, must be excluded from Lakewood's exit fee calculation in order to prevent double recovery.

There is no support for the position taken by Staff or the Company. As explained herein, Niagara Mohawk only collects generation-related costs through the Competitive Transition Charge paid by existing customers, and similarly, should only collect generation-related costs from departing customers. In addition, "R", which refers to "bundled price designs," pertains to revenues which must be adjusted so as to be Lakewood-specific, thereby resulting in the appropriate net revenues. In this case, there is a total offset associated with distribution and transmission costs, thus resulting in a net "R" that reflects production-only revenue.

Further, it is unlikely that price subsidization will be perpetuated in the new era of deregulation. Niagara Mohawk chides the Village for its belief that "postage stamp ratemaking" will not be continued indefinitely and in doing so, overlooks two important points. First, "postage stamp rates" as applied in this case, amount to more than a slight differential in rates permitted for administrative ease. Rather, these rates amount to substantial subsidies. Second, Niagara Mohawk can provide no basis for its view that residential customers will be forced to continue subsidizing other customers on the system in a competitive environment. Such an assumption neither results in "fairness to all ratepayers," nor is consistent with the notion of competition on a level playing field.

Niagara Mohawk utilizes an oversimplified methodology to determine avoided costs, as explained more fully in Lakewood's Initial Brief. This methodology directly contradicts the Company's position with regard to subsidies. In addition, it is inherently biased because it discriminates against smaller communities, such as Lakewood. Such discrimination occurs on the basis of a community's time of departure and geographic location. Further, avoided costs must be treated in the same manner as stranded costs. Inconsistent treatment of both types of costs produces inequitable results. Finally, the Company's failure to consider future load growth in the determination of distribution avoided costs will unfairly permit Niagara Mohawk to recover certain costs twice — once from Lakewood through the exit fee and then again through the distribution revenue received from new customers.

Niagara Mohawk claims that Lakewood is unwilling to enter into a long-term transmission contract as a condition for receiving the transmission revenue credit. This position ignores the fact that prior to entering into a long-term transmission agreement, the Village must obtain a source of power supply.

Lakewood notes that with regard to Niagara Mohawk's claim that it will incur a federal income tax liability in connection with the sale of the distribution system, it is impossible to ascertain the federal tax liability in the absence of a final determination of a sale price for the distribution assets. Further, in response to Niagara Mohawk's most recent argument, Rule 32 is inapplicable to a Rule 52 determination, as explained more fully herein and in Lakewood's Initial Brief.

It is proper to assume a 2 percent increase with regard to Lakewood's retail rates. Staff's position in support of a 1.5 percent increase is undermined based on the fact that a 2 percent increase in revenues would be required to recover the Company's projected cost increase even if Staff's adjustments are made. To the extent that a 2 percent increase exceeds the Company's cost of service, the excess may be used to reduce stranded costs and expedite the availability of true competition.

With regard to "E," the Company's recommended figure is grossly understated for several reasons. Niagara Mohawk fails to consider the 1000 MW increased demand and thus its market price of power is inordinately low. The Company's Witness, Mr. Meehan, did not make necessary adjustments regarding the capital costs of new combined cycle units and thus advocates inaccurate capital costs. Moreover, Mr. Meehan admittedly is unaware of the costs included in his "generic analysis" and cannot verify whether certain necessary costs were in fact included. Niagara Mohawk also ignores transmission costs in calculating the effective cost of merchant plants. As a result, the capital costs proposed by Niagara Mohawk for new merchant plants are grossly understated.

In addition, the manner in which Mr. Meehan calculated Operation and Maintenance ("O&M") costs for new merchant plants is erroneous in that he failed to distinguish between variable and fixed costs. Consequently, his PROMOD invalidly understates energy costs. Mr. Meehan did admit, however, that the O&M estimate advanced by Lakewood is reasonable. It is thus appropriate to use the Village's estimate.

Property taxes (as well as capital costs) of new market entrants should be based on greenfield plants alone, because the market must be able to support the full cost of a greenfield unit. Record evidence in this proceeding supports a property tax estimate of at least $12/kW.

The plant retirements assumed by the Village are reasonable and substantiated by record evidence. While Niagara Mohawk first supported and now contests Lakewood's assumed retirements, the Company's more recent claims are either unsupported or directly contradicted by the record.

The capital costs of new merchant plants should be computed utilizing a levelized fixed charge. As acknowledged by Mr. Meehan, lenders prefer receiving their money in the early stages, as do equity investors. A levelized fixed charge allows for debt recovery in a more expeditious fashion than the method advanced by Niagara Mohawk, and is thus more appropriate.

As construed by Niagara Mohawk, the marketing option, which is intended to serve as a check on the Company's calculation of "E," fails to expose it to any risk. Because the Company is only willing to market that portion of its portfolio which is hedged against risk, there is no incentive for Niagara Mohawk not to underestimate market prices. Such an application defeats the underlying rationale of the marketing option.

Lakewood and Niagara Mohawk utilize the identical methodology for the computation of "Y." Notwithstanding, Staff, which agrees that the methodology used by the Company is reasonable, rejects the Village's calculation. Staff erroneously believes that because Lakewood performed a production-only exit fee analysis, its approach to "Y" is incorrect. In fact, exclusion of transmission and distribution-related stranded costs in the exit fee calculation has no bearing on a determination of the recovery period, "Y." In addition, a Lakewood-specific "Y" should be calculated utilizing the Village's rates as opposed to entire system rates. In the absence of such a calculation, the determination of "Y" would not be on a case-specific basis and would thus be inaccurate.

III. ARGUMENT

A. "R"

1. PowerChoice and Rule 52 Provide for the Recovery of Generation Stranded Costs and Not Costs Associated with Transmission and Distribution.

Niagara Mohawk's and Staff's understanding of the scope of stranded cost recovery appears to have evolved substantially over time. As highlighted in Lakewood's Initial Brief, the Company prepared a number of stranded cost calculations at the request of various communities, on a production-only basis prior to the time it estimated Lakewood's exit fee in which it included transmission and distribution-related costs.[17]

Now, in the first exit fee determination before the Commission, both Staff and Niagara Mohawk argue that in addition to recovering production-related stranded costs, the Company is entitled to recover transmission and distribution-related stranded costs.[19] However, the justification offered by both parties in furtherance of broadening stranded cost recovery serves instead to reinforce Lakewood's generation-only calculation.

a. The Commission's Order Approving PowerChoice References Only Generation Costs.

This Commission's Order approving PowerChoice demonstrates that a production-only exit fee is appropriate here. In its Initial Brief, Staff takes issue with Lakewood's argument that Section 2.1 of the Settlement Agreement demonstrates that stranded cost recovery is limited to generation-only costs. The relevant portion cited by

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17 See Lakewood Initial Brief at 25-26.

18 See id. at 27-28,

19 See Niagara Mohawk Initial Brief at 5-9; Staff's Initial Brief at 3-7 (N.Y.P.S.C. Dec. 20, 1999) (No. 99-E-0681) ("Staff Initial Brief").

Lakewood states "...the company shall have a reasonable opportunity to recover its stranded generation costs ..."[20]

According to Staff, Lakewood's quote is incomplete and misleading in that the sentence continues as follows:

> *"...including costs associated with its own generation as well as the costs associated with the Master Restructuring Agreement."*[21]

What Staff fails to recognize is that the costs associated with the MRA are ***production*** costs. There is nothing in this clause which speaks to the inclusion of either transmission or distribution-related stranded costs.

Similarly, Staff quotes a paragraph from Opinion No. 98-8 which states, in part, "System plans were made, generation plants were built, and IPP contracts were entered into to meet the service requirements of towns and cities."[22] From this, Staff concludes that "system plans" relate to generation, transmission, and distribution.[23] Staff, however, does not focus on the next page of the Opinion, which defines stranded cost recovery in terms of "a nonavoidable [competitive transition charge] CTC" (a generation-related charge) and refuses to exempt municipal electric utilities from this charge.[24]

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20 Staff Initial Brief at 4, Lakewood Initial Brief at 22.

21 Staff Initial Brief at 4.

22 Id. at 6 (quoting Opinion 98-12 at 10).

23 See id.

24 Opinion 98-12 at 11.

Earlier in Opinion No. 98-8, this Commission demonstrated its understanding that the concept of uneconomic bypass refers to a bypass of generation costs. It determined that "customers who currently use the company's generation resources" should not be allowed to bypass the CTC (other than certain customers with grandfathered self-generation).[25] Lakewood agrees that it should not bypass the CTC — a generation charge.

b. Customers that Pay an Exit Fee Should Receive Consistent Treatment with Those that Pay a CTC.

Niagara Mohawk argues that the impetus behind Rule 52 was the Company's "skyrocketing strandable cost burden"[26] and cites its required purchases from QFs as "[b]y far the single largest factor in Niagara Mohawk's burgeoning strandable costs."[27] Niagara Mohawk further quotes the Commission's concerns about exiting customers bypassing the CTC and failing to pay their fair share of transition costs.[28] Then Niagara Mohawk leaps to the conclusion that it is entitled to collect non-generation costs, ignoring the fact that both QF payments and CTCs relate only to production costs.

As Niagara Mohawks notes, PowerChoice provides for the recovery of stranded costs through either (1) a CTC for customers which continue taking service from the

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25 Opinion No. 98-8 at 40 (emphasis added).

26 Niagara Mohawk Initial Brief at 2.

27 Id.

28 See id. at 6.

Company, or (2) an exit fee for customers that opt to leave the Company's delivery system.[29] The CTCs paid by remaining customers are entirely generation costs — neither transmission nor distribution-related costs are included in these charges. Additionally, the PowerChoice Settlement Agreement is limited in duration to a period of five years.

Currently, as a customer of Niagara Mohawk, Lakewood customers are paying Niagara Mohawk a CTC charge through retail rates. In fact, Lakewood customers will have paid about $3.6 million[30] — almost half of its PowerChoice CTC charges by the time Lakewood is currently targeted to depart the Niagara Mohawk system in 2001. It is important to note that there is absolutely no guarantee that the provisions of PowerChoice will extend beyond the five year period; yet, Niagara Mohawk insists that the Village should pay generation, transmission and distribution-related "stranded costs" for a period ending in 2012 — nine years after the CTCs under PowerChoice have ended. Thus, Niagara Mohawk, which would have collected an estimated $4.2 million in CTCs from Lakewood from January 2001 to the end of PowerChoice, intends instead to collect $18 million from the Village for the same period.

As discussed supra, the Company maintains that the Commission intended to allow the recovery of transmission and distribution-related stranded costs, in addition to production-related stranded costs, in order to ensure "both the benefits of PowerChoice

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29 See id. at 4-5.

30 This number is obtained by multiplying the 4.3 cent non-commodity charge in Exhibit 120 by Lakewood's estimated load.

and equality of treatment between customers who municipalize and those who do not."[31] However, a requirement that customers who municipalize pay, for a period ending in 2012, production, transmission and distribution-related costs, while the remaining customers pay a production-only charge that ends in 2003, will instead ensure disparate treatment between the two groups of customers.

c. "Bundled" Revenues Must Be Appropriately Adjusted So That They Are Lakewood-Specific.

Pursuant to the exit fee formula in Rule 52, "R" must be reduced by appropriate offsets. Where, as here, the exiting customer purchases the Company's distribution system and uses Niagara Mohawk's transmission system, the distribution and transmission component of "R" equals zero. Both Staff and the Company reference the "revenues lost formula" as set forth in § 4.11.3 of PowerChoice where "R" is defined as being equal to:

> *the "annual estimated revenue from the customer using the bundled price designs contained in the Settlement Agreement. There will be no credit for transmission related revenues, as proposed in FERC Order 888, since the customer will not be using the company's delivery system."*[32]

According to both parties, "'bundled' rates are clearly all inclusive, and not limited solely to generation costs."[33] Staff and Niagara Mohawk argue that the PowerChoice provision for a contingent transmission revenue credit presumes the

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31 Niagara Mohawk Initial Brief at 6-7.

32 Staff Initial Brief at 5; <u>see also</u> Niagara Mohawk Initial Brief at 7.

33 Staff Initial Brief at 5; <u>see also</u> Niagara Mohawk Initial Brief at 7.

inclusion of transmission revenues in the exit fee calculation.[34] The Company further notes that "R" is defined as "revenues," as opposed to "production-related revenues," and because exit fees are to be calculated based on total net lost revenues, transmission and distribution-related stranded costs are recoverable.[35]

While Lakewood recognizes that PowerChoice refers to "R" in terms of "bundled price designs," these revenues must be appropriately adjusted so as to be Lakewood-specific in order to determine the appropriate net revenues. Here, there is a complete offset of both distribution and transmission costs, therefore leaving a net revenue of zero for those two functions.

Where, as here, a departing customer pays for a distribution system through the condemnation process, distribution costs should be completely offset. This 100 percent offset was used by the Federal Energy Regulatory Commission ("FERC") in City of Las Cruces[36] and adopted by the Presiding Administrative Law Judge in City of Alma.[37]

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34 See Staff Initial Brief at 5; Niagara Mohawk Initial Brief at 7.

35 See Niagara Mohawk Initial Brief at 8.

36 See Ex. 107 (City of Las Cruces, N.M. v. El Paso Electric Co., 87 FERC ¶ 61,201 (1999)).

37 See Ex. 108 (City of Alma, Michigan, 88 FERC ¶ 63,002 (1999)).

Thus, when FERC computed the net present value of stranded costs owed, it did so on the basis of production costs only.[39]

Prior to Rule 52, a municipality seeking to form an electric utility did so pursuant to General Municipal Procedure Law § 360 (McKinney,1999) and the New York Eminent Domain Law (McKinney,1979). The utility whose assets were condemned received "fair compensation" for those assets as a result of the condemnation process. Any so-called distribution stranded costs were assumed to be captured in the compensatory amount granted by the presiding court. Neither PowerChoice nor Rule 52 should change that format. Niagara Mohawk pursued PowerChoice because of its claimed production stranded costs, not its distribution stranded costs. While it is understandable that Niagara Mohawk seeks to preclude bypass of payment for its distribution system (e.g., by construction of a separate distribution system and disconnection from Niagara Mohawk's system), the Company has failed to substantiate its theory that distribution costs should be treated differently after adoption of PowerChoice than prior to its adoption, where the exiting municipality is purchasing the Niagara Mohawk distribution system.

Additionally, the Village will continue to take transmission service from Niagara Mohawk, thereby resulting in no transmission-related stranded costs. As noted in

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39 See City of Alma, Michigan, 88 FERC ¶ 63,002, 65032-65033 (1999); City of Las Cruces, N.M. v. El Paso Electric Co, 87 FERC ¶ 61,201, 61,763 (1999); Ex. 107 at 41-43.

Lakewood's Initial Brief, and agreed to by Niagara Mohawk Witness Hodgson on cross-examination, when a utility's rates are based upon the embedded cost-of-service of the utility's transmission system, and if all customers took transmission service under the FERC tariff, that utility would recover 100 percent of its transmission cost-of-service.[40] Niagara Mohawk's transmission tariff has been filed with and approved by FERC. As Staff has recognized, if Niagara Mohawk requires additional wholesale revenue, it should seek such revenue and credit it to retail customers.[41] The Company should not be allowed to recover more than 100 percent of its transmission costs by obtaining an "adder" through this proceeding.

2. In a Deregulated Environment, it Cannot Be Assumed That Price Subsidies Will Be Allowed to Continue.

Lakewood should only be required to pay its fair share of Niagara Mohawk's stranded costs. Massive subsidies to Niagara Mohawk and to other customers cannot be considered Lakewood's "fair share."

Niagara Mohawk argues that "[b]y establishing [sic] a municipal utility, Lakewood will subject other stakeholders to substantial net lost revenues unless Lakewood's Rule 52 exit fee includes not only Lakewood's share of production stranded revenues, but also the full contribution to transmission and distribution net lost

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40 See Lakewood Initial Brief at 30. Tr. at 455, ll. 7-16.

41 See Staff Initial Brief at 9. Lakewood agrees with Staff that Niagara Mohawk's wholesale transmission revenues have been understated based upon its cost forecast.

revenues currently being made by retail customers in Lakewood."[42] Staff quotes Opinion No. 98-12, which states:

> *A stranded costs charge is intended to recover, to the extent not otherwise recovered for example through a condemnation award, a portion of the costs associated with these service requirements from those who were served by the system. To the extent groups of customers are permitted to avoid their proper cost responsibilities, costs would be shifted unfairly to other customers remaining on the system.*[43]

The key words in this quotation are "proper cost responsibilities" and costs which are shifted "unfairly." Here, Lakewood is not totally bypassing the system and is paying its appropriate share of generation stranded costs. Thus, it is bearing its "proper cost responsibilities" and no costs are shifted "unfairly" to remaining customers.

Niagara Mohawk and Staff, however, would propose the continuation of Lakewood's subsidies of other customers, Niagara Mohawk's continued employment of unnecessary staff (discussed infra) and Niagara Mohawk's recovery of more than 100 percent of its transmission costs (discussed supra). Opinion No. 98-12 did not prohibit fair shifting of costs or require payment of costs in excess of proper cost responsibilities. Lakewood's proposed Rule 52 calculation requires payment by Lakewood of its fair portion of Niagara Mohawk's stranded costs — no more and no less. By requiring Lakewood to pay more than this fair share, Niagara Mohawk would simply preclude the formation of municipal utilities which is necessary to bring competition to residential and small commercial customers.

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42 Niagara Mohawk Initial Brief at 8.

43 Staff Initial Brief at 6, (quoting Opinion No. 98-12 at 10).

Both Staff and Niagara Mohawk would require Lakewood to continue to subsidize other ratepayers through its exit fee; both claim that cost-shifting would otherwise occur.[44] This is analogous to requiring an underpaid and overworked employee to pay an employer for the privilege of quitting a job — otherwise, the remaining employees might receive compensation commensurate with their work. If Lakewood departs without paying a subsidy, other customers would merely pay their fair share.

By phrasing their argument in terms of "postage stamp rates," Staff and Niagara Mohawk attempt to convey the impression that there is a slight differential in rates to allow for administrative convenience and to enable rural customers to pay a more reasonable cost for electricity. In fact, however, the amount of the subsidy is substantial. In the case of Distribution and Street Lighting Rate Base, Niagara Mohawk has allocated to Lakewood $2,875,218,[45].

Company's claimed $1,568,063 net book value of Lakewood-specific physical assets.[47] A subsidy of 83 percent cannot be considered minor. Additionally, as noted in

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44 See Staff Initial Brief at 12-13; Niagara Mohawk Initial Brief at 9.

45 See Ex. 43.

47 See Ex. 109. Lakewood witnesses, relying upon tax records, derived a net book value of $732,439. See Tr. at 592; Ex. 50.

Lakewood's Initial Brief, the subsidy goes to large industrial customers as well as to small rural customers.[48]

Niagara Mohawk's insistence on a continued subsidy directly contradicts its treatment of avoided costs. The Company bases its revenue requirement on the costs it allocates to Lakewood, not on the costs Lakewood actually places on the system. In contrast, Niagara Mohawk calculates Lakewood's avoided costs on the costs actually spent on Lakewood services — far below the allocated costs.

The entire theory of stranded cost recovery would allow a utility to recover those above-market costs it incurred on behalf of a departing customer. All such departing customers should be treated in the same manner upon exiting the system. Thus, Chair Maureen O. Helmer envisioned that PowerChoice would "allow[] all forms of competition to begin with the same benefits and responsibilities [as] a simple matter of fairness to all ratepayers."[49] Requiring one exiting customer to subsidize remaining customers (as well as other exiting customers who receive subsidies) puts greater responsibilities on exiting customers, such as Lakewood, who have been forced to subsidize others in the past.

Additionally, in a deregulated competitive environment, it should not be assumed that residential customers will continue to bear the burden of subsidizing other customers on Niagara Mohawk's system. What would happen if the Commission decides to eliminate price subsidies after Lakewood has paid an exit fee that reflects

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48 See Lakewood Initial Brief at 7-8.

49 Niagara Mohawk Initial Brief at 6.

continuation of the price subsidies? It would seem that upon such a policy determination, price subsidies collected through Lakewood's exit fee would flow directly to the Company's shareholders. This untenable result would fly in the face of "fairness to all ratepayers" and would be directly contrary to the notion of competition beginning on a level playing field.

It its Initial Brief, Lakewood outlined various possibilities for the Commission to consider in dealing with the integral issue of price subsidies.[50] For example, a cost based allocation among all classes, including industrial customers, could result in a more equitable dispersion of any needed subsidy for rural customers.[51] In addition, Niagara Mohawk has at least two sources of potential funds that could be used to subsidize rural consumers: (1) $40 million in profits, as demonstrated in the Company's Form 10-K for the year ending December 31, 1998;[52] and (2) the projected $125 million in savings the Company experienced as a result of the Company's successful termination of an independent power producer contract with Norcon Power Partners Inc.[53]

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50 See Lakewood Initial Brief at 33-35.

51 See id. at 33.

52 See id. at 34; Ex. 125 at 7.

53 See id. at 35.

3. Niagara Mohawk's Admittedly Simplistic Methodology to Determine Avoided Costs Is Discriminatory and Underestimates Those Costs Associated with Lakewood's Departure.

According to Niagara Mohawk, the Company's calculation of the avoided service-related costs upon Lakewood's departure is "straightforward, if somewhat simplified."[54] The Company argues that its "systematic" methodology "utilize[s] a logical and easy-to-apply method" that "permits the nondiscriminatory calculation of exit fees in municipalization cases."[55] While Niagara Mohawk's simplistic methodology may be easy to apply, it is wholly illogical and inconsistent with its treatment of avoided costs. Moreover, the effects of the methodology are inherently discriminatory and will result in a windfall to the Company.

a. Niagara Mohawk's Sliding Scale Approach Contradicts its Subsidy Argument.

Using a sliding scale approach, Niagara Mohawk estimates that if the City of Buffalo were to depart the system, the Company would avoid approximately 90 percent of the costs of serving that City. Because Lakewood is 1/40 the size of Buffalo, the Company contends that it would logically avoid a mere 2.3 percent of costs upon Lakewood's departure.[56]

Buffalo, however, is an urban area; therefore, it is likely that Buffalo's residential and small commercial consumers, similar to Lakewood's, are paying subsidies for rural

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[54] Niagara Mohawk Initial Brief at 12.

[55] Id. at 12-13.

[56] See id. at 14.

and industrial customers in the first place. For example, if the actual cost to serve Buffalo is $100 but the actual cost allocation through rates is $150, then Niagara Mohawk is, effectively, avoiding only 60 percent of the costs of serving Buffalo (0.90 times 100 divided by 150). Thus, pursuant to Niagara Mohawk's subsidy argument, 90 percent of the costs allocated to Buffalo could not be avoided because they were never actually incurred by Buffalo. The Buffalo analysis highlights the problems associated with the assumption that subsidies will be perpetuated in a competitive market.

b. Niagara Mohawk's Methodology Discriminates Against Small Communities.

Niagara Mohawk's sliding scale methodology is inherently biased in that it discriminates against smaller communities, such as Lakewood. While it supposedly captures economies of scale, it neglects to consider customer density (e.g., customers per pole mile) in the calculation. Moreover, as explained in Lakewood's Initial Brief, this methodology discriminates on the basis of a community's time of departure and geographic location.[57] Additionally, Niagara Mohawk's methodology fails to account for future customer growth and resulting cost savings, and discriminates against those customers that have long borne the brunt of subsidizing the Company's rural customers and more recently of subsidizing the Company's industrial customers.

i. Stranded Costs and Avoided Costs Must Be Accorded Consistent Treatment.

Although service-related distribution costs may be locational in nature, the cost allocation used to determine rates is not. With its proposed methodology, Niagara

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[57] See Lakewood Initial Brief at 41-44.

Mohawk attempts to have its proverbial "cake and eat it too." That is, the Company expects Lakewood to pay lost revenues on a "slice of the system" basis (or, as demonstrated supra, on a multiple of a "slice of the system" basis) while at the same time it would apportion avoided costs on a "locational basis."

The end result is that Lakewood would be required to pay a stranded cost amount far exceeding that which it caused on the system, but would not receive consistent treatment in an avoided cost calculation. Because there is a strong nexus between stranded costs "caused" by a customer's exit and the potential for "avoided costs" with that customer's departure, the two must be viewed consistently.

ii. Niagara Mohawk's Avoided Costs Should Be No Less than Its 1997 Avoided Costs Estimate.

Both Niagara Mohawk and Staff elect to disregard Niagara Mohawk's previous methodology, submitted to Lakewood in August 1997, which resulted in a determination that Lakewood's departure would lead to 76 percent of service-related avoided costs, because the methodology pre-dated the approval of PowerChoice and Rule 52.[58] Similarly, both parties fail to cite record evidence which shows that Niagara Mohawk previously estimated a much higher percentage of avoided costs upon Lakewood's departure.[59] It is interesting to note that a document entitled "Municipalization Stranded Costs Under PowerChoice Preparation of Wing Community Estimate," which was

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58 See Staff Initial Brief at 11; Niagara Mohawk Initial Brief at 17.

59 See Ex. 51 at 7 ($296,277 avoidable); Ex. 121 ($322,047 of $584,213 or 55 percent avoidable).

prepared on June 4, 1998, months after the approval of PowerChoice by the NYPSC, stated that 76 percent in avoided costs was attributable to Lakewood.[60]

Niagara Mohawk also argues that the Company's prior methodology failed to consider the size of the departing community and must therefore be discounted.[61] Staff maintains that "[i]t is only logical that...the probability or extent to which [costs] can be avoided increases with the size of the community exiting."[62] Staff concludes that "the use of [sic] methodology that completely ignores this effect is likely to overstate the costs avoided by the exit of a smaller community and should be rejected since it would shift costs to other stakeholders and thereby undermine the underlying intent of Rule 52."[63]

However, Niagara Mohawk's prior methodology did account for the size of the departing community. In response to the Village's request for a stranded cost estimate under the FERC formula, Niagara Mohawk forwarded a calculation to Lakewood, along with an explanation of the Company's methodology, on August 20, 1997. With regard to the avoided cost component, Niagara Mohawk assumed 76 percent avoided costs for distribution services and 10 percent for avoided administrative and general costs.[64]

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60 See Exhibit 63 at 3.

61 See Niagara Mohawk Initial Brief at 17.

62 Staff Initial Brief at 11.

63 Id.

64 See Ex. 64 at 1; Tr. at 573, ll. 4-9. Compare Ex. 64 at 2 (showing an estimated avoided cost of $269,452 in 2002) with Ex. 51 at 15 (showing a 2002 avoided (continued...)

In its accompanying explanatory statement, the Company stated that "[b]ecause of economies of scale in the provisions of these [distribution and customer service] services, and the geographic scope of Niagara Mohawk's services relative to the size of individual municipalities, service-related expense costs are not avoided on a proportional basis to lost sales or lost customers that result from municipalization."[65]

This 1997 letter stands in direct contradiction to Niagara Mohawk's current assertion that its prior methodology should be discounted because the size of the departing customer was somehow not taken into account. Use of this Niagara Mohawk methodology and elimination of subsidies would result in a distribution stranded cost amount of $1,342,861,[66] as opposed to Niagara Mohawk's current claim of $4,731,244[67] in distribution stranded costs (other than the Distribution and Street Lighting Assets). Given that the Company did consider community size and geographical location in its prior avoided cost methodology, that analysis cannot be discounted as the Company and Staff now urge.

Instead of using Niagara Mohawk's prior calculation of 76 percent of avoided costs, Niagara Mohawk now calculates avoided costs at 2.3 percent while Staff has

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[64](...continued)
cost of $267,705 assuming avoided distribution service costs of 76 percent and avoided A&G costs of 10 percent).

[65] Ex. 51 at 4.

[66] See Ex. 64 at 2.

[67] See Ex. 57 at 3.

increased its calculation from 20 to 23.5 percent.[68] Niagara Mohawk's claim that it can only avoid 2.3 percent of its Labor, Transportation, and Contractor Costs[69] if Lakewood departs is drastically understated. As noted by Lakewood witnesses, this theory would result in total system avoided costs of less than 14 percent if all of Niagara Mohawk's customers exited.[70] In other words, if Niagara Mohawk lost all of its customers it would have no distribution costs, but it would effectively recover 86 percent of its distribution service-related costs through exit fee payments because, according to Niagara Mohawk's theory, 86 percent of its distribution service-related costs would not have been "avoided."

Staff appropriately recognizes that Niagara Mohawk's avoided costs are understated. However, even Staff's 23.5 percent in avoided costs is far too conservative. It would allow Niagara Mohawk to retain 76.5 percent of Lakewood's payments in these categories, which would (1) reflect the continuation of subsidies (as discussed infra); (2) ignore future savings associated with load growth, as discussed in the prior subsection; and (3) be contrary to Niagara Mohawk's own prior avoided cost estimates.

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68 See Staff Initial Brief at 9-11.

69 See Niagara Mohawk Initial Brief at 14.

70 See Tr. at 572; Ex. 62 at 13.

As demonstrated in Lakewood's Initial Brief, Niagara Mohawk is capable of reducing its costs by consolidating operations when Lakewood departs.[74] Niagara Mohawk has reduced costs in that manner in the past[75] and would be encouraged to do so following Lakewood's departure if this Commission sent the proper signal. An appropriate benefit of competition is the reduction in costs which results when a utility is forced to streamline its operations in order to attract and retain customers. Allowing recovery of costs that a utility could avoid — if it chose to do so — merely encourages that utility to continue "business as usual" and avoid cost reductions it might otherwise make. From society's perspective, it is preferable that lost customers lead to cost cutting, which has the triple benefit of (1) avoiding excessive exit fees, thereby encouraging competition; (2) preventing cost-shifting; and (3) demonstrating means of general utility cost reductions. It would be detrimental to allow utilities to over recover claimed unavoidable distribution costs, because such over-recovery discourages cost reductions.

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[73](...continued)

[74] See Lakewood Initial Brief at 36-39.

[75] See Tr. at 15-16; Tr. at 229-230; Ex. 75.

iii. Niagara Mohawk's Methodology Does Not Consider Future Load Growth.

Based on Niagara Mohawk's projected customer growth, Lakewood's 2,000 customers will be replaced on the Niagara Mohawk system in approximately 2 months.[76] Niagara Mohawk takes issue with this assertion and claims that Lakewood "fails to recognize that the predicated one percent annual growth will occur on a systemwide basis."[77] In fact, however, a substantial portion of Niagara Mohawk's customers are located near Lakewood.[78] Assuming that only 20 percent of the Niagara Mohawk customers are located near Lakewood, it would take only 10 months for Niagara Mohawk to absorb the employees currently serving Lakewood.

Niagara Mohawk neglects to acknowledge that the Company's incremental costs to serve these new customers will be zero while, at the same time, the Company will receive revenues from those customers that will replace the revenues lost from the departing Lakewood customers. Niagara Mohawk will quickly absorb the departure of Lakewood because the Company will experience the benefit of increased revenues due to its projected load growth without the corresponding increase in costs. As customer growth occurs on the system, the revenues of the departing community are replaced.

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76 See Lakewood Initial Brief at 37.

77 Niagara Mohawk Initial Brief at 16.

78 For example, Buffalo, Tonawanda, North Tonawanda, and Niagara Falls alone constitute 13 percent of the system. See Ex. 62 at 1. Compare Ex. 62 with Ex. 102 at 1.

iv. Given Niagara Mohawk's High Non-Production O&M Costs, the Company Has the Opportunity to Realize Additional Savings.

In Lakewood's Initial Brief, the Village argued that because Niagara Mohawk's non-production O&M costs have historically been above average, the Company will have to implement cost savings in order to compete effectively in a deregulated environment.[79] These cost savings, in turn, would reduce the amount of distribution stranded costs to be recovered from Lakewood. The Company dismisses Lakewood's contention by arguing that "by the admission of the Village's own witnesses, Lakewood's 'national study' did not provide the proper basis for comparison."[80] However, as the Lakewood witnesses explained during cross-examination, the study in question is an appropriate benchmark, management level study which serves to compare Niagara Mohawk's O&M distribution costs with those of other utilities.[81]

Niagara Mohawk argues that without the "extraordinary storm costs" it faced in 1998, its distribution O&M costs are not above average.[82] In fact, in determining Lakewood's avoidable distribution O&M costs, the Company used 1997 expenses instead of 1998 figures under the rationale that the 1998 figures were distorted by

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79 See Lakewood Initial Brief at 44-45; Tr. at 565-568; Ex. 60.

80 Niagara Mohawk Initial Brief at 19.

81 See Tr. at 636.

82 See Niagara Mohawk Initial Brief at 19.

unusually high ice storm repair costs.[83] Niagara Mohawk certainly was not the only utility to experience increased costs due to the 1998 weather. As set forth in Lakewood's Initial Brief, the Village's witnesses calculated a long-term average in order to account for price fluctuations associated with severe weather, and Niagara Mohawk's costs were still above-average.[84] Thus, Niagara Mohawk may cut costs further since its distribution costs remain above average.

4. Certain Steps Must Be Taken Before Lakewood Can Enter into a Long-term Transmission Service Contract.

As stated previously, the Village plans to continue taking transmission service from the Company upon formation of a municipal utility system. Niagara Mohawk takes issue with what the Company deems Lakewood's "unwilling[ness] to enter a long-term contract for transmission service from Niagara Mohawk as a condition of receiving the transmission revenue credit."[85] Niagara Mohawk overlooks the fact that Lakewood will not require wholesale transmission service until it forms a municipal electric utility, an action which will require a Village vote. In addition, the Village must obtain a source of power supply (or make the decision to be served by the New York Independent system Operator) prior to requesting transmission service. Thus, it is not yet timely for Lakewood to sign a transmission contract.

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83 See Niagara Mohawk Initial Brief at 13. Lakewood's rates, however, presumably are sufficiently high to account for weather volatility.

84 See Lakewood Initial Brief at 44.

85 See Niagara Mohawk Initial Brief at 21.

5. Gross Receipt Taxes and Federal Income Taxes

Niagara Mohawk did not raise the issue of Gross Receipts Taxes ("GRTs") or Federal Income Taxes ("FITs") until its Rebuttal Testimony.[86] Rather than seeking 100 percent recovery of these claimed costs, Niagara Mohawk suggested that they be offset against a 1.3 percent annual increase in capital cost credits which the Company now agrees is appropriate.[87]

Subsequently, however, Niagara Mohawk has claimed that it must recover the full amount of GRT and use the 1.3 percent offset for FIT. Neither is appropriate.

First, Niagara Mohawk should not assess Lakewood any FIT. Niagara Mohawk contends that "[i]t is undisputed that Niagara Mohawk's federal income tax liability would exceed the impact of even the higher of the two escalation factors proposed for the Distribution and Street Lighting Capital Cost Credit."[88] Lakewood notes that the only reason this issue is "undisputed" is because it is impossible to know what the federal tax implications are until the final sale price is determined. For example, if the assets were sold at an amount equal to the net tax basis of the property, there would likely be no tax liability.

Second, to the extent any GRT is applicable, Niagara Mohawk should not be allowed to collect from Lakewood any amount in excess of 1.3 percent increase in the Distribution and Street Lighting Capital Cost Credit over the Period "Y." The

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86 See Tr. at 437-438.

87 See Tr. at 436-438.

88 Niagara Mohawk Initial Brief at 22.

Company's latest argument on GRT is that because compliance with Rule 32 of P.S.C. 207 is mandatory, it "would be illegal not to apply Rule 32 to a Rule 52 charge."[89] Thus, Niagara Mohawk is now seeking 100 percent recovery of any applicable GRT. As discussed in Lakewood's Initial Brief, Rule 32 is inapplicable to a Rule 52 determination because Rule 32 relates to service taken, while Rule 52 is a payment for no longer taking service.[90] Thus, Niagara Mohawk should be limited to collecting only an amount equal to the 1.3 percent increase in the Capital Cost Credit over the period "Y" for any combined FIT and GRT determined to be appropriate. However, as Lakewood discussed in its Initial Brief, no such charges are appropriate.[91]

Lakewood notes that it is difficult to comprehend how an issue that is now deemed so important could initially be left out of the Company's testimony as the result of an "oversight" and further, how the Company's justifications for its inclusion continue to change.

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[89] Niagara Mohawk Initial Brief at 22-23.

[90] See Lakewood Initial Brief at 48-49.

[91] See id. at 48-50. The parties have agreed to present a set of facts to the New York Department of Taxation and Finance to obtain a ruling on the applicability of the GRT.

6. The Proper Increase to Assume for Lakewood's Retail Prices Is 2 Percent.

In its Initial Brief, Staff disagrees with Niagara Mohawk's projected 2 percent increase in rates for both Lakewood and the total system.[92] Instead, Staff argues that the projected rate increases should be levelized at 1.5 percent per year.[93] The apparent basis of Staff's recommendation is that Niagara Mohawk's costs will be less and, therefore, its revenue requirement is lower.

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012

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92 See Staff Initial Brief at 7.

93 See id.

Thus, even after reduction for the Return-On the MRA, Niagara Mohawk's costs would still exceed Niagara Mohawk's projected revenues through 2005 and for 2007 and 2008. Niagara Mohawk's estimated 2 percent annual increase was based upon inflation, not upon projected costs. A 1.5 percent increase in revenues, as recommended by Staff,[95] would be insufficient to recover those costs.

In short, a 2 percent increase in costs is not unreasonable. A 2 percent rate increase could be necessary even if the adjustments made by Staff are accepted. To the extent that Niagara Mohawk recovers more revenues than costs with a 2 percent increase, those additional revenues can be used to offset stranded costs, shorten the stranded cost recovery period and hasten real competition.

B. "E"

1. Niagara Mohawk's Market Price of Power Fails to Consider the Increased Demand in 1999 and Is Thus Understated.

As explained more fully in Lakewood's Initial Brief, Niagara Mohawk's proposed market price of power is erroneous.[96] Niagara Mohawk bases its estimates on Mr. Meehan's flawed analysis which results in understated prices. For the reasons set forth herein and in Lakewood's Initial Brief, Niagara Mohawk's market price of power is unreasonable and should be rejected.

Evidence that Niagara Mohawk's figures are understated is illustrated by the fact that Mr. Meehan acknowledged that in performing his analysis, he failed to consider,

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[95] See Staff Initial Brief at 7-9.

[96] See Lakewood Initial Brief at 56-62.

inter alia, the fact that New York will require 1,000 MW in excess of that which he assumed. The 1999 New York Power Pool Load and Capacity Data Report, which was not considered by Mr. Meehan despite the fact that it had been available over two months prior to his testimony, provides a demand forecast for power in New York State showing an increase of 1,000 MW from the 1998 Report, relied on by Mr. Meehan. By relying upon a 1,000 MW lower demand, Mr. Meehan's analysis is understated. In fact, Mr. Meehan admitted that an increased demand of 1,000 MW would tend to increase the market price of power.[97] As Mr. Meehan admitted, because he failed to consider this additional 1,000 MW of demand, his analysis is understated. Therefore, it should be rejected.

2. Niagara Mohawk's Failure to Make Necessary Adjustments Regarding the Capital Costs of New Merchant Plants Produces Capital Costs Which are Understated.

a. The Company's Adjustments Are Incomplete and Produce Inaccurate Capital Costs.

When all factors are considered, Lakewood's estimate of $600/kW for new capital costs is both reasonable and conservative. With appropriate adjustments, the capital costs of the Athens, Independence and AES/Ironwood plants support the $600/kW assumption. Niagara Mohawk, in its Initial Brief, criticizes Lakewood's reliance on the Capital District Business Review, the source of Lakewood's $500/kW

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97 See Lakewood Brief at 60; Tr. 143, ll. 15-22 (admitting that increased demand would increase market price of power in 2001).

capital cost for the Athens plant and $972/kW capitol cost for the Millennium plant.[98] The Company fails to explain, however, how this publication, which was relied upon by Niagara Mohawk for property tax rates,[99] is trustworthy when relied on by Niagara Mohawk but not by Lakewood.

In its Initial Brief, Niagara Mohawk alleges that the reported costs for the Athens plant, as set forth in the data base upon which Niagara Mohawk relied, are lower than those reported by Capital District Business Review.[100] Based upon this alone, Niagara Mohawk contends that this publication is unreliable. However, as demonstrated in the Village's Initial Brief, the costs contained in the data base utilized by Niagara Mohawk are understated by 16-20 percent.[101] Increasing the data base cost of $463/KW by 16-20 percent would yield a total cost of $537-$556/KW, substantially above the number for the Athens plant used in Lakewood's testimony.

Niagara Mohawk also claims that the capital costs for Sithe Independence plant ("Sithe"), which entered into service in 1994, should be modified to account for the approximately 25 percent decrease in capital costs between the time that plant came into service and 1998, resulting in capital costs of $541/kW.[102] What Niagara Mohawk fails to take into account, however, is that as of 1998, capital costs increased by

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98 See Niagara Mohawk Initial Brief at 29; Ex. 19.

99 See Niagara Mohawk Initial Brief at 32.

100 See id. at 29.

101 See Lakewood's Initial Brief at 78-79.

102 See Niagara Mohawk Initial Brief at 28-29.

approximately 10-15 percent, thereby requiring further adjustment to the capital costs of the plant.[103] Thus, Niagara Mohawk only performed half of the calculation. The figure must be further adjusted to account for that increase. After the appropriate adjustments are made, the capital costs of Sithe would be $595/kW - $622/kW, consistent with Lakewood's position.

In addition, Niagara Mohawk asserts that the Millennium plant costs $556/kW according to a 1999 McGraw-Hill publication.[104] In fact, however, this amount must be adjusted by 16-20 percent based upon the flaws in the data base.[105] Making this adjustment, the Millennium plant would cost $645-$667.

With these adjustments, the average of the Athens, Independence and Millennium plants would be $592/kW-$615/kW, a range which comports with the $600/kW used by Lakewood's witnesses.

In an attempt to substantiate Mr. Meehan's construction cost assumption, Niagara Mohawk, in its Initial Brief, claims that the prospectus of the AES/Ironwood plant introduced on cross-examination supports the reasonableness of Mr. Meehan's testimony and even indicates that his assumption may be too high.[106] This argument should be rejected, however. The Village of Lakewood's witness, Mr. Filsinger, of PHB

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103 See Lakewood Initial Brief at 72a-73; Ex. 101 at 2; Ex. 89 at 20-22.

104 See Niagara Mohawk Initial Brief at 28.

105 See Lakewood Initial Brief at 73-79.

106 See Niagara Mohawk Initial Brief at 29-30.

Hagler Bailly, the market expert on the Ironwood project,[107] testified that Mr. Meehan's $550/kW figure for greenfield plants is not representative of New York State.[108] Further, as stated by Mr. Filsinger, the Ironwood prospectus shows that AES made equity contributions but it does not indicate whether any other entity also made such contributions.[109]

Significantly, Mr. Meehan's $507/kW estimate with regard to the Ironwood plant fails to take into account the fact that the plant is located in Pennsylvania and thus costs must be adjusted to provide for transmission of such power to New York. Wheeling charges will increase the cost in New York State, as explained in Lakewood's Initial Brief.[110] In the case of Ironwood, the PJM long-term firm point-to-point transmission service charge for deliveries at the border of the control area is $20.758/kW per year.[111] Over a period of 30 years, this additional sum would be equivalent to $205/kW (assuming a 9 percent cost of capital), without considering tariff increases. With this wheeling charge, the Ironwood plant would cost New York ratepayers the equivalent of $712/kW.

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107 See Ex. 88 at 21-23.

108 See Tr. at 579.

109 See Tr. at 634.

110 See Lakewood Initial Brief at 79-80.

111 See PJM Open Access Transmission Tariff, Third Revised Sheet No. 84, Schedule 7.

In fact, the Ironwood plant is unlikely to be used in New York State, both because its total capacity cost (including transmission) is too high and because it is likely to be needed in the PJM system. As Mr. Meehan stated in his direct testimony: "PJM has a capacity need date similar to NYS and . . . will not have a significant influence on the NYS capacity market."[112]

b. Niagara Mohawk Erroneously Omitted Significant Costs From Its Analysis of Capital Costs of New Units.

As explained in Lakewood's Initial Brief, the understated capital costs in the data base used by Mr. Meehan are likely due to the exclusion of many items.[113] Mr. Meehan admitted that certain items should be included in the costs for the plants in the data base, yet had no knowledge regarding whether these items were in fact included in the data he used for his own analysis. He stated:

> Well, I don't know the extent to which [these costs] are included . . . you're right, we've used generic costs. . . it's not a detailed estimate of the costs, so I can't tell the extent to which they are included. The costs are not really built up with that level of detail.[114]

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112 Tr. at 57.

113 See Lakewood Initial Brief at 68-69 and 77-78. For brownfield plants, these items include AFUDC, land and land rights, financing, distillate tanks, insurance, interest during construction, infrastructure incremental to the development of the plant, Nox control, closing costs, transmission improvements, gas pipeline extensions, and workman's compensation. For greenfield plants, these items include cooling tower technology, cost of financing, switchgear, gas pipelines, distillate tanks, electric transmission, infrastructure incremental to the development of the plant, Nox control technology, and closing costs.

114 See; Tr. at 93-95; see also Lakewood Initial Brief at 77-78.

Similarly, Mr. Meehan conceded that the capital costs reported in the data base upon which he relied should have included such costs as costs of elevation, distance from gas, transmission rates based upon constraints and transmission and connection costs. He confessed, however, that he did not specifically analyze such items but rather only used "generic units."[115]

Niagara Mohawk's reliance on a generic analysis as evidence of specific costs, the inclusion of which Niagara Mohawk is not even able to verify, is unreasonable. Based on the fact that the data base relied upon by Mr. Meehan is incomplete for purposes of the relevant analysis, as demonstrated more fully in Lakewood's Initial Brief, it would be appropriate to increase the average cost shown in that table by 16-20 percent.[116]

Gas Turbine World, a source upon which Niagara Mohawk relies, illustrates that non-equipment costs can be significant and thus exclusion of such costs, as erroneously done by Mr. Meehan, may result in costs which are significantly understated.[117] Actual equipment prices and the range of services and labor prices are shown in Gas Turbine World with regard to a plant located at John F. Kennedy International Airport in New York. That publication, considered reliable by Mr. Meehan,

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115 See Tr. at 97-98.

116 See Lakewood Initial Brief at 78-79.

117 See Ex. 89 at 22.

shows total costs for this plant ranging from $735/kW to $1245/kW.[118] This plant is a cogeneration plant which has some additional costs associated with the heat recovery steam generator and balance of plant equipment. While not all costs in these categories are related to the cogeneration part of the plant, even if all costs in these categories are excluded, total costs of the plant would be in the range of $618/kW to $1,131/kW.

In addition, Mr. Meehan failed to include the value of land and land rights in his estimate. The brownfield costs of $450/kW used by Mr. Meehan are understated, as discussed more fully in Lakewood's Initial Brief.[119] In fact, Mr. Meehan admitted that the $450/kW figure is low because he failed to take into account land and land rights. Mr. Meehan recognized that the land has an independent value and that a brownfield site could be desirable even if it contained an uneconomic unit in order to gain access to the advantages of the site.[120]

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118 This is derived by dividing $78,600,000 - $133,600,000 by the 107 kW size of the plant.

119 See Lakewood's Initial Brief at 68-70.

120 See Tr. at 130.

3. Mr. Meehan's Understated Capital Costs Could Be Due, in Part, to His Lack of Experience Regarding Merchant Plant Financing.

As discussed in Lakewood's Initial Brief,[121] Mr. Meehan possesses no experience with regard to merchant plant financing.[122] In contrast, Mr. Filsinger, who appeared on behalf of the Village, has extensive experience in this regard. Mr. Filsinger has (1) served as an independent engineer for the financial community, preparing detailed appraisals of electric generation and transmission property,[123] (2) provided management consulting services for various clients, including investment banks, bank lenders, and power project developers; and (3) negotiated credit terms for merchant power facilities.[124] Significantly, Mr. Filsinger has market pricing experience with actual plants planned in New York. Mr. Meehan admitted that his analysis contained "generic units" for which he could not state with any degree of certainty whether certain costs essential to an accurate representation of costs of a new combined cycle unit were included, thus invalidating his own figures. To the contrary, Mr. Filsinger, based on his substantial experience, including experience in New York

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121 See Lakewood's Initial Brief at 63-64; Tr. at 77-78.

122 See id.

123 See Tr. at 527.

124 See Ex. 48 at 1-2.

State, believes that the estimate of $600/kW is an accurate representation of the cost of combined cycle units in New York State.[125]

For the reasons set forth above, as well as in Lakewood's Initial Brief, Niagara Mohawk's proposed capital cost of a new merchant plant is unreasonable and should be rejected. The capital cost proposed and fully explained by the Lakewood witnesses who, contrary to Niagara Mohawk, can ascertain the costs analyzed, is more accurate and should be accepted.

4. The Manner in Which Niagara Mohawk Calculated O&M Costs for New Plants, and the Resulting Costs, are Incorrect.

In conducting his analysis, Mr. Meehan did not consider variable O&M costs of a combined cycle unit. Instead, he included both fixed and variable O&M costs in a single amount.[126] By lumping variable and fixed O&M costs, Mr. Meehan has artificially reduced energy costs, thereby erroneously skewing his PROMOD model's anticipated dispatch of those plants.[127] As a result, energy costs projected by Mr. Meehan are understated.

Niagara Mohawk's statement that Lakewood has not questioned the Company's utilization of PROMOD in order to project long-term energy prices is imprecise.[128] While the Village does not question the use of PROMOD itself, Lakewood does

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125 See Tr. at 649.

126 See Tr. at 73.

127 See Tr. at 582.

128 See Niagara Mohawk Initial Brief at 26.

challenge the Company's input into PROMOD. The PROMOD results are only as reliable as the information inputted into the program. As illustrated above, Mr. Meehan's failure to identify variable O&M costs results in erroneous PROMOD inputs which in turn results in distorted energy costs.

Niagara Mohawk rejects Lakewood's estimate of $27.30/kW in O&M costs claiming that this estimate "is substantially higher [than Mr. Meehan's estimate], and is not supported by any independent evidence."[129] The Company ignores the fact that Mr. Meehan himself admitted that Lakewood's estimate is reasonable[130] and that Lakewood witnesses have hands-on experience with merchant power plants while Mr. Meehan does not.[131] Based upon the foregoing and Lakewood's Initial Brief,[132] it is appropriate to use Lakewood's O&M costs.

5. Property Taxes Proposed by the Company Are Unreasonable.

a. Property Taxes of New Market Entrants Should be Based Solely on Greenfield Plants.

Niagara Mohawk is critical of Lakewood's application of the same property tax rate to greenfield and brownfield plants alike.[133] As demonstrated in Lakewood's Initial

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129 Id. at 31.

130 See Tr. at 73.

131 See Tr. at 649.

132 See Lakewood Initial Brief at 85-86.

133 See Niagara Mohawk Initial Brief at 31.

Brief,[134] a $12/kW property tax for all plants is appropriate and conservative. To the extent there is any validity to the argument that property taxes are higher for greenfield plants, market prices should be based upon greenfield costs alone, as explained fully in Lakewood's Initial Brief.[135] By definition, merchant plants do not rely on long-term contracts.[136] Lending institutions and equity investors, therefore, must rely upon the anticipated market sales from those plants to justify financing.[137] If market prices are too low to support a greenfield project, then no such projects would be built. As a result, if the market anticipates a mix of greenfield and brownfield plants, it is the greenfield plant that establishes the market price of power, not the brownfield plant.

Thus, assumed property taxes of new market entrants should be based upon greenfield plants. It is irrelevant whether lower property taxes may be applicable to brownfield plants because the market must be able to support the higher priced plant — and the higher property taxes — in order to obtain financing.

b. Niagara Mohawk's Property Tax Rates Are Undervalued.

As established in Lakewood's Initial Brief, a property tax rate of 2 percent of the recommended $600/kW capital costs, or $12/kW, is appropriate in calculating market

134 Lakewood Initial Brief at 80-85.

135 See id. at 64-67.

136 See Tr. at 80.

137 See id. at 81, ll. 4-5.

prices.[138] This $12/kW rate is particularly conservative in light of the fact that, in 1997, the average property tax Niagara Mohawk paid for its steam plants was $22.50/kW.[139] Niagara Mohawk proposes a lower property tax based upon information relating to plants locating in areas wanting such power plants when, in fact, new plants in New York are locating in high tax jurisdictions which do no want such plants.

In an attempt to justify its understated property tax rates, Niagara Mohawk cites the Reeb Report in support of its contention that new merchant plants are analogous to plants of independent power producers ("IPPs") which allegedly have relatively low property tax rates.[140] Mr. Meehan undermined this position himself, however, in testifying that the Reeb Report describes plants which were not contemplated in Mr. Meehan's mix of future facilities, as explained more fully in Lakewood's Initial Brief.[141] The Reeb Report predated divestiture of existing New York utilities, and its analysis is based primarily on cogeneration facilities and other Qualified Facilities under the Public Utilities Regulatory Policy Act, a category which Mr. Meehan does not believe will be predominant in the future.

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138 See Lakewood's Initial Brief at 80-85.

139 See Opinion No. 98-8 at 42.

140 See Niagara Mohawk Initial Brief at 31-32.

141 See Lakewood Initial Brief at 81-82.

In addition, the Company claims that several new plants have negotiated or are currently negotiating with their host jurisdictions property tax concessions.[142]

The IDAs are seeking money in furtherance of economic development. Mr. Meehan stated that he does not expect future greenfield or brownfield plants to be IDA projects.[144]

Further, Mr. Meehan's plans call for 2160 of 3600 MW to be brownfield sites in areas which he admitted are generally opposed to the construction of new power plants.[145] It is thus unintelligible how Niagara Mohawk, disregarding the testimony of its own witness, can claim on brief that new merchant plants will enjoy relatively low property tax rates "as a result of concessions by communities hoping to lure them."[146] Very simply, the new power plants are being located in downstate New York because of transmission congestion concerns. Downstate New York has a "not in my backyard"

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142 See Niagara Mohawk Initial Brief at 32.

144 See Lakewood Initial Brief at 81-83; Ex. 13 at iv.

145 See Tr. at 140.

146 Niagara Mohawk Initial Brief at 32.

mentality. Therefore, property tax concessions are unlikely to be granted to new powerplants.

6. Plant Retirements

a. The Assumed Retirement of the East River Plant Is Justified.

As demonstrated in Lakewood's Initial Brief,[147] Lakewood determined that the assumed retirement of the East River powerplant was appropriate. Niagara Mohawk, in criticizing this determination, has mischaracterized the facts with regard to its analysis of the East River plant.

Niagara Mohawk claims that the Lakewood Panel did not consider whether that plant produces steam; yet, the Company failed to produce any evidence supporting its belief that the East River plant does produce steam and, in fact, the evidence in the record suggests the contrary. Niagara Mohawk confuses the definition of a "dual steam unit" with that of a "steam selling unit" in intimating that because the East River plant is a dual steam facility, it necessarily follows that the plant is currently producing steam for sale separate from electricity.[148] Such is not the case however. Mr. Filsinger stated that to his knowledge, the East River plant is not selling steam at the present time.[149] In addition, Mr. Meehan assumed the retirement of this unit in his own testimony.[150]

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147 See Lakewood's Initial Brief at 55-56.

148 See Tr. at 622.

149 See id.

150 See Ex. 6; Tr. at 59.

b. **Lakewood Correctly Avers That System Reliability Will Not Be Affected Based on its Assumed Plant Retirements.**

Niagara Mohawk claims that the Lakewood Panel cited no evidence to support its opinion that retirement of the East River plant would not affect system reliability.[151] However, Niagara Mohawk, which originally assumed retirement of the East River plant,[152] cites no evidence that such retirement would adversely affect reliability. There is no evidence in the record which would support such a claim. Mr. Filsinger, who has significant experience in the relevant geographic area, stated that market studies he has performed regarding that area consistently show the retirement of the East River plant.[153] Further, "there are other facilities planned in the New York area that would take care of any reliability problems that are being currently planned by several developers in that area."[154] As noted in Lakewood's Initial Brief, additional facilities are being developed in order to alleviate transmission constraints, thereby combating reliability concerns.[155]

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151 See Niagara Mohawk Initial Brief at 34.

152 See Ex. 6.

153 See Tr. at 623-624.

154 Tr. at 624.

155 See Lakewood Initial Brief at 59-60.

c. The Use of Western New York Prices for Plants Located in Eastern New York Is Immaterial Because Locational Differences in Prices Will Disappear.

The Company insinuates that because Lakewood priced the power produced by the East River plant, which is located in New York City, and the Indian Point 3 plant, which is located in Southeastern New York, at Mr. Meehan's forecasted prices for Western New York, Lakewood's analysis is flawed.[156] This is not the case however. As noted by the Lakewood Panel, the energy prices vary slightly between the Eastern and Western regions of New York, and will be insignificant in the long-term.[157] Additionally, Mr. Meehan recognized: "As capacity is added and developed in Southeastern New York, these differences will diminish, and by 2006 will become negligible."[158] Both Lakewood and Mr. Meehan assumed retirement of East River Units 6 and 7 and Indian Point 3 in 2004.[159] Thus, the fact that Lakewood priced the power produced by the plants at Western New York prices is immaterial because, as Niagara Mohawk agrees, locational differences will disappear, thereby minimizing the price differential.

Further, the Lakewood Panel projected revenues for these plants utilizing "E" as proposed by the Village – a figure substantially higher than Niagara Mohawk's figure.[160] Based upon this higher figure, the Lakewood Panel determined that the East River and

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156 See Niagara Mohawk Initial Brief at 34.

157 See Tr. at 649.

158 Tr. at 51.

159 See Tr. at 603-04.

160 See id.

Indian Point 3 plants are likely to lose money consistently during the period from 2000 to 2007. Had Lakewood instead performed this analysis using Mr. Meehan's lower figures, as advocated by Niagara Mohawk, the results would have indicated that these plants are even less economical, thus providing even greater confirmation regarding their retirement.

d. Indian Point 3 Is Not Economic.

Niagara Mohawk points out that the average capacity factor for the Indian Point 3 plant of 44 percent projected by the Lakewood Panel "produces a capacity factor so low as to ensure, by itself, that no nuclear plant could be economic."[161] The Company correctly notes that this result demonstrates that Indian Point 3 is not economic. The Lakewood Panel does not expect that any nuclear plant would be economic if it had a capacity factor of only 44 percent on a long-term basis.[162] In order to examine the effects of possible changes in the dispatch of plants, the Lakewood Panel performed a sensitivity analysis, calculating the profitability of plants if operated at a load factor 10 percentage points higher.[163] The results of this analysis demonstrated that the plants still exhibited substantially negative profits, thus confirming Lakewood's expectation. Niagara Mohawk ignores this sensitivity analysis.

Additionally, Niagara Mohawk claims that it is reasonable to infer that Entergy, Inc. would not have made an unsolicited approach to the New York Power Authority

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161 Niagara Mohawk Initial Brief at 34.

162 See Tr. at 617-618.

163 See Tr. at 604.

with regard to the possibility of purchasing Indian Point 3 if it did not believe that the plant could be operated economically on a going-forward basis.[164] The Company, though, fails to cite to any information verifying its hunch. However, the Lakewood Panel, based upon its extensive analysis of all nuclear plants throughout the United States, concluded that Indian Point 3 is a candidate for retirement.[165] It made that conclusion after considering Entergy's proposal to purchase the plant.[166] According to the Lakewood Panel, "it would take a tremendous amount of capital to get this plant up to par as far as performance, likely above that of a new entrant."[167] In addition, Entergy, which is involved only in negotiations and has not purchased the plant, may be seeking to purchase Indian Point 3 for the site. As acknowledged by Mr. Meehan, an uneconomic brownfield plant may be valuable merely for the purpose of gaining access to the site.[168] Thus, contrary to Niagara Mohawk's argument, it is not necessarily reasonable to infer that Indian Point 3 is economic by virtue of the fact that Entergy has expressed interest in its purchase.

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164 See Niagara Mohawk Initial Brief at 34-35.

165 See Tr. at 619.

166 See id.

167 See id.

168 See Tr. at 130.

7. Costs of New Plants Should Be Computed on a Levelized Nominal Charge Basis.

As explained more fully in Lakewood's Initial Brief, capital costs should be measured on a levelized fixed charge basis.[169] While Niagara Mohawk advocates the use of a real levelized carrying charge, this methodology is not best suited for the current deregulated market. Merchant power plants lack firm long-term contracts and, thus, in an era of deregulation, there is no guarantee of sufficient revenue to cover the costs of such plants. Mr. Meehan, who possesses no experience regarding financing of merchant power plants, admitted that banks want their money early in the process, rather than in the later stages.[170] In light of the above, and as explained more fully in Lakewood's Initial Brief, a levelized fixed charge is more appropriate.[171]

Niagara Mohawk's accusation that Lakewood "compounded the effect of using a nominal levelized carrying charge by inflating the capital costs to which it applies each year,"[172] is inaccurate. The Lakewood Panel and Mr. Meehan both appropriately escalated the capacity charge to reflect the increase in capital costs due to inflation. The distinguishing feature is that the capital costs in the method employed by Lakewood remain level over the term, while Niagara Mohawk's method starts with lower carrying charges in earlier years which increase over time. Niagara Mohawk's

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169 See Lakewood's Initial Brief at 86-89.

170 See id. at 88; and Tr. at 85.

171 See Lakewood's Initial Brief at 88-89.

172 Niagara Mohawk Initial Brief at 36-37.

methodology is not sensitive to the current market because in later years, when the plant is incurring capital costs equivalent to those of a new combined cycle unit, the vintage plant would be producing at a lower capacity factor than the new plant; yet its capital costs would be equivalent. Consequently, at the end of the plant's life, rather than its recovery increasing, it would be unable to recover sufficient funds for its debt and equity financing.

A levelized fixed charge provides for debt recovery in a more expeditious manner than the economic carrying charge, which, as recognized by Mr. Meehan, is preferred by lenders.[173] For the reasons set forth above and in Lakewood's Initial Brief, costs of new plants should be computed on a levelized nominal charge basis.

C. Marketing Option

The marketing option in Rule 52 is intended to serve as a check on the validity of market price estimates, as explained fully in Lakewood's Initial Brief.[174] As construed and implemented by Niagara Mohawk in this case, however, the marketing option does not serve its intended purpose. More specifically, Niagara Mohawk proposes to take no risk that its "E" is too low because it is willing to market to the Village only that portion of its portfolio that is hedged against risk.[175] The Company claims that the objective of the marketing option is to "mitigate any incentive to under-estimate market

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173 See Tr. at 85.

174 See Lakewood Initial Brief at 90-94.

175 See Niagara Mohawk Initial Brief at 23-24.

prices;"[176] yet, pursuant to its application of the marketing option, it has no risks and, thus, no incentive to under-estimate market prices.

Niagara Mohawk has every reason to increase stranded cost obligations by grossly understating "E" and no reason to be conservative in its estimate of market costs. The marketing option as construed by Niagara Mohawk provides no protection to a departing customer. The Company should be required to provide Lakewood 100 percent of its load at the "E" rate and its refusal to do so should be considered in determining the reasonableness of its proposed "E."

D. "Y"

1. Projected Growth

Both Lakewood and Niagara Mohawk agree that the appropriate projected growth rate to assume for Lakewood's, as well s the total system's retail rates is 2 percent.[177] This amount is less than the projected increase in inflation.[178] As Niagara Mohawk notes, it is difficult to predict revenue requirements far into the future, and a 2 percent growth rate proxy is reasonable.[179]

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[176] Niagara Mohawk Initial Brief at 24.

[177] See Section III.A(6) supra.

[178] See Niagara Mohawk Initial Brief at 23.

[179] See Tr. at 274. Lakewood notes for the record that Niagara Mohawk appears to have an uncorrected typographic error on page 44 of its Initial Brief in the first full paragraph, third line, where it attributes an annual increase of 3 percent to transmission and distribution costs. It is Lakewood's understanding that the annual increase is 1.3 percent, and Lakewood has prepared its brief with that assumption.

2. Lakewood's Production-Only Analysis Does Not Change its 7.5 Year "Y."

"Y" is the number of years it would take Niagara Mohawk to recover its stranded costs. Although Lakewood uses the same methodology, with certain adjustments, to determine "Y" as that used by Niagara Mohawk, Lakewood calculates a 7.5 year recovery period as opposed to Niagara Mohawk's recovery period of 11.5 years.[180] Staff however, rejects Lakewood's 7.5 year calculation because "it applies only to generation related stranded costs."[181] At the same time, however, Staff concedes that the methodology used by Niagara Mohawk is reasonable.[182]

The fact that Lakewood performed a production-only analysis of the exit fee should not change the approach to calculating "Y."

In fact, the only other way of calculating "Y" consistently with Niagara Mohawk's method would be to eliminate transmission and distribution costs from both retail

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180 <u>See</u> Tr. at 550.

181 Staff Initial Brief at 16-17.

182 <u>See</u> <u>id</u>. at 17.

183 As demonstrated in Lakewood's Initial Brief at 96-97, the more appropriate revenues to use would be Lakewood specific revenues as a proxy for a Lakewood-only "Y".

revenues and retail costs. The result would be the same, as illustrated by the following table which takes Lakewood's calculation of "Y" and eliminates transmission and distribution costs and revenues:

Niagara Mohawk Power Corporation
Village of Lakewood Exit Fee Calculation
Case No. 99-E-0681

Calculation of Production-Only "Y"
(dollars in millions)

Description		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total System Revenue Forecast	[1]	2,865	2,950	3,048	3,136	3,227	3,314	3,403	3,496	3,589	3,678
Less:											
Distribution Costs	[2]	867	874	893	914	939	944	953	970	984	996
Transmission Costs	[2]	205	207	215	225	236	239	244	254	264	273
Production Revenue Forecast		1,793	1,869	1,940	1,997	2,052	2,131	2,206	2,272	2,341	2,409
Total System Cost Forecast	[1]	2,865	2,955	3,140	3,379	3,428	3,422	3,479	3,511	3,438	3,522
Less:											
Distribution Costs	[2]	867	874	893	914	939	944	953	970	984	996
Transmission Costs	[2]	205	207	215	225	236	239	244	254	264	273
Production Cost Forecast		1,793	1,874	2,032	2,240	2,253	2,239	2,282	2,287	2,190	2,253
Lakewood's Adjustment to Stranded Costs	[1]	(179)	(232)	(153)	(323)	(253)	(181)	(152)	(231)	(430)	(327)
Adjusted Production Cost Forecast		1,614	1,642	1,879	1,917	2,000	2,058	2,130	2,056	1,760	1,926
Retail Revenue-Retail Cost		179	227	61	80	52	73	76	216	581	483
Present Value		171	199	49	59	35	45	43	113	279	213
Cumulative Present Value		171	371	419	478	513	559	602	715	994	1,206
Annual Production-Related Strandable Costs		625	593	740	695	729	728	726	559	239	332
Present Value		599	521	596	514	494	453	415	293	115	146
Cumulative Present Value		599	1,120	1,716	2,230	2,725	3,178	3,592	3,885	4,000	4,146
Present Value Remaining Strandable Costs		3,874	3,353	2,757	2,243	1,749	1,296	881	588	473	327
Determination of Y		(3,703)	(2,983)	(2,338)	(1,765)	(1,235)	(737)	(279)	126	520	879
Y		7.5									

[1] See Exhibit___49C, Sheet 3 of 10.
[2] See Exhibit___30C, Sheet 2 and 3.

The addition of transmission and distribution-related stranded costs in an exit fee is irrelevant to a determination of the "Y" recovery period pursuant to the Company's proposed methodology. Because Staff acknowledges that the underlying methodology is sound, Staff's argument against Lakewood's calculation should be disregarded.

3. Use of the Appropriate Market Value of Energy Reduces Power Supply Stranded Costs.

Niagara Mohawk voluntarily entered into transition power contracts ("TPCs") with the purchasers of its fossil, hydroelectric and nuclear powerplants. Despite the fact that Niagara Mohawk sold its fossil-fueled plants below book value, an unusual feat in a time in which most entities have sold fossil plants at multiples of book value, it agreed to TPCs with purchasers of those fossil-fueled plants which, Niagara Mohawk claims, are at above market rates. As discussed in Lakewood's Initial Brief, Niagara Mohawk's voluntary contract for repurchase of power from divested plants help form the market for power purchases.[182] Thus, these purchases cannot be deemed to be "above market" merely because Niagara Mohawk considers them to be.

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182 See Lakewood Initial Brief at 57-59.

4. Lakewood's Revenue Forecast Should Be Used for a Lakewood-Specific "Y".

As indicated in Lakewood's Initial Brief,[184] a Lakewood-specific "Y" should be determined using Lakewood's rates rather than system rates. Otherwise, all determinations of "Y" would be on a system, rather than a case-specific basis.

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184 See Lakewood Initial Brief at 94-97.

CONCLUSION

WHEREFORE, for the reasons set forth above, and those in Lakewood's Initial Brief, Lakewood respectfully requests that the Presiding Judge find that a Rule 52 exit fee should be calculated on a production-only basis where the community (1) plans to purchase the Utility's distribution system and (2) will continue to take transmission service from the Company. In addition, Lakewood requests that it not be required to subsidize other customers through its exit fee, that avoided cost assumptions consider system load growth and the Company's ability to streamline costs, that any calculation of "E" should reflect the real-world costs and financing situation in the competitive market, and calculation of "Y" be based upon the rates for the departing customers.

Respectfully submitted,

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Date: January 14, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding by electronic transmission, hand delivery or first class mail. Dated at Washington, D.C., this 14th day of January, 2000.

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