Wirebury Connections Inc. INTERROGATORY #34

Interrogatory

KQ concludes that allowing service territories to overlap will increase the incumbent utility's average cost because its fixed costs will remain the same and the level of consumption will be reduced if some or all customers in the overlap area are served by an alternate distributor.

Reference: KQ p.7

a) In reaching this conclusion, did KQ assume that customers would be served through the alternative distributor's system rather than using the incumbent's network? If the answer is no, please describe how the customers would be served.

b) Would KQ's opinion change if an embedded distributor served the customers using the same upstream assets that the incumbent LDC would have used? If not, please explain how assets would be stranded or duplicated under an embedded distribution connection.

c) Would KQ's opinion change if, in addition, to meeting the conditions in (b), the embedded distributor is also required to pay the cost of using the incumbent's distribution system and the capital and operating costs associated with connecting and servicing the new customers. ? If not, please explain how assets would be stranded or duplicated under this scenario.

d) Please explain why the incumbent's average costs would increase if the incumbent receives additional revenue from the incremental consumption without investing any new capital since all of the connection costs in excess of the costs covered through existing rates would be paid by the embedded distributor as a capital contribution.

e) Does KQ agree that under cost of service regulation the incumbent's existing ratepayers would pay the full cost of maintaining the current system independent of how many future customers are attached? If not please explain why.

Response

The premise of the question does not recognize the impact on revenues - it mentions only the impact on the level of consumption. It is important to recognize that the incumbent's financial loss is driven by the loss of revenues without its fixed costs being reduced.

An incumbent utility's costs will be higher in situations that make the responsibility to serve ambiguous and in situations that reduce the economies of scale of the distribution operation than if these situations did not exist. Overlapping service territories create this condition of uncertainty and reduce economies of scale. Even if an embedded distributor were to use the existing distribution assets, paying a cost of service based rate for such use and selectively removing customers and/or sub-regions from the incumbent's defined territory, the costs of the entire system would be higher than they would otherwise be have been.

Recovering the costs of the current system (and in fact, the entire current and future system) is done over the lifetime of the equipment and thus includes payments from both current and future customers.

With respect to the specific questions:

(a) Yes, exclusively or in conjunction with the incumbent's network.

(b) No. Planning uncertainty will still increase costs for both entities. Other fixed costs related to customer service and other support functions will be under-utilized (e.g. financial transaction processing).

(c) Please refer to response (b).

(d) The incumbent's average cost would not necessarily increase but would be higher than it would have been if the revenues received by having customers served through an alternative distributor are less than the revenues received by having customers served directly through the incumbent utility.

(e) Under cost of service regulation, utilities recover their cost of service from all present and future customers through rates and charges approved by regulators. Such cost of service includes the costs associated with building, operating, maintaining and expanding the network system. However, the increase in planning uncertainty will tend to make such costs higher for all customers, in the case of an uncertain service area.