

STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL

DEPARTMENT OF PUBLIC UTILITY : DOCKET NO. 97-01-15RE02
REVIEW OF ELECTRIC COMPANIES :
COST OF SERVICE AND UNBUNDLED :
TARIFFS – REOPENING : January 16, 2007

BRIEF OF RETAIL ENERGY SUPPLY ASSOCIATION

Introduction and Summary of Argument

The Retail Energy Supply Association (“RESA”) is a nonprofit organization and trade association that represents the interests of its members in regulatory proceedings in the New England, New York, Mid-Atlantic and Great Lakes regions. RESA’s members include providers of competitive supply products to electricity and gas consumers in the five New England states – including Connecticut – that have restructured their electric markets.¹ RESA commends the Department for reopening this docket to further examine the unbundling of Electric Distribution Company (“EDC”) retail generation costs and is pleased to submit this Brief on that topic.

This proceeding has revealed common ground among the stakeholders on many of the complex issues that are attendant to the unbundling of EDC costs. Most significantly, all participants agree that EDC bad debt expense arising from uncollectible generation service revenues should be recovered through the generation service charge (“GSC”). Most participants also agree that the allowance on working capital that is related to generation service also should be recovered through the GSC. These are important steps in the right direction.

¹ RESA member companies include Consolidated Edison Solutions, Inc., Direct Energy Services, LLC, Hess Corporation, Reliant Energy Retail Services, LLC, Semptra Energy Solutions, Strategic Energy, LLC, SUEZ Energy Resources NA, Inc. and U.S. Energy Savings Corp. The opinions expressed in this filing may not represent the views of all members of RESA.

The principal points of disagreement relate to less significant expenses that are presently recovered by The Connecticut Light and Power Company (“CL&P”) and, to a far lesser extent The United Illuminating Company (“UI”), in distribution rates but are clearly incurred in whole or in part on behalf of their retail generation business and are avoidable as customers migrate to competitive supply. These include, among others, costs related to supply acquisition, portfolio management, contract negotiation, load settlement, regulatory compliance costs and regulatory commission expense. One school of thought is that these expenses are immaterial and, therefore, they should remain in the distribution rates. But as Stephen Baron, the expert witness for the Connecticut Industrial Energy Consumers (“CIEC”) testified, such misclassifications, when combined, can have a significant impact on the electricity costs of large energy consumers, like the CIEC member companies. Mr. Baron therefore recommends that all costs should be allocated and recovered based on principles of causation unless the EDCs can clearly demonstrate that it is impracticable to do so. RESA shares this view.

Another school of thought was advanced by Lee Smith, the expert witness of the Office of Consumer Counsel (“OCC”). Ms Smith opined that generation-related costs, other than bad debt expense and possibly the working capital allowance should not be transferred from distribution rates to the GSC unless they would decline in proportion to the drop in generation revenues that are attributable to customer migration to competitive supply. Thus, Ms. Smith would not transfer to the GSC even those costs that are incurred solely on behalf of the EDC retail generation function, like supply acquisition, portfolio management and similar expenses. RESA urges the Department to reject Ms. Smith’s view as it undermines all of the goals of unbundling that have been recognized by the Department in its prior decisions, as discussed in Part I of this Brief. Specifically, it would: (1) mask the true price of electricity to EDC

customers; (2) prevent customers from performing meaningful price comparisons of generation service offered by EDCs and competitive suppliers; (3) overcharge customers who choose to participate in the retail marketplace; (4) allow the EDCs to gain an unfair competitive advantage over competitive suppliers; and (5) violate longstanding principles of cost causation.

RESA also urges the Department to deny the proposal of UI to recover certain generation-related costs in the System Benefits Charge (“SBC”). Although UI has done a commendable job of including many of the generation costs listed above in its GSC, it now proposes to shift these costs to the SBC on the ground that they are incurred to support the State’s restructuring policy. This proposal is contrary to law and the goals of this proceeding.

Comments

I. BACKGROUND AND GOALS OF THIS PROCEEDING

The initial phase of this proceeding was conducted by the Department in 1998 to separate the EDC price of electric generation services from the price of distribution and transmission services (commonly known as “unbundling”), as required by Section 5(b) of Public Act 98-28, An Act Concerning Electric Restructuring (the “Restructuring Act”), which is codified at Conn. Gen. Stat. § 16-244e(b). By Decision dated July 29, 1998, the Department completed the first step of this unbundling initiative by classifying EDC costs into three major functions – generation, distribution and transmission.² The Department stated that the principal purpose of unbundling the generation rates was to promote retail competition by providing “equal treatment to all competitors.”³ It further noted that a fair assignment of costs to each function was necessary to minimize cross subsidization of costs among ratepayer classes.⁴

² Decision (July 29, 1998), p. 2, Docket No. 97-01-15RE02, DPUC Review of Electric Companies Cost of Service and Unbundled Tariffs.

³ Id.

In October 1998, the Department reopened this docket for the first time to establish the means by which EDCs would separate electric generation services from delivery charges on customer bills. On April 30, 1999, the Department issued a Decision on this topic in which it observed that the purpose of segregating such charges was to enable customers to make an informed choice of competitive market alternatives.⁵

In the ensuing years, the Department has continued to examine the impact of EDC cost allocations on retail choice.⁶ This topic, however, gained new momentum in 2006, when the Department reviewed UI's rates in Docket No. 05-06-04, Application of The United Illuminating Company to Increase its Rates and Charges. In its January 27, 2006 Decision in that docket, the Department observed that UI was collecting certain generation costs in its distribution rates and that such an approach was undesirable.⁷ Specifically, the Department explained that the inclusion of generation costs in distribution rates: (1) overcharges customers who choose competitive suppliers because distribution charges are not avoidable; (2) prevents customers from receiving accurate price signals regarding the true cost of electricity; and (3) prohibits competitive suppliers from knowing "the price they have to compete with."⁸ To rectify these flaws, the Department stated that it would open a generic proceeding to review the methods by

⁴ Id.

⁵ Decision (April 30, 1999), p. 1, Docket No. 97-01-15RE01, DPUC Review of Electric Companies Cost of Service and Unbundling Tariffs – Unbundled Bills and SBC.

⁶ For example, in May 2004, the Department opened Docket No. 04-05-06 to review various rate design issues, including whether modifications to the current design could stimulate retail competition. See Notice of Scope of Proceeding (May 26, 2004), p. 2, Docket No. 04-05-06, DPUC Review of Rate Design for Electric Distribution Companies.

⁷ Decision (Jan. 27, 2006), pp. 125-26, Docket No. 05-06-04, Application of The United Illuminating Company to Increase its Rates and Charges.

⁸ Id. at 125-27.

which the EDCs recover generation costs and to adopt new allocation and/or recovery approaches as needed.⁹

In May 2006, the Department examined the EDCs' longstanding practice of recovering 100% of their bad debt expense through distribution rates in Docket No. 05-08-05, DPUC Investigation into the Process by which Customers can Choose an Electric Supplier when Initiating Electric Service. The Department stated that this practice is unfair to competitive suppliers and is contrary to principles of cost causation:

Suppliers are disadvantaged if bad debt costs are not properly allocated to generation rates. The proper allocation of this cost to generation rates will place retail suppliers on a more level playing field with regard to the EDCs TSO charges. In addition, the allocation also more closely aligns the rate treatment of bad debt with appropriate cost causation principles by collecting generation-related debt costs through the generation portion of customer bills. Therefore, the Department concludes that the energy component of customer bills must include an allocation of this cost.¹⁰

Four months later, on September 13, 2006, the Department reopened this docket to “review and refine the allocation of [EDC] costs to electric generation services.”¹¹ As the Department undertakes this task, it should draw on its prior decisions, including those cited above, to articulate a concise list of goals that should guide the refinement of cost allocation and recovery methodologies for EDC retail generation costs. These should include the following:

- Standard service and supplier of last resort (“SOLR”) customers should receive accurate price signals regarding the true cost of electricity to foster energy conservation and incent customers to consider competitive market alternatives.

⁹ Id. at 127.

¹⁰ Decision (May 10, 2006), p. 19, Docket No. 05-08-05, DPUC Investigation into the Process by Which Customers can Choose an Electric Supplier when Initiating Electric Service.

¹¹ Decision (Sept. 13, 2006), p. 1, Docket No. 97-01-15RE02, DPUC Review of Electric Companies Cost of Service and Unbundling Tariffs – Reopening.

- Standard service and SOLR service customers should be able to make meaningful price comparisons between generation services offered by the EDCs and competitive suppliers.
- Customers who choose competitive suppliers should not be penalized by paying generation costs twice – once in the competitive offering price and again in EDC distribution or other nonbypassable rates.
- EDCs should not be able to gain an unfair advantage over competitive suppliers by subsidizing generation costs through distribution rates or other nonbypassable rate components.
- The allocation and recovery of generation costs by the EDCs should adhere to well-settled principles of cost causation.

II. THE ANALYTICAL FRAMEWORK

A. Approach Suggested by Department Staff

At the hearings in this docket, which were held on November 27 and 28, 2006, Department staff (“Staff”) asked participants to comment on an analytical framework to guide the determination of cost recovery methodologies for EDC generation costs. This approach requires the Department to proceed through three questions for each type of EDC cost listed in Interrogatory EL-1. These questions are:

1. Do competitive suppliers also incur this cost in providing generation services to their customers? If yes, proceed to step 2.
2. Would the EDCs avoid this cost if customers switched to competitive supply? If yes, proceed to step 3.
3. Is it practical to allocate this cost to generation services and recover it through generation rates?

RESA fully concurs with steps two and three of this analysis. It recommends, however, that the Department substitute the first question with the following inquiry: *Do the EDCs* incur this cost in providing generation services to their customers?

Staff's suggested approach is creative and recognizes the importance of enabling competitive suppliers to compete on an even playing field with the EDCs if a robust retail market is to emerge in Connecticut. RESA appreciates that emphasis. It believes, however, that elevating the costs incurred by competitive suppliers to an analytical criterion in this proceeding, departs from the fundamental goal of utility rate-making – that is, to ensure that costs incurred *by the EDCs* are properly allocated to generation, distribution and transmission services and recovered through the corresponding rate components based on cost causation principles. It is not necessary to inquire into the business expenses of competitive suppliers to achieve that objective as it pertains to EDC generation costs. Moreover, to the extent that there are EDC generation costs that are not incurred by competitive suppliers, these costs should nonetheless be recovered through generation rates. Otherwise, the important principles that the Department has recognized (i.e., cost causation, accurate price comparisons, avoidance of duplicate charges, etc.) are undermined.

RESA further notes that the costs incurred by competitive suppliers are not regulated by the Department. RESA is concerned that the first question proposed by the Staff would pave the way for the Department to mandate reporting of supplier costs under the umbrella of utility rate-making. This result, though well-intentioned, contravenes principles of a free market and necessitates disclosure of commercially sensitive, proprietary information by supplier companies. For these reasons, RESA recommends that the first question in the proposed analytical framework be modified to inquire whether *the EDCs* incur the cost in providing generation services to their customers. If that question is answered in the affirmative, then the Department should proceed to the second and third questions recommended by Staff.

B. Costs Incurred by the EDCs in Providing Generation Services

There is no question that purchased energy, capacity and ancillary services, including, but not limited to, costs incurred by EDCs to comply with the Renewable Portfolio Standard and certain charges levied by ISO New England, Inc. (“ISO-NE”), are directly related to the generation function and should continue to be recovered through generation rates. RESA believes that the costs listed below also are incurred in whole or in part by EDCs to support their retail generation business:

- Non-hardship bad debt expense that culminates from uncollectible generation service revenues;
- Allowance on working capital that is maintained by the EDCs to accommodate the lag between payment of expenses associated with providing retail generation service and recovery of associated revenues;
- Salaries, wages and fringe benefits for EDC personnel and fees for lawyers and consultants dedicated to supply acquisition, portfolio management, contract negotiation, wholesale supplier relations and load settlement, including information technology (“IT”) professionals who support these functions, and the return of and return on associated IT systems.
- The portion of the expense incurred by the EDCs to fund the operating costs of the Department and OCC in accordance with Section 16-49(b) of the General Statutes (“Regulatory Commission Expense”) that is associated with generation service revenues.
- Salaries, wages, and benefits for EDC employees and fees for lawyers and consultants who are dedicated to regulatory compliance initiatives (“Regulatory Compliance Costs”) as they pertain to generation service, including, but not limited to, proceedings before the DPUC and the Federal Energy Regulatory Commission (“FERC”) on generation-related matters; and
- Salaries, wages and fringe benefits for EDC employees that perform and/or support billing, collections and customer service functions relating to generation service, including IT professionals, and the return of and return on IT systems that support these activities.

Most participants in this proceeding do not dispute the fact that the above-listed costs are incurred in connection with the EDCs provision of retail generation service to their customers. Most importantly, there is consensus that the bad debt expense and working capital allowance relating to generation service should be recovered through the GSC.¹² Participants differ in their views, however, as to the proper means to recover the other costs listed above. Some argue that they are not truly avoidable and should remain in the distribution rates.¹³ Others contend that these costs are not sufficiently material to warrant a transfer from distribution rates to the GSC.¹⁴ RESA believes that the Department should follow the analytical framework set forth above: if a generation-related cost is avoidable in whole or in part by the EDCs, it should be included in the generation rates unless the EDCs clearly demonstrate that it is impracticable to do so. In order to minimize the administrative burden on EDCs, the Department should endorse the use of estimates.

C. Avoidable Generation Costs Incurred by the EDCs

In RESA's response to Interrogatory EL-8, it advanced a cost-avoidance principle to guide the Department's identification of EDC costs that should be recovered through the generation rates. This principle, which is rooted in cost causation, states: If the generation-related cost component identified in step 1 would cease to exist in whole or in part if all EDC customers were served by competitive suppliers, the appropriate portion of such cost that is attributable to generation services should be recovered in the present generation rates. Many

¹² See e.g., Pre-Filed Testimony of Lee Smith (Oct. 31, 2006), p. 14 (bad debt expense); OCC Response to Interrogatory CIEC-3 (bad debt expense and working capital allowance); Pre-Filed Testimony of Charles R. Goodwin and Robert A. Baumann (Oct. 31, 2006), p. 5 (bad debt expense); UI Revised Response to Interrogatory EL-1-1 (bad debt expense and working capital allowance); RESA Response to Interrogatory EL-8 (bad debt expense and working capital allowance); CIEC Response to Interrogatory EL-7 (bad debt expense and working capital allowance).

¹³ See Pre-Filed Testimony of Lee Smith (Oct. 31, 2006), pp. 6-7.

¹⁴ *Id.* at 7; Pre-Filed Testimony of Charles R. Goodwin and Robert A. Baumann (Oct. 31, 2006), pp. 3-5.

other participants in this proceeding endorse this principle. For example, UI states:

”[C]osts that are reduced or eliminated when retail customers choose an alternate retail supplier (rather than fully bundled service from UI) should be recovered through the GSC.”¹⁵ This approach is sound and comports with the second analytical step recommended by Department staff.

1. Bad Debt and Working Capital Costs

All participants agree that bad debt expense relating to uncollectible generation service revenues should be recovered through the GSC because it is avoidable.¹⁶ Furthermore, all participants agree that working capital for retail generation services also is avoidable, and most posit that the allowance thereon should be recovered through the GSC.¹⁷ Although CL&P does not dispute the avoidability of working capital costs, it maintains that the working capital related to generation services provides a small net distribution rate benefit based on lead/lag studies and, consequently, a rate design change is not warranted at this time.¹⁸ This assertion, however, does not alter the fact that such working capital, whether positive or negative, is directly attributable to the provision of generation service and, accordingly, the allowance on that capital should be recovered through the GSC under principles of cost causation. Finally, no participant contends that it would be impracticable to compute and/or track the generation portion of bad debt and working capital costs. Thus, the Department should direct the EDCs to include these costs in the GSC without the need for further analysis.

¹⁵ Pre-Filed Testimony of Michael A. Coretto (Oct. 31, 2006), p. 1.

¹⁶ See footnote 12, supra.

¹⁷ Id.

¹⁸ CL&P Response to Interrogatory EL-1.

