The Process of Designing Cost-Reflective Tariffs

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Presentation Outline

I. Tariff Design and StructureII. Monitoring of Retail Rates

I. Tariff Design and Structure

Electric Rates in New York State

- Firm Service Classifications
 - Residential
 - Commercial
 - Industrial
- Delivery Charge, T&D (Set by the Commission)
 - Reflects the costs of moving electricity from the generator to the customer's meter
- Electric Supply Charge
 - Reflects the costs of electricity produced or purchased from the market (commodity and capacity). Utilities use hedging instruments to moderate price volatility

Gas Rates in New York State

- Delivery Charge (Set by the Commission)
 - Reflects the costs of moving the gas from the citygate (interconnection with interstate pipeline company) to customer's meter
- Gas Supply Charge
 - Adjusted monthly and reconciled annually
 - Reflects the costs of gas supplies purchased on interstate pipelines or from local production (commodity and capacity)
 - Commodity price is set by the marketplace; utilities use hedging instruments to moderate price volatility
 - Capacity price is set by FERC

Why Costs Studies are Necessary

- To assign utility costs to customer classes of service
- To determine how to recover costs from customers in a class
 - For example: time-of-use vs. flat rate residential customers, or
 - Differentiate costs caused among different voltage levels in a large general service class
- To determine the number and types of service classifications
- To establish system, class and subclass rates of return (ROR)
 - Significant class ROR deviations from system average ROR suggests over or under contributions (inequity among classes)
- To form the basis for rates or contract prices for special services
 - Delivery or standby
 - Interruptible or curtailable

Various Types of Cost Studies

- Embedded Cost of Service Study (ECOS)
 - Historic focused on how existing costs were incurred, use of historic test year data
 - ProForma estimates forward looking costs projections – from recent historic test period costs
 - Allows for known and anticipated changes from historic base
 - Significant capital expenditures, major changes in workforce, supply cost changes, etc.

Various Types of Cost Studies

- Marginal Cost of Service Study (MCOS)
 - Measure the change in cost levels in response to a change in customer usage or demand
 - Short Run versus Long Run
 - Short run based on small per unit changes (usually variable cost sensitive)
 - Long run considers broader time spectrum 3-5 or 10 year planning horizons and capital expenditures

II. Monitoring of Retail Rates

Capital Investment in New York

- In last five years, the six investor owned utilities in New York have invested \$9.5 billion in T&D and are projected to invest an additional \$12 billion in T&D in the next five years.
 - New York rate case reviews have a significant focus on the proposed capital budgets and the utility's internal budgeting process, project management tools and cost management process to insure just and reasonable rates as they relate to capital budgets
 - Periodic Management Audits by third party
 - Use of downward -only reconciliation on carrying costs associated with projects that have not been completed but for which rate relief had been provided
 - Extensive on-going monitoring and reporting on a project-by-project basis

Mechanisms to Capture Efficiencies

- Capital Net Plant Caps
 - Downward-only reconciliation on utility infrastructure investments
 - Commission approved net plant forecast is the target. If the utility under spends, it is required to defer the carrying charges related to the difference between actual plant closed to books and the net plant target used for rate making
 - The deferred carrying charges can be used for future ratepayer benefits
- Imputed Productivity Adjustment
 - Commission has imputed 1% to 2% adjustment to labor costs in most recent rate case decisions to reflect expected productivity achievements

Losses and Bad Debts

- Electrical System Line Losses
 - Losses vary by voltage level
 - Different service classes pay for a different level of losses depending upon voltage level being served at
 - % determined by study and reflected into rate design
- Uncollectible and Theft of Service Losses
 - Forecast levels of revenue associated with these losses during rate case process
 - All customer classes contribute toward paying for these losses
 - Any over or under forecast is absorbed by the utility shareholders until level is reset
 - These losses increase during bad economic conditions

Balancing Cost of Supply

- Supply costs are unbundled from delivery rates
- Price determined primarily by the wholesale market as opposed to historic cost based regulation
- Utility forecasts supply costs on a monthly basis for its full service customers and determines the cent/kWh rate, based on forecasted volumes
- Any over or under collection due to variations in price and volume are reconciled in a subsequent month
- There is no profit made on supply, utility is provided with full cost recovery