Utility Performance and the Need for Improvement and Consumer Protection and Oversight

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Introduction

The importance of continuous electric utility service was underscored by large scale power outages due to Superstorm Sandy. These outages, and outages following other storms in recent years, are forceful reminders of the essential role of reliable electric service to consumers in today's world. Continuous electric service is essential for household lighting, refrigeration, cooking, and in many circumstances, for heating, cooling, sanitation, water supply, elevator service, and telephone and internet service. When electric service is interrupted, household life may quickly become chaotic, and there is increased risk of illness or possible death of persons vulnerable to heat or cold. Society as a whole faces significant costs from unsafe or unhealthy situations in the absence of utility service. Public health and safety are impaired requiring emergency aid and medical care and additional policing when civil disorder or other mass emergencies occur during outages. Burdensome restoration costs are incurred, causing long-lasting economic injury. These costs include the short term cost of fire, police, and other first responders, and the longer term diversion of major financial resources to repair and restore damaged utility facilities in the aftermath of storms. It is the priority of utility services, whether or not available from competitive or monopoly providers, which makes regulation necessary to assure that utility company conduct is aligned with the public goals of safe, continuous and affordable utility service.

Executive Order 73

In response to widespread perceptions that recovery from the loss of utility service experienced by many customers resulting from Superstorm Sandy in November 2012 and from other recent storms lasted for far too long, a Moreland Act Commission ("Commission") on the performance of utilities in emergencies, utility structure, regulation and oversight was appointed by New York Governor Andrew M. Cuomo. The Governor's Executive Order 73 finds that "serious questions have been raised about the adequacy of utility management, structures, resources, the current regulatory framework and oversight."[1]

[1] The Commission's charge is "to: (A) study, examine, investigate and review: (i) the emergency preparedness and response of utilities . . . including the performance of the utilities during and following emergency weather events; (ii) the adequacy of present laws, rules, regulations, practices and procedures with respect to utilities' emergency preparedness and response; (iii) the adequacy of existing oversight and enforcement mechanisms; (iv) the structure, organization, ownership, financing, control, management and practices of the utilities as they affect emergency preparedness and response; and (v) the provision of utility services to New York State under the existing legal regulatory framework, including but not limited to the jurisdiction, responsibilities and missions of the New York Power Authority, the Long Island Power Authority, the New York State Energy and Research Development Authority, as well as the Public Service Commission; (B) report

On January 7, 2013, the Moreland Act Commission released preliminary findings and recommendations: options for restructuring the Long Island Power Authority (LIPA), strengthening oversight of the state's utilities and bolstering enforcement mechanisms; and streamlining the state's energy agencies and authorities. Many of the Moreland Act Commission recommendations were included by Governor Cuomo in his 2013-2014 New York State Executive Budget proposal. The following comments by AARP and the Public Utility Law Project of New York, Inc. ("PULP")[2] are respectfully offered to Governor Cuomo and the Legislature as our state moves forward in improving the performance of its utilities during emergencies, restructuring, and addressing the needs of and consumer protections for utility customers in developing a final state budget. Our organizations also offer recommendations regarding the Commission's second phase, investigating the utilities' response to the recent storms.

Summary of AARP and PULP recommendations:

I. Independent Utility Consumer Advocate – Essential to the strengthening of oversight of the state's utilities is an independent, funded, utility consumer advocate office.

II. LIPA Consumer Protections – The costs, benefits, and rate impacts concerning utility consumers on Long Island must be examined when proposing to re-privatize LIPA as well as in comparison with continued public ownership.

III. Review Performance Regulation – The New York Public Service Commission ("PSC") "Performance Regulation" ratemaking approach should be reviewed and revised or eliminated.

IV. Storm Recovery Costs – New York consumers should be protected from investor-owned utilities' automatically passing through of storm-related costs without thoroughly examining the utility's liability.

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and make recommendations for legislative, policy and regulatory changes, as well as reforms as deemed appropriate in utility structure, management and practices, to best protect and serve the public's interest with respect to emergency preparedness and response, and the provision of safe, reliable, responsive utility services; and (C) review any other matters or activities which may affect the issues herein before specified." Executive Order 73, Nov. 13, 2012.

[2] AARP is a nonprofit organization that helps people over the age of 50 to exercise independence, choice, and control in ways beneficial to them and to society as a whole. AARP's more than 2,500,000 New York members who need reliable and affordable residential electric service may be directly affected by the Commission's recommendations. PULP is a not for profit organization whose mission includes advocacy on behalf of low-income utility consumers for universal, affordable service and customer protections.

Improving Consumer Protection and Oversight and Utility Performance

I. New York Should Provide Resources for Independent Utility Consumer Advocacy

The Interim Report calls for rebuilding and strengthening of the PSC to improve its regulation of utilities, which we support. However, it fails to mention any representation for consumers. As Co-Chair Lawsky said at the December 6 hearing, this is "an investigation that we need to carry out that puts the consumer, the everyday New Yorker who suffered from this storm, first." AARP and PULP agree. As the state grapples with the aftermath of Superstorm Sandy, residential ratepayers must be represented as potentially hundreds of millions of dollars of rate hikes, accountability of utilities, and new reliability measures, are discussed. Yet New York State's support for utility consumer advocacy has dwindled to the point that New York consumers, who pay some of the highest utility rates in the nation, lack full and independent representation in major matters affecting the reliability and affordability of essential utility services. New York's support for this function also lags in comparison with other states' allocation of resources for utility consumer representation.

Regulatory commissions often view their role and the role of their staff as mediating the competing interests of utilities and others in their decision making. They depend on vigorous external "stakeholder" participation in their complex proceedings to develop facts that will be included in the record upon which decisions must ultimately be based. There is no shortage of such participation from utilities, or from large commercial and industrial customers. But there is a lack of input from parties representing consumers who would focus regulatory attention upon current and emerging issues facing consumers, and who would protect residential consumer interests from being eroded by competing interests. The proper functioning of the regulatory process depends on vigorous and full professional representation of consumers that is separate and independent from the regulatory body. Industrial and commercial consumers have associations which employ legal counsel to represent their interests before state and federal regulatory bodies and throughout the judicial review process, while residential consumers find it difficult to pool their resources and secure independent legal counsel and experts to represent them. Bolstering the PSC, while needed, is not enough to protect New York's residential consumers.

More than 40 states and the District of Columbia have independent state offices charged with the mission to represent residential utility service consumers in cases

before state and federal utility regulatory commissions. These offices typically appear on behalf of consumers as parties in state and federal regulatory commission proceedings and in judicial review proceedings concerning rates and conditions of service of public utilities. The state advocates typically have independent authority to commence proceedings and to take legal positions different from those of utilities and their regulators, and to seek judicial review of state and federal regulatory agency decisions.[3] They monitor utility customer complaints and grievances, and investigate independently the services and rates of utilities, often through the discovery process within the context of formal proceedings. They collect and analyze data concerning utility issues, prepare and issue testimony and reports and make recommendations, and are empowered to initiate complaints or other proceedings in response to patterns of customer complaints. They provide public information, consultative services, and technical assistance, and strive to adequately and professionally represent the interests of residential customers in the course of proceedings affecting them. Such offices are necessary to support sustained high quality representation of consumers.

New York's commitment to support of residential consumer advocacy in utility matters is but a fraction of what it once was. In 1994-95 the Consumer Protection Board ("CPB") was budgeted for 39 staff, with 31 dedicated to utility intervention work in PSC cases. The CPB was abolished and the utility intervention function transferred to the Department of State, where there are now four persons who work on utility matters in the Utility Intervention Unit ("UIU").[4] Funding for the Public Utility Law Project of New York, also dwindled over the past 20 years, was halted in 2010 and 2011, and was resumed with a legislative addition to the Executive Budget at a $505,000 level in the 2012-13 budget. Had funding for PULP kept pace with inflation, it would have been more than $1 million in 2012. Similarly, activity and staffing of the Attorney General's office for participation in utility cases at the PSC has diminished greatly. The estimated

[3] The Constitution of the National Association of State Utility Consumer Advocates ("NASUCA") requires its members to be independent with respect to "policy determination, hiring and firing of personnel, and fiscal control," to be separate from the regulatory commission, and capable of seeking judicial review of regulatory decisions. NASUCA Constitution, Art. III, Sec. 1, available at http://www.nasuca.org/archive/NASUCA%20Constitution.pdf.

[4] The powers of the UIU set out in Section 94-A of the New York Executive Law only authorizes UIU to participate in administrative proceedings of the PSC and federal agencies. The UIU, formed after dissolution of the New York Consumer Protection Board, lacks express power independently to challenge or support any utility regulatory commission decisions in judicial review proceedings. In its early days, the former CPB similarly lacked any express statutory power to question orders of the PSC. *Pooler v. PSC*, 89 Misc.2d 700, 58 A.D.2d 940, *aff'd* 43 N.Y.2d 750 (1977). That deficiency of CPB was subsequently addressed. In the transfer of legacy utility intervention functions of CPB to the Department of State, however, no authority was given to UIU, on its own motion, to question in court a state or federal regulatory decision affecting New York utility consumers.

total amount of funding being utilized for residential utility consumer advocacy in 2012-13 is approximately $1.1 million. Also, as a result of the reorganization of CPB, there is no longer an independent state utility consumer office responsible for its own staffing and budget, with the capability of taking a legal position in court different from that of the PSC, the Federal Energy Regulatory Commission ("FERC") or the Federal Communications Commission ("FCC").

There is a growing recognition that New York must restore funding to support meaningful representation of residential and small commercial utility customers. In 2012, FERC made funds disgorged by an alleged energy market manipulator available for allocation by eligible state agencies. Of the $78 million available for the benefit of New York electricity consumers, Governor Cuomo requested $10 million over a ten-year period be used for advocacy on behalf of electricity consumers in matters affecting wholesale electric rates. Starting this year, $1 million per year will be available from this source to the Department of State Utility Intervention Unit to increase advocacy for consumers on New York Independent Systems Operator ("NYISO") and FERC wholesale electricity matters. [5]

In addition to being much reduced from prior funding levels, New York's resources for utility consumer representation is significantly lower than in other states. Even if one includes the new funds for the UIU for advocacy regarding wholesale electric rates and tariffs set at the NYISO and reviewed in FERC proceedings – which are not available for work on rates of state-regulated utilities – the total New York allocation of resources for the UIU and PULP are estimated to be approximately $2,100,000, representing about 10 - 11 cents per capita. In contrast,

- New Jersey allocates resources in the amount of $7,000,000 that represent a $0.79 per capita expenditure;
- Pennsylvania allocates resources in the amount of $5,100,000 that represent a $0.40 per capita expenditure;

[5] In comments to FERC, AARP pointed out that the UIU lacks the indicia of a truly independent state utility consumer advocate which typically is a separate entity with control over its own budget and operations, capable of taking legal positions in court different from those of the utilities and the utility regulatory commissions. See *AARP Comments on State Agency Filings Regarding Use of Disgorged Funds in FERC Case IN12-7*, available at http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=13072909, and *Order approving New York Public Service Commission's allocation and distribution proposal re Constellation Energy Commodities Group, Inc. under IN12-7, available at* http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=13091829.

- Connecticut allocates resources in the amount of $2,989,134 that represent a $0.83 per capita expenditure;
- Maine allocates resources in the amount of $1,700,000 that represent a $1.28 per capita expenditure;
- Massachusetts allocates resources in the amount of $2,355,145 that represent a $0.35 per capita expenditure;
- Maryland allocates resources in the amount of $3,162,242 that represent a $0.54 per capita expenditure;
- Ohio allocates resources in the amount of $8,500,000 that represent a $0.74 per capita expenditure;
- Illinois allocates resources in the amount of $2,642,684 that represent a $0.21 per capita expenditure.

We urge the Governor and the Legislature to include in a final state budget measures to restore independent utility consumer advocacy in New York, with increased funding for an independent state utility consumer advocate office solely dedicated to representing residential and small commercial ratepayers, increased funding for PULP to advocate on behalf of low-income consumers, and enactment of an intervener compensation program, funded by PSC utility assessments, that would financially support not-for-profit organizations representing the interests of residential customers who contribute to developing the record for decision by the PSC in its proceedings.

II. The Costs, Benefits, and Rate Impacts of any Proposal to Re-Privatize LIPA in Comparison with Continued Public Ownership Must be Considered

In its initial recommendations, the Commission indicates that it supports re-privatization of LIPA and the Governor has included this in his Executive Budget proposal. We agree that LIPA's performance was nothing short of disastrous. The Interim Report lays out LIPA's failures in detail. There is no question that LIPA must be reformed. However, a change in ownership is not necessarily the only way to improve service for LIPA customers. Our organizations have not taken a position for or against re-privatization of LIPA because we do not yet have all the facts regarding the rate impacts of any decision to alter the ownership structure.

When LIPA took ownership of Long Island Lighting Company assets, utility rates on Long Island, once highest in the state, were reduced by 20%. Subsequently, Long Island rates have remained below those of Consolidated Edison Company of New York ("Con Edison"). Prior reports considering the merits of re-privatization have recognized that it would entail higher costs and higher rates, principally due to the higher commercial borrowing rates on debt (LIPA is tax exempt and thus eligible for lower interest rates) and due to the fact that when a utility is investor-owned, regulators are required to set rates so that the owners receive a reasonable after-tax return on their invested capital. Recently, a bond rating service has cautioned that a shift to investor ownership could result in higher rates.[6] Under the current ownership, LIPA rates may gradually decline as its large debts are paid off or refinanced at currently low tax exempt bond interest rates. Thus, proposals for "rate freezes" along with privatization may actually prolong the period of high rates that could be avoided under the current public ownership. Also, "rate freeze" proposals may not take into account higher energy supply costs over time if LIPA were to sell its interest in low cost upstate nuclear power supply.

The LIPA operational structure, in which it contracts out its operations to a private utility rather than operating its systems through its own employees, is highly unusual. Publicly owned utilities in New York State and across the nation generally operate with their own employees. Common issues such as the need to attract highly competent executives and funding of employee pension plans have been addressed by municipally owned utility systems, including those within New York State. The Governor, the Moreland Act Commission and the Legislature should look to examples of other publicly-owned utilities to see how the rates and storm outage performance of publicly-owned and -operated utilities that run their own operations compare with utilities that are investor-owned.[7] We believe this examination should be undertaken by the

[6] "Fitch believes the suggested privatization of Long Island Power Authority (LIPA) could be extremely expensive and may not result in the ratepayer benefits projected." Fitch, *LIPA Proposal Could be Money for Nothing, available at http://www.marketwatch.com/story/fitch-lipa-proposal-could-be-money-for-nothing-2013-01-08*. "[T]he promise of stable rates flies in the face of a 2010 report prepared for LIPA by the Brattle Group, which found that privatizing would result in a rate increase of from 15 percent to 20 percent…. Equally skeptical, Moody's noted a private utility would lose the benefit of tax-exempt debt and would be ineligible for major storm cost reimbursements. The firm said the cost was "likely greater than any potential synergies or economies of scale that could be achieved by combining with another utility." Newsday, Jan. 8, 2013, *available at* http://www.newsday.com/long-island/cuomo-expected-to-announce-lipa-privatization-plan-1.4422905.

[7] "Some of the nation's largest cities – Los Angeles, San Antonio, Seattle and Orlando – operate publicly owned electric utilities, but many public power communities are small with their utilities serving 3,000 or fewer customers." APPA, About Public Power, *available at* http://www.publicpower.org/aboutpublic/index.cfm?ItemNumber=429&navItemNumber=20955.

Commission before the Governor and the Legislature agree to a final state budget that re-privatizes LIPA in order to determine the impact to residential rate payers on Long Island.

III. The New York PSC "Performance Regulation" Ratemaking Approach Should be Reviewed and Revised or Eliminated

The Interim Report at page 38 notes that the Commission has a concern, to be explored in the next phase, that the independently-owned utilities ("IOUs") may not be adequately prepared to respond to major storms, and notes that "[k]ey components [of maintenance] may therefore be sacrificed under rate plans that allow years to go by without detailed D[epartment] of P[ublic] S[ervice] scrutiny". AARP and PULP support this line of inquiry. Our organizations believe the relaxed oversight of such rate plans has harmed reliability.

The New York PSC has shifted the regulatory regime to a "performance based regulation" or "PBR" approach under which rates are often set for multi-year periods, during which utilities are given great flexibility to allocate resources, cut costs and keep any savings during the term of the rate plan as profit, so long as they satisfy minimum performance standards. A theory supporting this approach is that a utility has an information advantage over regulators when it seeks to justify costs but the utility will find ways to cut costs when they directly improve the bottom line. PBR raises the risk that maintenance will be deferred, because any dollars saved by, for example, not sufficiently trimming trees and limbs, or not replacing weak power poles, will immediately benefit utility shareholders as increased short term profits. Thus, it is essential for a PBR regime to (i) identify and prescribe the minimum reliability standards which the regulator expects the utility to satisfy, (ii) establish appropriate measurements and mechanisms by which to gauge utility performance, and (iii) promptly impose financial consequences sufficient to encourage compliance (and not efficient breach) when standards are not met.

In its approach to PBR, the New York PSC adopted statistical reliability performance "metrics" and standards for measuring the number and duration of power outages. In rate cases, frequently settled, economic sanctions are set for breach of the standard so that, ostensibly, utilities will not slash costs for functions that eventually affect service quality and reliability. The apparent intent of regulators is to focus more intensely on "performance" and "results," while at the same time reducing regulatory scrutiny of inputs, such as detailed budgets for infrastructure investment, prescribed maintenance,

and staffing levels. This gives utilities increased "flexibility" in spending and staffing so long as the desired results are achieved. The Commission should inquire whether, under this approach, utilities may have reduced or deferred once customary maintenance, such as scheduled tree-trimming and replacement of weak power poles, with a result that greater damage and longer outages occur when large storms bring down limbs, trees, lines and poles.

As explained in a recent publication: "Performance-based regulation (PBR) ties growth in utility revenues or rates to a metric other than costs, providing the utility with opportunities to earn greater profits by constraining costs rather than increasing sales. **** ***Commissions have learned to establish strict service quality standards when approving multi-year PBR mechanisms, because experience showed that some utilities took actions to improve earnings at the expense of reliability and customer service quality.*** " [8] In other words, it may be economical for a utility to risk failing to satisfy the PSC performance metrics if the cost of meeting the standard is greater than the risk and cost of failing it. [9] In 2004, in an order regarding the investigation of an electrocuted pedestrian in New York City, the PSC suggested that public safety may have been compromised under its regulatory policies that rely more on utility choices under "performance based" plans:

> "Over the past 10 to 15 years, we and other regulatory commissions across the nation have moved from traditional one-year litigated rate cases to multi-year performance-based rate plans. The purpose of these plans is to allow for rate stability while allowing the utilities greater flexibility in managing their operations. Staff's investigation into this matter suggests that the utilities may not have been placing enough attention and emphasis on safety matters."[10]

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[8] Regulatory Assistance Project, Electricity Regulation in the U.S., A Guide: Performance Based or Price Cap Regulation, p. 61 (March, 2011) (Emphasis added).

[9] After the 2006 Queens outage, a New York State Assembly task force raised questions regarding the PSC's "macro" approach to regulation, i.e., whether investor owned utilities are cutting costs on maintenance and keeping the savings as profit, whether the performance measures are adequate, whether the performance measures can be gamed or efficiently breached due to inadequate sanctions. The Assembly task force report is available at http://assembly.state.ny.us/member_files/036/20070130/ #toc2c.

[10] Case 04-M-0159, Proceeding on Motion of the Commission to Examine the Safety of Consolidated Edison Company of New York, Inc.'s Electric Transmission and Distribution Systems, Order on Staff Proposal, p. 8 (Issued July 30, 2004).

The Commission adopted performance standards in that case for stray voltage testing and remediation, over the objection of some utilities. Significantly, utilities argued that negative rate adjustments when a utility fails to meet PSC-prescribed performance standards are a "penalty" that can only be imposed after judicial process under Section 25 of the Public Service Law ("PSL"). The same argument might be made with regard to *any* performance standard whose breach would result in an administrative decision to reduce utility revenues. The Commission summarized the utilities' argument as follows:

> **"Performance Mechanism**
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> The Upstate Utilities dispute our authority to enforce the performance mechanism included in the Safety Order. They contend that the performance mechanism is contrary to Public Service Law (PSL) §25, contravenes separation of powers, is inconsistent with due process, and contains rate adjustments that are arbitrary and capricious. ***********They contend that we do not have authority to impose penalties other than those identified in PSL §25.*** The Safety Order indicates that the performance mechanism is designed to operate in a similar fashion as those found in multi-year rate plans. ***The Upstate Utilities, however, assert that performance mechanisms included as part of multiyear rate plans are agreed to voluntarily as part of a joint proposal. They continue that we cannot diverge from the penalty structure in PSL §25 without the utilities' consensual agreement.*** They further contend that the punitive nature of the performance mechanism is unmistakable and should not be considered an incentive mechanism for ratemaking purposes. Labeling the performance mechanism a ratemaking adjustment does not change its administrative penalty nature, and, as defined, the potential revenue adjustments are penalties, not ratemaking adjustments. The Upstate Utilities argue that the performance mechanism is directly contrary to the PSL §25 because it is intended to punish the utilities for failure to comply with the standards. They claim this contradiction between the Safety Order and statutory requirements makes the performance mechanism unlawful because it violates the separation of powers doctrine. The Upstate Utilities also argue that the performance mechanism is inconsistent with the due process allowed when a utility violates a Commission order. They claim that the Safety Order is self-executing and fails to provide notice, opportunity for hearing, or right to a jury. They contend that this is inconsistent with the statutory schemes of PSL §§24 and 26, and the fundamental

> requirements of due process. They also indicate that utilities should have the right to a jury trial, given the magnitude of the rate adjustment. Additionally, the Upstate Utilities assert that the two rate adjustments are arbitrary and capricious and that the performance mechanism lacks a rational basis because it is disproportionate and does not reflect any degree of non-compliance (i.e., missing tests on only one or most facilities results in the same rate adjustment). The structure fails to consider exculpatory factors and does not recognize good faith efforts to comply with the Safety Order. The Upstate Utilities claim the performance mechanism would not withstand judicial scrutiny." [11]

The PSC rejected the legal argument of the utilities questioning its powers, asserting that the monetary consequences of breaching the safety performance standard would simply be an administrative rate and revenue adjustment and not really a "penalty" requiring the cumbersome judicial process of PSL §25. *Id.* at 26 - 29. The PSC's rationale for administratively imposing nonconsensual financial liabilities due to breach of performance criteria established in a rule or order, however, has never been tested or upheld in court. As a result, any economic consequences flowing from breach of performance standards have been voluntarily agreed upon by the utilities as part of their rate plans. Thus, the issue of Commission power to impose performance criteria backed with financial sanctions, other than those agreed upon by the utilities, remains in serious doubt.

In any event, the PSC has no performance criteria or explicit financial sanctions relating to storm outages. The existing "Reliability Performance Mechanism" (RPM) provisions of the current electric rate plans approved by the PSC exempt all outages due to major storms which affect designated percentages of customers <u>or</u> which involve any outages longer than 24 hours.[12] For example, the current Con Edison rate plan contains RPM provisions which impose upon the utility adverse economic consequences (a "negative revenue adjustment") if service outages exceed certain agreed-upon levels. The RPM, however, excludes from the count of outages any that are due to a major storm, where

[11] Case 04-M-0159, Proceeding on Motion of the Commission to Examine the Safety of Electric Transmission and Distribution Systems. Order on Petitions for Rehearing and Waiver, p. 5-6 (July 21, 2005).

[12] "The duration and frequency targets included in the RPMs are based on normal modes of operation; that is, excluding unusual circumstances. A major event (i.e., an unusual circumstance that should be excluded from normal reliability calculations) is defined by the Commission's regulations as any storm which causes service interruptions to at least 10% of customers in an operating area, and/or interruptions with duration of 24 hours or more. The NYPSC does not use the IEEE 2.5 beta method for defining major events." Hesmondhalgh, Zarakas, and Brown, *Approaches to setting electric distribution reliability standards and outcomes*, Brattle Group, January, 2012, *available at* http://www.brattle.com/_documents/UploadLibrary/Upload1014.pdf.

either 10% of the customers lose service or service to some customers is off for 24 hours or more.[13] Thus, the existing filed rates now in force do not provide for *any* performance requirement when storm related outages are due to lines downed by untrimmed trees or limbs or fallen poles, there are no performance standards for repairing downed lines and poles and restoring service after such events, and there are no articulated financial consequences for not taking adequate prophylactic measures or for tardy restoration.

The Institute of Electrical and Electronic Engineers (IEEE) has developed a draft reliability guideline that seeks to standardize the calculation of reliability indices with a measurement of "major event days" that would include metrics for storm related outages. The New York PSC has not adopted the IEEE reliability standards which include storm outages. The Commission should explore this issue and any reasons why the PSC has excluded major storm related outages from its performance measures.

In a recent Con Edison rate case, the PSC rejected its staff's proposal for a new performance measure of timely restoration of service after major outages, including those caused by storms, with financial sanctions – "negative revenue adjustments" – for not meeting a standard. The proposal was opposed by Con Edison, and the staff recommendation was not adopted by the PSC:

> Staff proposed a performance mechanism that would hold the Company accountable for restoration times for all outage events. Restoration targets would be established based on the emergency level created by the outage. Failure to meet those targets would result in a $5 million

[13] See Case 09-E-0428, 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, Case 08-M-0152 - Comprehensive Management Audit of Consolidated Edison Company of New York, Inc., *Order Establishing Three-year Electric Rate Plan*, March26, 2010, Joint Proposal P. 29, Adobe at 77, *available at* http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={60F5E842-B7B6-43CC-A589-8C16347B59FD}. See, *Initial Report of Consolidated Edison Company of New York, Inc. Concerning Network and Load Area Outages Resulting from Hurricane Sandy*, Dec. 13, 2012, at 8-9 ("None of the four major outage incidents during Hurricane Sandy are subject to a RPM revenue adjustment because exclusions established in the RPM are applicable to each incident). See also, *Order Regarding Reliability Performance Mechanism*, Case 09-E-0428, 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, (Issued September 14, 2012), *available at* https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&ved=0CEsQFjAB&url=http%3A%2F%2Fdocuments.dps.ny.gov%2Fpublic%2FCommon%2FViewDoc.aspx%3FDocRefId%3D%257BF4797A12-4B20-4AF8-B3E6-AFC3D76E0DCB%257D&ei=J772UMPmKqfg0QHIk4CIDA&usg=AFQjCNFfAnt2T0snlcYkYkQ4c4nlMk7VZA&sig2=lQga8Mqym27--nN76sZ7GQ&bvm=bv.41018144,d.dmQ

> revenue adjustment per event, with unlimited annual exposure. Staff proposed specific threshold targets for outages affecting overhead systems based on estimated restoration times in the Company's emergency plans. Similar estimated restoration times do not exist for the Company's underground systems. Staff recommended that the Company propose underground thresholds within 30 days of the Commission's order in this case.
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> The Company argued that there are no current performance standards for emergency management and that rather than a performance standard, best practice standards should be developed.
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> We find that communication of restoration times, and achieving restoration time estimates, are an essential component of the provision of safe and reliable service. We agree with the recommended decision that Staff has demonstrated the need for a performance mechanism tied to restoration times. We also agree with the recommended decision that the Company's criticisms of Staff's proposed mechanism have merit.
>
> In order to advance the process of developing an optimal restoration mechanism, *without placing an undue burden on the Company, we will adopt Staff's proposal on a trial basis with the proviso that there will be no negative rate adjustment for failure to meet the standard*.[14]

Furthermore, under the New York PSC's rate plans, when existing reliability performance standards for non-storm outages are not met, typically there is no prompt refund to consumers of the amount of the rate reduction. Instead of a prompt downward rate adjustment or refund to customers, utility revenue reductions due to missing performance targets are "deferred," to be taken into account in a future rate case when calculating rates for future years. For example, after Con Edison failed to meet reliability standards in 2002, a 2003 PSC order said the company was "directed to defer $7.5 million in shareholder funds on its books for the benefit of ratepayers, use of such deferral to be determined at a later date." Ultimately, this credit for ratepayers was amortized, along with other credits and debits, over three years beginning in 2005. The impact of the delayed reliability performance adjustment for 2002, amortized from

[14] *Order Establishing Rates For Electric Service,* Case 07-E-0523, 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, at 174-175 (Issued March 25, 2008) (*Emphasis added*).

2005 - 2008, was utterly insignificant in the context of the 2005-2008 rate plan, where sums far larger than the deferred rate adjustments for poor reliability performance were eventually compromised in the final joint proposal for settlement of the case approved by the PSC. Similarly, in 2009 a $5 million penalty for poor reliability performance was not refunded to customers immediately but instead was deferred as a credit for ratepayers in future proceedings.[15] The Commission should examine why the PSC allows the financial impact of Con Edison performance failures to be so disconnected from the time of failure, melded into future proceedings that often involve compromise of much larger sums in the next rate case, and only notionally credited to customers in future years.[16] A more direct and prompt impact of poor reliability performance that could affect a utility's quarterly earnings statements would likely have greater effect in encouraging utility attention to continuous service and compliance with performance standards, and would provide more direct benefit to customers who suffered from poor utility performance.

As mentioned above, utilities maintain that the PSC cannot impose nonconsensual performance based rate reductions without prior judicial trials satisfying due process of law, under the penalty provisions of Section 25 of the Public Service Law. Section 25 was enacted before modern administrative law and procedure was developed, and requires court proceedings before imposing any financial penalties upon a utility for failure to obey a law, rule, or PSC order. It remains unclear whether under existing law the PSC could require a set of reliability performance criteria and impose prompt adverse financial consequences for failure to satisfy them without following the antiquated and cumbersome procedures of Section 25 and without the agreement of the utility in rate case settlement agreements to be exposed to such adjustments based on performance. The legislature has authorized administrative imposition of penalties by the PSC only in limited circumstances, e.g., for violation of "call before you dig" rules, and for violation of rules against "slamming" of telephone customers to switch their service to competitive suppliers. The Legislature has not authorized the PSC to impose

[15] *Order Adopting Revenue Adjustments For Poor Reliability Performance*, Case 07-E-0523, 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, (Issued July 20, 2009), *available at* http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={69EB436E-B071-4DE9-9785-BF4F9D7281BB}.

[16] The pending Joint Proposal for settling National Grid's upstate electric and gas rate cases provides for bill credits to customers of service quality performance penalties ("negative revenue adjustments"). See Joint Proposal for settlement of Cases 12-E-0201 and 12-G-0202, , Appendix 7, Attachment 1, p. 8, Adobe p. 746 *available at* http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={AF4EB1D2-C041-4646-BA8E-1448AA2117D9}.

any financial sanctions for violations of rules or orders creating reliability performance standards. The Commission should examine whether a lack of legislative clarity is a factor in the weak PSC reliability performance plans, which typically are agreed to by utilities in the context of their major rate case settlements. The Commission should examine this issue and make appropriate recommendations for legislative changes so that performance criteria and sanctions can be established by the PSC without hinging them upon voluntary acquiescence of utilities in their rate case settlement agreements.

The Commission should inquire whether New York utilities have less incentive to restore service promptly under PSC approved "revenue decoupling" mechanisms. These mechanisms, which were intended to foster utility support for energy efficiency programs, assure utilities that their revenues will not be affected by reduced customer usage. They also, however, assure the utility of the same revenue even if service is off for an extended period after a storm. Revenue decoupling, in combination with rate plans which create strong financial incentives to limit maintenance expenses, like tree trimming and weak pole replacement, may lessen the incentive of the utility for making the utility more resilient to major storms. Also, there may be incentives to minimize expenses for extra crews and overtime after storm damage occurs. Reductions in maintenance expenses, and avoided expenses, can work to enhance current quarter profits, because the utility revenue stream is not affected even if service to thousands of customers is off for extended periods after storms. This hazard has been recognized by the Regulatory Assistance Project, in their publication addressing common criticisms of revenue decoupling:

> 12.11 "Decoupling diminishes the utility's incentive to restore service after a storm." This can be a problem if not addressed in the design of the decoupling mechanism. After a storm, utilities normally bring in extra crews, pay overtime, airlift in supplies, and otherwise do everything reasonably possible to restore service. The primary reasons for this are the deeply-held sense of obligation that drives utilities and their employees to provide reliable service and their appreciation of the far-reaching and deleterious impacts of an outage.
>
> But there is also a more prosaic motive: the need to "get the cash register running" again, so revenue flows to the utility*. If a decoupling mechanism allows the utility to receive the revenues that it would have collected if the power were on, consumers both suffer an outage and pay for service they did not receive. The utility is made whole, and really does not suffer any penalty from slow service restoration.*

> This is easily addressed in the design of an RPC decoupling mechanism. One approach would be to adjust the number of customers for whom the allowed revenue is computed to reflect only those who were receiving service during a particular time period, deducting days when power was unavailable.... Another approach would be to address service quality issues such as outages separately, in a comprehensive Service Quality Index, with penalties tied to outage frequency and duration.[17]

None of the solutions suggested above to address the lack of monetary incentive to provide continuous service after "revenue decoupling" have been adopted by the PSC. There is no provision to reduce utility revenue in months when customers do not receive continuous service for the full month, there has been no adoption of appropriate quantifiable service quality performance standards for major outage prevention work such as tree trimming, weak pole replacement and repositioning, and there are no established time limits for repair of downed or damaged lines after major storms, and there is no system for prompt administratively determined monetary sanctions for noncompliance. Ultimately, the limited exposure to the risk of sanctions for poor reliability performance created in the voluntary rate case settlements has been acceptable to the utilities.

The Commission should examine whether reliability has been impaired as a result of the lack of PSC standards relating to major storm related outages, whether the PSC "performance metrics" actually and accurately measure the right attributes to assure reliability and adequacy of service before and after major storms, whether economic consequences to utilities of not attaining existing performance targets set by the PSC are sufficient, and whether the power of the PSC to impose prompt, meaningful rate refunds or reductions in response to objectively measured failure to provide reliable service needs to be clarified or bolstered by the Legislature.

IV. The Second Phase of the Commission Investigation Should Examine Whether the Entire Cost of Storm Damage Recovery Should Be Borne by Customers

The Interim Report concludes with "next steps" that include an investigation of the storm preparation and response of the State's six investor-owned utilities. As stated

[17] Regulatory Assistance Project, *Revenue Regulation and Decoupling: A Guide to Theory and Application*, June 2011 (*Emphasis added*).

above, AARP and PULP believe the utilities' performance-based regulation plans should be part of any investigation. In addition, we urge the Commission to review the Rate Plans approved for Con Edison and make recommendations to ensure that storms costs are not automatically passed on to New York consumers, with the utility bearing no liability.

After enduring the unprecedented high water surges of Superstorm Sandy, New York utility customers living in the impacted areas are now at risk of another surge: rising rates to cover costs for utility storm response, recovery and restoration of service. According to a Con Edison 8-K filing with the Securities and Exchange Commission, preliminary estimates of Hurricane Sandy related costs are from $350 million to $450 million for Con Edison, and from $75 million to $100 million for its holding company affiliate, Orange & Rockland.[18] In a competitive industry, companies risk losing customers and sales if they attempt to raise charges to recoup storm losses not suffered by competitors. To avoid that, they typically take precautionary measures to protect their property from damage (tree trimming, storm water protection, pumps) and they may obtain insurance to protect against catastrophic loss. In contrast, there remains a strong likelihood that Con Edison will seek to collect all of its net storm recovery costs

[18] "CECONY and O&R estimate, on a preliminary basis, their response and restoration costs for Hurricane Sandy (and a subsequent Nor'easter) to be $350 million to $450 million and $75 million to $100 million, respectively. The primary basis for these preliminary estimates is the experience of CECONY and O&R with Hurricane Irene. These preliminary estimates do not include the costs that will continue to be incurred to inspect and assess the condition of the energy systems of CECONY and O&R, and to repair them to their normal operating condition." Con Edison 8-K, Nov 14, 2012, *available at* HYPERLINK "http://investor.conedison.com/phoenix.zhtml?c=61493&p=irol-SECText&TEXT=aHR0cDovL2lyLmludC53ZXN0bGF3YnVzaW5lc3MuY29tL2RvY3VtZW50L3YxLzAwMDExOTMxMjUtMTItNDY3OTMzL3htbA%3d%a/.
\"The Commission's current policy on materiality is that an item must exceed 5% of the company's net income to qualify for deferred accounting treatment.\" Case 01-G-1821, *Petition of Central Hudson Gas & Electric Corporation for Approval for Environmental Site Investigation and Remediation Costs, filed in C 9218*, Issued Oct. 25, 2002.
Case 01-M-1958, Petition of Consolidated Edison Company of New York, Inc. for Permission to Defer the Costs Related to Emergency Response and the Restoration of Service Related to the World Trade Center Disaster, filed in C9187, at p. 3, *available at* http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={0790E19D-3ED6-4E2A-AA53-463D27254D5B}.
In contrast, the recently submitted Joint Proposal for settlement in the pending National Grid (Niagara Mohawk) rate case provides for a storm reserve of $29 million per year and would require the utility to petition the Commission for deferral of major storm expenses above that amount. Con Edison 2011 Financial Report, at Adobe p. 112, *available at* http://investor.conedison.com/phoenix.zhtml?c=61493&p=irol-SECText&TEXT=aHR0cDovL2lyLmludC53ZXN0bGF3YnVzaW5lc3MuY29tL2RvY3VtZW50L3YxLzAwMDExOTMxMjUtMTItNDY3OTMzL3htbA%3d%3d3d"

from customers through higher utility rates, even though shareholders receive compensation through the allowed rate of return for taking investment risk.[19]

The current Con Edison rate plan approved by the PSC appears to allow full pass through to customers of all storm recovery and restoration costs, with no costs borne by shareholders. Before turning to provisions of the current Con Edison rate plan regarding storm costs, a review of some general utility ratemaking principles may be helpful. Utility rates for investor-owned utilities are set prospectively, mainly based on projected operation and maintenance expenses plus the return allowed on capital investment. Once rates are fixed, additional recovery from customers if costs turn out to be higher than expected (or reducing rates if actual expenses are lower than projected) is normally not allowed under the filed rate doctrine and the general rule against retroactive ratemaking. Thus, recoupment of unanticipated losses is ordinarily barred. These rules, however, are sometimes eased in limited, extraordinary situations. For example, regulators may allow utilities to petition for "deferral" of unexpected costs they incur during a rate plan, for consideration and possible recovery of the costs from customers at a later time, typically when rates are reset in the next major rate case. The following conditions for deferral of unanticipated costs usually apply:

- The cost must be material.[20]
- The cost must be unusual, and not reasonably forecast in a rate proceeding.
- The deferral request must be incremental to the amount currently allowed in rates.
- The utility cannot be over-earning its allowed return on equity, or over-earn if the deferral is allowed.
- The company must show it attempted to mitigate the expense to the extent possible.

As an example of the typical deferral process, when Con Edison petitioned for deferral of certain costs it incurred after the terrorist attack in lower Manhattan in 2001, the PSC

[19] Utilities refused to shoulder unanticipated costs after the 2001 terrorist attack. See *2 Utilities Say 9/11 Costs May Raise Rates*, N.Y. Times, Feb. 28, 2002 ("'Absent reimbursement, area consumers would have to fund the restoration and rebuilding of the utility systems.... Verizon and Con Edison officials have refused to consider passing the losses on to their shareholders or borrowing to pay the costs)."

[20] "The Commission's current policy on materiality is that an item must exceed 5% of the company's net income to qualify for deferred accounting treatment." Case 01-G-1821, *Petition of Central Hudson Gas & Electric Corporation for Approval for Environmental Site Investigation and Remediation Costs, filed in C 9218*, Issued Oct. 25, 2002.

did not allow blanket deferral of all costs for recovery from customers, apparently because the fifth factor above, cost mitigation, was incomplete:

> Consideration of WTC-related expenses is premature because of the unsettled nature of such costs. Con Edison and the State of New York continue to pursue multiple avenues for recovery of those extraordinary costs, including, but not limited to, insurance claims, federal aid and other reimbursement programs, and possible state and federal tax deductions.[21]

In contrast to the normal procedure, by which a utility must petition the PSC for deferral of extraordinary costs incurred after rates have been set, under the current Con Edison rate plan deferral of major storm costs for future recovery from customers appears to be total and automatic. The current rates were set to allow funding for a major storm cost reserve of only $5.6 million per year, with <u>all</u> costs above that amount deferred for future recovery from customers, subject only to PSC staff review:

> <u>Major Storm Expense Reserve</u>
>
> The Company's annual revenue requirements provide funding for major storm expenses of $5.6 million in each of RY1, RY2 and RY3, incurred for major storms.[fn] Cumulatively over the term of this Electric Rate Plan, the amounts provided for major storm costs total $16.8 million. To the extent that over the term of the Electric Rate Plan, the Company incurs cumulative incremental major storm damage expenses in excess of $16.8 million, *the Company will defer on its books of account expenses in excess of the $16.8 million for future recovery from customers*. To the extent that over the term of the Electric Rate Plan the Company has incurred cumulative major storm damage expenses less than $16.8 million, the Company will defer any variation less than $16.8 million for the benefit of customers. *All major storm expenses will be subject to Staff review*.
>
> [fn] a 'major storm' is defined in 16 NYCRR Part 97 as a period of adverse weather during which service interruptions affect at least ten (ten)

[21] *Case 01-M-1958, Petition of Consolidated Edison Company of New York, Inc. for Permission to Defer the Costs Related to Emergency Response and the Restoration of Service Related to the World Trade Center Disaster, filed in C9187*, at p. 3, *available at* http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={0790E19D-3ED6-4E2A-AA53-463D27254D5B}.

> percent of the Company's customers within an operating area *and/or results in customers being without electric service for durations of at least twenty-four (24) hours*.

Joint Proposal approved in Case 09-E-0428, etc., 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, Order Establishing Three-year Electric Rate Plan, p. 23-24, Adobe P. 71 (March 26, 2010) (Emphasis added). There appears to be no requirement for Commission review and approval of a petition for deferral, and the standard to be employed by Department of Public Service Staff in its review of deferred amounts is unclear.

The PSC definition of "major storm" encompasses any outage to customers lasting more than 24 hours. As a consequence, when the $5.6 million reserve for storm damage recovery built into Con Edison's annual rates is used up any remaining expenses are automatically deferred for future recovery from customers. Indeed, at the end of 2011, Con Edison recorded in its financial statements a regulatory asset of $128 million in deferred storm costs the utility expects to be recovered from its customers at a future time. This was up from $57 million in 2010, probably due to Irene and other 2011 storms.[22] Unless mitigated by aid, insurance recovery, shareholder sharing of costs, or financing, a second surge of Superstorm Sandy recovery costs may financially swamp many New York utility customers, many of whom already have a difficult time making payment for service under current rates. If federal storm recovery aid is not sufficient to cover all losses, the Commission should recommend that a priority be given to using funds for utility restoration, in order to spare utility customers from further hardship.

LIPA reportedly estimates its recovery and restoration costs as between $900 million and $950 million.[23] As LIPA rates are set without the need to compensate shareholders for risk on their investments, who conceivably might shoulder part of the risk of storm losses, it is to be hoped that costs of these magnitudes will be largely offset by federal or state aid or private insurance, or to the extent they are not covered, spread over time through ratemaking and financing measures to avoid rate shock.

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[22] Con Edison 2011 Financial Report, at Adobe p. 112, *available at* http://investor.conedison.com/phoenix.zhtml?c=61493&p=irol-SECText&TEXT=aHR0cDovL2lyLmludC53ZXN0bGF3YnVzaW5lc3MuY29tL2RvY3VtZW50L3YxLzAwMDExOTMxMjUtMTItNDY3OTMzL3htbA%3d%3d3

[23] WNYC News, *State Officials Mull End of LIPA*, Dec. 20, 2012, available at http://www.wnyc.org/articles/wnyc-news/2012/dec/20/state-officials-mull-end-lipa

Conclusion

AARP and PULP commend Governor Cuomo for his leadership and commitment to help the millions of New Yorkers who were impacted by Superstorm Sandy. Continuous electric utility service is essential to the everyday life of millions of New Yorkers. The establishment of a Moreland Act Commission underscored the Governor's resolve to make sure New Yorkers never have to experience lengthy service outages ever again.

Our organizations have a strong interest not only in the essential role of reliable electric service, but in ensuring that utility service is affordable and that utility rate payers have the consumer protections they need.

The time has come for New Yorkers to have more robust consumer protections in the utility marketplace. The recommendations enumerated within this paper should be passed in the final 2013 New York State Budget as well as the preliminary recommendations by the Moreland Act Commission contained in the Governor's budget proposal. We believe the Governor, the Commission and the Legislature should take this opportunity to assure New Yorkers that they will not be left in the dark the next time a storm threatens.