

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission to Investigate Potential Electric Delivery Rate Disincentives Against the Promotion of Energy Efficiency, Renewable Technologies and Distributed Generation.

Case 03-E-0640

In the Matter of the Investigation of Potential Gas Delivery Rate Disincentives Against the Promotion of Energy Efficiency, Renewable Technologies and Distributed Generation

Case 06-G-0746

INITIAL COMMENTS OF THE
NEW YORK STATE CONSUMER PROTECTION BOARD

Teresa A. Santiago
Chairperson and Executive Director

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Dated: August 28, 2006
Albany, New York

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In 2003, the Public Service Commission (“PSC” or “Commission”) instituted a proceeding to determine if disincentives to utility promotion of energy efficiency and load reduction efforts exist, and if so, to identify appropriate remedies.¹ The New York State Consumer Protection Board (“CPB”) and other parties filed two rounds of comments regarding those issues in 2003.² The PSC took no action in the case at that time, but in June 2006, it invited comments to update the record and expand the inquiry to include natural gas.³ The CPB submits these comments in response to that Notice.

In our comments in 2003, the CPB emphasized the importance of energy conservation and load reduction activities and the need to ensure that utilities do not contravene such efforts. We expressed concerns, however, with some remedial

¹ Case 03-E-0640, Order Instituting Proceeding, May 2, 2003.

² See, Comments of the New York State Consumer Protection Board, October 24, 2003; Reply Comments of the New York State Consumer Protection Board, November 21, 2003.

³ Cases 03-E-0640, 06-G-0746, Notice Soliciting Comments, June 26, 2006 (“2006 Notice”).

measures proposed to address any remaining utility disincentives to promote energy efficiency objectives. We explained that shifting recovery of delivery revenue from volumetric to fixed charges would be counterproductive, since it would reduce the incentive for consumers to conserve energy. We also identified several concerns with the design and implementation of suggested revenue decoupling measures, which are intended to sever the current link between the volume of utility sales and profits.

In the three years since those comments were filed, there have been several noteworthy developments. First, electricity and natural gas demand continues to increase. In the last two years alone, the statewide demand for electricity broke a record four times, most recently at 33,939 MW on August 2, 2006. That record is 9.54% above the peak load record set on August 9, 2001.⁴ Second, some conservation efforts have not achieved anticipated results. For example, the New York State Energy Research and Development Authority (“NYSERDA”) recently concluded that it “will be unable to achieve the 150 MW demand reduction goal” in the current rate plan for Consolidated Edison Company of New York, Inc. (“Con Edison”).⁵ Third, the impact of high electricity demand has led to considerable strain on utilities’ distribution networks, resulting in numerous disruptions including the recent lengthy outage in Con Edison’s Long Island City network. Fourth, both natural gas and electricity commodity prices reached record highs, and for the foreseeable future are expected to remain far above their levels in 2003.

⁴ New York Independent System Operator, News Release, Heat Wave Drives Another Record for Power Usage, August 2, 2006.

⁵ Case 04-E-0572, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Electric Service, Petition for Modification, filed by NYSERDA, August 11, 2006, p. 1.

These factors have substantially increased consumers' energy bills and have heightened awareness of the need to assure electric system reliability. The CPB strongly urges the PSC not to underestimate the effect of these events on New Yorkers, including residential and businesses who are having difficulty paying their energy bills and who have suffered the hardship of frequent and long system outages.

In view of these new circumstances, the CPB commends the PSC for taking a fresh look at the issue of utility disincentives discouraging promotion of energy efficiency, renewable technologies and distributed generation. New York State has worked hard to promote conservation and ratepayers pay hundreds of millions of dollars through the System Benefits Charge each year for this purpose. Utilities can and should be vital partners in these conservation and load reduction efforts. Currently, however, utilities may be penalized at the bottom line for reductions in customer usage and have a strong incentive to promote sales between rate cases. Their current incentive to offset these conservation and load reduction accomplishments should be removed.

Cost effective energy conservation and load reduction will assist in reducing overall demand for electricity and natural gas and create downward pressure on electricity and natural gas prices, thereby benefiting all consumers. It can also help reduce negative environmental impacts and enhance the reliability of the energy transmission and delivery systems. In the CPB's view, cost effective conservation and load reduction provides one of the best opportunities to place downward pressure on energy prices over the next few years.

To help achieve these objectives, the CPB recommends that the Commission approve the implementation of a well-designed revenue decoupling mechanism (“RDM”) for energy utilities in New York State. If designed and implemented as we recommend, such a mechanism would be in the public interest because it would further energy efficiency and load reduction, thereby placing downward pressure on energy prices, enhancing system reliability and reducing environmental impacts.

In Point I, we explain that suggestions by the Commission to shift recovery from volumetric to fixed charges would be counterproductive, since they would diminish the incentive for consumers to conserve energy. In Point II, we further explain that a well-designed RDM would be in consumers’ interest. In Point III, we identify several of the most important issues that must be addressed in the design and implementation of this mechanism. We also briefly recommend a process that the Commission should adopt for the remainder of this proceeding.

I. SHIFTING RECOVERY OF REVENUE FROM VOLUMETRIC TO FIXED CHARGES WOULD BE COUNTERPRODUCTIVE.

Many state agencies have been working diligently to provide consumers tools to manage their energy bills, through energy efficiency measures and load reduction. The intent of these proceedings is to address the conservation incentives for energy utilities, in particular, to determine whether energy utilities have a disincentive to promote energy efficiency and if so, to consider the development and implementation of remedies. The 2006 Notice suggests repeatedly that any such disincentive to utility promotion of energy efficiency could be corrected by further shifting recovery of utility revenue from

volumetric to fixed charges. From its opening sentence citing “progress” since 2003 in increasing fixed charges at the expense of volumetric charges, to many of the questions in that Notice, the PSC seems to be under the impression that shifting recovery of utility revenue to fixed charges is the preferred remedy to address this utility disincentive.⁶

That notion is incorrect. It neglects the fundamental fact that consumers respond to price signals, so that a shift to fixed charges reduces consumers’ responsiveness to energy price increases. Even if a shift from volumetric to fixed delivery charges reduces the disincentive for utilities to engage in conservation, it would nevertheless reduce the incentive for consumers to engage in conservation. Therefore, such an approach would be counterproductive, particularly in view of the efforts by NYSERDA and others to encourage and increase energy conservation and the vast sums of money spent by consumers on these efforts.

Moreover, a further shift from volumetric to fixed delivery rates may not be warranted for public policy reasons, since it would result in higher and unavoidable charges for customers with relatively low energy use, particularly low income consumers. The Commission has nevertheless increased the proportion of delivery revenue that is recovered from fixed charges in recent years, in an effort to design utility rates closer to what it understands to be utility costs. The PSC should also recognize that its policy diminishes consumers’ motivation to conserve energy.

⁶ 2006 Notice, pp 1-3, questions 1, 3, 4, 8.

II. A WELL-DESIGNED REVENUE DECOUPLING MECHANISM WOULD BE IN CONSUMERS' INTEREST.

The CPB supports a RDM that removes utilities' disincentives for the promotion of energy efficiency, renewable technologies and distributed generation while minimizing cost impacts on consumers. Such a mechanism should compensate utilities for profit losses attributable to utility efforts regarding such initiatives.

RDMs have received increased attention throughout the country since this proceeding was initiated. For example, the National Association of Regulatory Utility Commissioners recently adopted a "Resolution on Energy Efficiency and Innovative Rate Design" which says:

RESOLVED, that the National Association of Regulatory Utility Commissioners (NARUC)...encourages State commissions and other policy makers to review the rate designs they have previously approved to determine whether they should be reconsidered in order to implement innovative rate designs that will encourage energy conservation and energy efficiency that will assist in moderating natural gas demand and reducing upward pressure on natural gas prices...⁷

In addition, several states have adopted RDMs, including California and Maryland. Other states are considering such mechanisms, including New Jersey and Ohio.

A RDM should not, however, shift from utilities to consumers, the risk of profit losses resulting from other factors such as general economic downturns, a decline in the number of customers and conservation not attributable to utility activities. Utilities should continue to bear the risk of those changes between rate cases. To address utility disincentives for the promotion of energy efficiency, renewable technologies and

⁷ Adopted by the NARUC, November 16, 2005.

distributed generation, there is no reason to require consumers to bear the risk of unrelated factors.

The ability of utilities to recover the difference between target and actual net revenues, regardless of the reasons for the variance, was an unfortunate feature of the RDMs that the PSC adopted in the early 1990's. Those measures permitted utilities to recover most of their operating costs on a cost-plus basis, thereby eliminating consumers' most valuable defense against excessive rates, namely the efficiency incentive that results from the current practice of basing rates on rate-year expense forecasts. Those mechanisms were properly terminated shortly after they commenced.

III. SEVERAL IMPORTANT ISSUES MUST BE CONSIDERED IN THE DESIGN AND IMPLEMENTATION OF A REVENUE DECOUPLING MECHANISM.

A properly designed RDM can remove the disincentives against the promotion of energy efficiency, renewable technologies and distributed generation, and benefit consumers through downward pressure on energy prices, improved delivery and transmission reliability and lower environmental impacts. However, the gains to consumers could be lost if the mechanism is not properly designed and implemented.

The following issues must be correctly addressed in the design of a revenue decoupling mechanism:

Proper measurement of lost profit. As explained in Point II, a properly designed RDM should not shift to consumers, the risk of sales variations that are not attributable to utility energy efficiency and load reduction efforts. In addition, the Commission should ensure that utilities provide full support for their claims of lost profit due to their

efficiency and load reduction initiatives and that all parties have an opportunity to review and comment on those assertions. The Commission must be vigilant to ensure that alleged efficiencies were actually achieved.

Adjustment for Rate of Return. The June 26, 2006 Notice invited comments on whether changes to the rate of return for utilities would be appropriate in connection with a RDM. If the mechanism is designed as we recommend, so that ratepayers fund lost profit attributable to utility energy efficiency and load reduction initiatives, no adjustment to the utility's rate of return is necessary. However, if, contrary to CPB's recommendations, a mechanism is designed that shifts the risks of sales variations due to other factors, from utilities to consumers, then an adjustment for rate of return is required. Such a RDM would reduce utilities' risk, thereby decreasing investors' required return. To reflect that shift, the mechanism must be accompanied by a commensurate reduction in the authorized rate of return for utilities.

Cap on Lost Profit. The RDM should include a limit on the amount of lost profit to be recovered from consumers in future years. Several RDMs implemented in the 1990's did not contain such a limit, and resulted in large deferrals that were the obligation of consumers. The resulting burden on ratepayers led to the termination of those mechanisms, a result which obviously was not consistent with promoting energy efficiency and load reduction. Therefore, an essential feature of any RDM is a cap on the amount of lost profit to be recovered from customers.

In addition, the PSC should have discretion as to when to implement any rate adjustments resulting from this mechanism, in consideration of relevant economic and utility-specific factors.

Impact on utility economic development efforts. The design of an RDM should not diminish utilities' current cost effective economic development initiatives. Such efforts facilitate economic development and help spread utilities' fixed costs over more customers, thereby benefiting the general body of ratepayers.

Flexibility. The design of an RDM should recognize the fact that in some circumstances, promotion of greater use of natural gas or electricity is in the public interest. For example, at current prices, natural gas has a far lower cost per BTU than fuels such as # 2 heating oil and propane.⁸ Accordingly, utility efforts to promote the use of natural gas instead of these alternative fuels is in the public interest in certain circumstances. Similarly, it may be in the public interest in the future to promote the use of plug-in electric cars because of environmental and energy security reasons.

IV. NEXT STEPS

The CPB recommends that the Commission issue an Order indicating its general support for a properly designed RDM and initiating a generic proceeding to establish a general framework for RDMs in New York State. Progress in that proceeding could be accelerated by development of a "strawman" proposal by Staff of the Department of Public Service. With participation of interested parties, a proposed framework would be

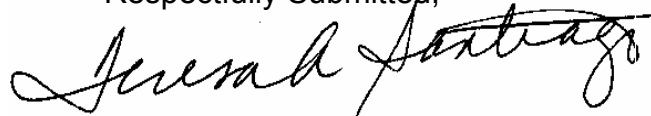
⁸ http://www.nyserda.org/Energy_Information/wkly_htg_fuel_rpt.asp

submitted to the Commission for a decision. Specific details and utility-specific circumstances would be addressed in rate cases for individual utilities.

CONCLUSION

The New York State Consumer Protection Board urges the New York Public Service Commission to adopt the recommendations reflected herein.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Teresa A. Santiago". The signature is written in a cursive, flowing style with a large initial "T" and "S".

Teresa A. Santiago, Chairperson and Executive Director
Douglas W. Elfner, Director of Utility Intervention

Dated: August 28, 2006
Albany, New York