STATE OF NEW YORK

PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corporation for Electric Service	Case 05-E-1222

NEW YORK STATE CONSUMER PROTECTION BOARD

BRIEF OPPOSING EXCEPTIONS

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On June 6, 2006, the presiding Administrative Law Judges issued a Recommended Decision ("RD") in this proceeding following over three weeks of hearings which generated more than 4,000 pages of transcript. On June 29, various parties filed exceptions to that decision. The New York State Consumer Protection Board ("CPB") hereby submits its opposition to certain of those exceptions. Our failure to address any specific exception should not be construed as support for it, but rather our view that either no further discussion is required or the matter will be adequately addressed by other parties.

NYSEG Exception No. 1 – ROE

Claiming that the national average ROE for electric utilities in 2005 was 10.5%, NYSEG asserts that the RD's recommended ROE of 9.3% is so low as to be confiscatory, that is, so insufficient that it amounts to an unconstitutional governmental taking of private property without just compensation.[1] In support of its position, it cites two seminal cases in the history of regulatory law, Bluefield and Hope.[2]

Contrary to the impression conveyed by NYSEG, however, the significance of Hope was not in the Supreme Court's reiteration of the definition of a fair rate of return, but in its conclusion that a regulatory agency satisfies that standard when it fulfills its statutory obligations. "Since there are no constitutional requirements more exacting than the standards of the Act," the Court stated, "a rate order which conforms to the latter does not run afoul of the former."[3] The statute involved in that case, the Natural Gas Act, incorporates exactly the same "just and reasonable" requirement for rates that is included in the New York Public Service Law.[4]

In this State, it is well-established that in setting utility rates, "The PSC is free to entertain or ignore any particular factor, or to assign whatever weight it deems appropriate," and its determination that rates are just and reasonable will not be set aside "unless it is shown that the judgment of the PSC was exercised without any rational basis or without any reasonable support in the record."[5] Thus, an ROE for which there is "any reasonable support in the record," is not "confiscatory."

[1] Brief on Exceptions of New York State Electric & Gas Corporation, pp. 2-4 ("NYSEG BOE").

[2] Bluefield Waterworks & Improvement Company v. Public Service Commission of West Virginia, 262 U.S. 679 (1923); Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944).

[3] Hope at p. 607.

[4] "All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable." Natural Gas Act, 15 USC § 717c(a); "All charges made or demanded by any such gas corporation, electric corporation or municipality for gas, electricity or any service rendered or to be rendered, shall be just and reasonable." PSL § 65(1).

[5] Abrams v. Public Service Commission, 67 N.Y.2d 205, 212 (1986).

The RD used an average of the ROEs recommended by the Department of Public Service Staff ("Staff") and the CPB, updated to the time of the decision.[6] Both those parties applied the methodology set forth in the Recommended Decision in the Generic Finance Case ("GFC").[7] Despite using very different proxy groups of companies for their analyses, the Staff and CPB results were nearly identical, differing by only 11 basis points, or less than 1.5%.[8]

The GFC methodology has provided an objective basis for the determination of ROE for over a decade and has been consistently applied by the Commission in litigated rate cases. It is the antithesis of arbitrariness. Changes have been made to the approach over time, but these have been necessary to keep it up-to-date and in tune with available market data. For example, NYSEG complains that Staff and the CPB used risk premium information published by Merrill-Lynch rather than that produced by Ibbotson, as the GFC Recommended Decision originally prescribed.[9] This modification is not an arbitrary choice by those parties, but rather comports with a 1995 decision in which the Commission concluded that use of the Merrill-Lynch data was preferable because it is "more current."[10]

[6] NYSEG's contention that there is no record basis for this average because the RD does not include the calculations underlying the update is frivolous. The methodologies, proxy groups and market data sources used by Staff and CPB are fully described in the testimony.

[7] Case 91-M-0509, Proceeding on Motion of the Commission to Consider Financial Regulatory Policies of New York Utilities, "Recommended Decision," July 19, 1994.

[8] Initial Brief of the New York State Consumer Protection Board, p. 33 ("CPB Initial Brief").

[9] NYSEG BOE, pp. 6-7.

[10] Case 95-G-1034 - Central Hudson Gas & Electric Corporation - Rates, Opinion No. 96-28 (issued October 3, 1996) p. 14.

An objective evaluation of ROE inherently generates a rate that is the product of a snapshot of current market conditions. It is time dependent. Even significant differences in rates determined in different cases at different times do not imply that one is correct and another wrong, but merely that the underlying parameters have changed. It has been standard practice for the Commission to update such variable rates to comport with market conditions prevailing at the time a decision is issued. We recommend that be the case here, as well.

NYSEG's exception to the RD's conclusion that the Company should be allowed a return on equity of 9.3% is little more than a recapitulation of the arguments the utility made in its initial and reply briefs, all of which were specifically and fully addressed in the decision. NYSEG has presented nothing new to suggest that the RD's recommendation is in error, and the exception should be denied.

NYSEG Exception No. 6 – Apprenticeship Program

NYSEG contends that the RD's one-third reduction in the Company's proposed revenue requirement allowance for its apprenticeship program constitutes "micro-management" that will result in "workforce reductions and degradation in current levels of customer service."[11] This assertion, of course, assumes that NYSEG has demonstrated that the funding is actually necessary. It completely ignores the fact that NYSEG, as the proponent of increased expenditures for this program, first has to meet the burden of proving that the revenue requirement allowance requested is necessary for the provision of safe and reliable service. Absent such proof, it is not "micro-management" to deny the request. It is rational ratemaking.

[11] NYSEG BOE, p. 21.

The only error made by the RD on this issue was that it did not deny the entire increase. As the CPB has complained repeatedly, the Company has never made any effort to provide a factual demonstration of why a program that has maintained a stable workforce for years at current staffing levels now suddenly needs to be augmented by 30 positions. NYSEG's "explanations" amount to nothing more than, "Because our management says so, and our management knows best."[12]

As noted in the RD, the 30 positions that formed the basis for the increased revenue requirement for the apprenticeship program were not, in fact, filled by NYSEG as scheduled in November 2005.[13] In a footnote, the Company now claims that this decision was taken only because of "[t]he uncertainty of the outcome of this proceeding."[14] Never, in any previous filing in this case has the Company made such an assertion. This attempt to insert new "testimony" at this late stage is clearly improper and deserves to be stricken from the record, but it is also highly revealing.

There was no greater uncertainty about the outcome of this case in November 2005 than there was at the time the rate filing was first conceived by the Company. NYSEG's actions unequivocally reveal that it had decided that it did not need to hire more apprentices, but that it would be willing to do so if it could get some more money from ratepayers in this case. That is not a reasonable basis for a rate increase, and NYSEG's exception should be denied.

[12] See "Reply Brief of the New York State Consumer Protection Board," pp. 4-5.

[13] RD, p. 16.

[14] NYSEG BOE, p. 21, n. 33.

NYSEG Exception No. 6 – Restricted Meter Read Access Program

The essence of the CPB's position on this issue is that excess costs imposed on the NYSEG system by uncooperative customers should not be borne by the general body of ratepayers. As we suggested, this problem can be avoided either by creating an incentive for customers to change their behavior by charging them the costs they cause, or by giving NYSEG an incentive to find ways to avoid incurring incremental expense for this category of meter reads. Including an allowance for the restricted meter read access program in rates does neither, and merely perpetuates the problem to the detriment of ratepayers. The RD was absolutely correct in noting that "it does not appear that NYSEG would give the CPB proposal any serious consideration if it is not supported by the ratemaking adjustment presented here."[15] The Company's exception should be rejected.

NYSEG Exception No. 11 - Hydro Plant Operation and Maintenance Expense

The RD, at p. 33, recommended adoption of a $1.076 million adjustment to revenue requirement for hydro plant O&M expense proposed by a CPB sponsored panel of witnesses.[16] NYSEG's exception to this recommendation reflects a completely erroneous reading of the decision and is, therefore, baseless.

In its initial filing, NYSEG included an historic test year expense for Hydraulic Power Generation of $2,437,202.[17] CPB witnesses Larkin and DeRonne noted that this

[15] RD, pp. 18-19.

[16] The CPB panel proposed a reduction of $1.027 million in the test year expenditures for this function. (Tr. 3812) In calculating revenue requirement, NYSEG inflated test year expenses for the hydro plant category by 4.8%. (Tr. 3811).   After inflation, the rate year revenue requirement adjustment becomes $1.076 million, as calculated in the RD (i.e 1.048 x $1.027 million = $1.076 million).

[17] Tr. 3809.

amount was some 102%, or $1,229,000, above the average of expenditures for calendar years 2001 through 2004.[18] They recommended that the test year amount for this expense be reduced by $1,027,000 to match the Company's actual expenditures for the year ended December 31, 2004.

NYSEG complains, first, that "there is no evidentiary support for the RD's utilizing a four-year average" as the basis for a recommended adjustment to revenue requirement for hydro plant expense.[19] In fact, however, the RD did no such thing. It simply recommended adoption of the CPB's adjustment which it expressly noted was intended to bring NYSEG's budget for this expense "in line with the Company's costs and experience in 2004."[20] The reduction called for, as shown in Appendix B, Schedule B, page 1 of the RD is $1.076 million. Had the RD used the four-year average expense as the basis for the adjustment, it would have required a reduction of over $1.278 million.[21]

Next, NYSEG argues that the adjustment is inappropriate because the CPB failed to prove that the Company's projected expenditures were either non-recurring or not annual.[22] The CPB, however, never contended that these types of hydro plant expenditures were not recurring, but simply that the amount stated by NYSEG for the test year was grossly exaggerated. The RD, correctly, agreed.

[18] Tr. 3810

[19] NYSEG BOE, p. 27.

[20] RD, p. 33.

[21] In other words, if the RD had adjusted test year expenditures downward by $1,229,000 to match the average for the previous four years, it would have required a rate year revenue requirement reduction of 1.048 x $1,229,000 = $1.278 million.

[22] NYESEG BOE, p. 27.

Finally, NYSEG attempts to play the deterioration of reliability card by contending that the adjustment "would negatively impact NYSEG's maintenance of its hydro facilities."[23] In fact, however, as the CPB explained in its Initial Brief, the entire difference between the hydro plant O&M expense incurred by NYSEG in 2004 and the amount included in the test year was attributable to an anomalous increase in the budget for operations, not maintenance.[24] NYSEG's test year budget for hydro plant maintenance was actually 15% lower than its expenses in 2004. Consequently, every penny included by the Company in revenue requirement for hydro plant maintenance remains available after the adjustment called for by the RD. NYSEG's exception to this recommendation should be rejected.

NYSEG Exception No. 12 – Productivity Factor

NYSEG suggests that the RD's recommendation that a productivity factor of 3% be used to reduce the Company's revenue requirement "effectively directs NYSEG to cut its labor by 3%, which is absurd."[25] In reality, it is the Company's assertion that this recommendation amounts to "mandated employee reductions" that is truly absurd.

Both the CPB and the DPS Staff advocated substantial reductions in revenue requirement to account for additional merger savings that NYSEG has acknowledged it expects to achieve but has not accounted for in its filing and to recognize efficiency savings associated with major improvements such as the TDIRP and Customer Care

[23] Id.

[24] Tr. 3810 (table).

[25] NYSEG BOE, p. 28.

System.[26] In the absence of cost-benefit studies, which the Company says it did not perform, Staff and the CPB were forced to develop alternative methodologies for quantifying the expected savings. They approached the problem from different directions, but came up with comparable adjustments ranging from $7.5 to $10.2 million.[27]

The RD agreed that a case had been made for reflecting additional merger savings and efficiency gains in revenue requirement, but found neither of the approaches taken by Staff and the CPB to be entirely satisfactory. Instead, as a proxy for the savings it found could not be precisely quantified, it proposed an increase in the productivity factor applied by the Commission from the standard 1% to 3%. The cost of this adjustment is $2.3 million.[28]

The fact that the productivity factor is applied to labor expense neither mandates, nor even implies, that savings must or will be achieved through workforce reductions. Even assuming the recommendation required additional expense cutting efforts by NYSEG, the Company would be free to achieve the reductions in any manner it saw fit. It might, for example, choose to reduce the $2.5 million allowed by the RD for management incentive compensation before laying off essential employees.

In reality, however, the adjustment will require no cost-cutting efforts whatsoever, because the savings that reduce NYSEG's revenue requirement for the rate year have already been achieved but were not reflected in the Company's filing. That is the

[26] Brief on Exceptions of the New York State Consumer Protection Board, pp. 8-9 ("CPB BOE"). "TDIRP" is the Transmission, Distribution and Infrastructure Replacement Program.

[27] Id.

[28] RD, Appendix B, Schedule B, p. 2.

essence of the RD's finding that "an ample and sound basis has been established on the record" for an increase in the productivity factor.[29] NYSEG's exception is meritless.

Exceptions Related to Customer Charges

Having found no need for any delivery rate increases, the RD cautioned with respect to rate design that:

> care should be taken so as not to adversely affect any individual customers, or any customer classes, with rate design changes that would cause them to see material and adverse bill impacts.[30]

Accordingly, it concluded that the customer charge for residential customers should be increased by $1.00, to $13.00 per month, as proposed by the CPB, rather than the $2.00 requested by NYSEG. Both the Company and Staff except to this recommendation.

NYSEG does not address the bill impact issue but rather continues to defend its proposed increase on a cost of service study basis.[31] DPS Staff, on the other hand, clearly agrees with the RD's recommendation that there be no adverse bill impacts for any customers, but contends that this objective will be achieved even if the customer charge for residential customers is increased by $2.00 per month.[32] Unfortunately, the calculations underlying that contention were not provided in Attachment A to Staff's Brief on Exceptions. If Staff's conclusion is verified, the CPB would not oppose Staff's exception on this issue, given the overall rate reduction proposed by the RD. Should

[29] RD, p. 39.

[30] RD, p. 75.

[31] NYSEG BOE, p. 33.

[32] Brief on Exceptions of the Department of Public Service Staff, p. 18 ("Staff BOE").

the Commission determine that a lesser reduction is called for, it should ensure that no accompanying customer charge increases result in “material and adverse bill impacts” for any group of customers.

Exceptions Related to the Recommended Commodity Program

The RD recommended that NYSEG be required to continue to offer a fixed price option for commodity service, but at a significantly reduced rate, and under modified terms designed to reduce the impediments to expansion of retail access presented by some of the features of the current Voice Your Choice program. Several ESCO parties, most notably Direct Energy Services, LLC, and the Small Customer Marketer Coalition/Retail Energy Supply Association (“SCMC/RESA”), except to this decision, contending that it is contrary to the Commission’s vision for the future of competitive markets and its policies aimed at achieving that vision. The CPB strongly disagrees.

The RD’s decision on commodity issues is the result of an exceptionally thorough and thoughtful evaluation of an extensive record developed with the full participation of a broad spectrum of interested parties. It was explicitly crafted with a view to furthering the objectives enunciated by the Commission in its Retail Access Policy Statement[33] to the maximum extent possible given the circumstances presented by the NYSEG system as it exists today. It is a “transition mechanism” made necessary by the fact that the “end state” envisioned by the PSC “is not yet here.”[34]

[33] Case 00-M-0504, Proceeding on Motion of the Commission Regarding Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets and Fostering Development of Retail Competitive Opportunities. “Statement Of Policy On Further Steps Toward Competition In Retail Energy Markets,” Issued August 25, 2004 (“Policy Statement”).

[34] RD pp. 122-123.

The Commission recognized in its Policy Statement that the road to its vision for competitive markets would not be smooth and that its "public charge to ensure the provision of safe and reliable energy at just and reasonable rates"[35] would require flexibility rather than prescription because "markets rarely develop in the precise manner envisioned by regulatory authorities."[36] Rather, it is a "predictably unpredictable process."[37]

The ALJs in this case were faced with three salient facts for which the record evidence was clear and extensive: (1) the vast majority of small customers were taking fixed price commodity service from NYSEG and the overwhelming majority of them express the desire to see that service continued; (2) the rate charged by NYSEG for that service has generated revenue far in excess of the Company's cost to provide it; and (3) alternative offerings from ESCOs have been few and far between and have been slow to develop. The RD resolves these issues by continuing the utility fixed price offer, requiring the charging of a cost-based rate for the service, and loosening the strictures of the Voice Your Choice program to give ESCOs a better opportunity to market effectively. This result appropriately balances the interests of the utility, competitive entities and consumers, and should be affirmed.

Staff continues to maintain its position in direct testimony that "the Company should not be permitted to offer a fixed price commodity option," based on its understanding of the Commission's stated policy.[38] The RD thoroughly discredited that

[35] Policy Statement, p. 2.

[36] Id.

[37] Id., p. 10.

[38] Staff BOE, p. 19.

mistaken notion, concluding that:

> requiring the utility to offer a fixed price option for commodity is consistent with the view expressed in the Retail Markets Policy Statement that utilities should continue to hedge the spot market price of power for their residential customers, in the short term, to continue to protect customers from price volatility.[39]

The absence of reasonably priced competitive fixed price products requires that the utility offer a fixed price commodity option and that Staff's exception be denied.

SCMC/RESA argues that if the Commission approves continuation of NYSEG's fixed price commodity offering, it should expressly recognize the transitional nature of the program by providing a "sunset" provision. It suggests that if on any August 30, four or more ESCOs are offering a fixed price product to either residential or small commercial customers, the program would be terminated at the end of the calendar year.[40] DPS Staff offers a similar proposal.[41]

A sunset provision is neither necessary nor appropriate. The RD correctly concludes that requiring NYSEG to offer a fixed price option is consistent with the Commission's Retail Markets Policy Statement.[42] It also sets forth the standard to be used to determine if, and when, NYSEG should no longer offer such a service – when the market is sufficiently developed to rely on it to provide fixed price service at a reasonable price.[43] That assessment requires a careful review of the facts as they exist at the time a change is proposed. Unsupported standards of the type proposed by

[39] RD, p. 98.

[40] Brief on Exceptions of the Small Customer Marketer Coalition and Retail Energy Supply Association, p. 27-28.

[41] Staff BOE, p. 19.

[42] RD, p. 98.

[43] RD, p. 97.

SCMC/RESA and Staff, which materialized for the first time in their briefs on exceptions and are bereft of any record support, should not supplant an assessment based on market realities. Those exceptions should be denied.

Direct Energy suggests that the Commission should allow NYSEG to decline to provide fixed price commodity service if the Company decides that the rate it is allowed to charge is unsatisfactory.[44] We disagree. One of the fundamental objectives of the regulation of utility monopolies is to secure for consumers the rates and services they could expect to receive in a competitive environment. As the RD found, the overwhelming majority of customers in NYSEG's territory want a fixed price commodity option.[45] In a competitive environment, that kind of demand would generate products. Here, however, the record demonstrates that "the market is not sufficiently developed to rely on it to provide fixed price service at a reasonable price."[46] Consequently, in this regulated environment, it is not just perfectly reasonable, but essential, for the Commission to order that the product be provided by the utility.

That conclusion is particularly justified in this case, given that the demand was created by NYSEG in the first place. To permit the Company to refuse to provide a fixed price offer simply because it does not like the rate it will be permitted to charge makes no more sense than giving utilities the power to veto any other service that the Commission might find to be in the public interest.

[44] Brief on Exceptions of Direct Energy Services LLC, p. 26.

[45] RD, pp. 93-94.

[46] RD, p. 97.

NYSEG has, in fact, made it quite clear that it is not happy with the pricing scheme laid out in the RD. In its Exception No. 2, it contends both that (1) the roughly 22% markup over wholesale prices proposed in the RD as the basis for setting the fixed price offer "will not reflect market prices, will not compensate the utility adequately, will not send appropriate price signals to consumers and competitors and will not minimize barriers to entry,"[47] and (2) that 80%/20% sharing of gains and losses outside the ±$5 million deadband is inadequate to compensate the Company for the risks associated with a fixed price offer.[48]

The first objection misses the point that the RD was not attempting to establish a proxy for a retail market price but rather to fix a rate that would compensate NYSEG for its actual costs and risks. This is standard, cost-based ratemaking, and the markup recommended is clearly reasonable on a record that includes undisputed testimony that NYSEG's actual costs to provide fixed price service were approximately 17% above wholesale prices. Similarly, the sharing mechanism described in the RD was not intended to continue what has been a source of excessive profits for the Company over the life of its current rate plan, but rather to provide "some small incentive, through sharing, for the Company to minimize losses and maximize earnings in managing its fixed price portfolio."[49]

Although the RD's approach to pricing and earnings sharing is clearly reasonable and would justify rejection of NYSEG's exceptions, the CPB recognizes that attempting to quantify in a vacuum the costs associated with the risks inherent in a fixed price offer

[47] NYSEG BOE, p. 12.

[48] NYSEG BOE, p. 14.

[49] RD, p. 106

in the real, volatile world is difficult. The Commission may, therefore, conclude that the so-called "retail conversion factor" should be increased.

It has been the CPB's position throughout this case that the interests of consumers can be adequately protected either by establishing a cost-based rate for fixed price service, or by returning to ratepayers any earnings that exceed a just level of compensation for the services provided. Consequently, we would not object to a raising of the retail conversion factor if, and only if, the earnings sharing mechanism proposed in the RD were retained or modified in favor of ratepayers. NYSEG's exception to this portion of the RD should be rejected no matter what decision the Commission reaches on the conversion factor.

The CPB also opposes the suggestion by the Staff that the time between enrollment periods under the Voice Your Choice program be one year, rather than the six months proposed in the RD.[50] As we have stated repeatedly, customers have shown a preference for a fixed price offer and would undoubtedly want that offer to be the default if they failed to make an affirmative choice. Despite this, in the interest of promoting ESCO competition by reducing NYSEG's advantage in acquiring fixed price customers, we agreed that the variable price option should be the default, but only if the period that customers could be "stuck" in this option were minimized. We recommended that enrollment be open every month. NYSEG advocated continuation of the current two years. Staff called for one year. The RD choice of six months was a reasonable compromise which is acceptable to the CPB. Extending the period to one year puts an unacceptable burden on consumers who may not realize the consequences of their inaction until it is too late. If the Staff recommendation is

[50] Staff BOE, p. 23.

adopted, the fixed price option should be the default commodity service.

Staff suggests that the six month interval between enrollment periods is unworkable because this is a one-year rate plan. It contends that customers who choose a one-year fixed price six months into the rate year will have a service agreement that extends six months beyond the life of the plan, and that, in the interim, delivery rates may change. Clearly, given the short duration of this rate plan, customers would have to be warned that the delivery rate component of their otherwise fixed rate could change. This is hardly a major inconvenience given that the primary concern is the volatility of energy commodity prices. It is also nothing new, since the possibility has always existed for customers who chose service from an alternative provider. The issue is simply not of sufficient consequence to outweigh the benefit of permitting default service customers a more frequent opportunity to make a new choice of service.

Conclusion

The CPB respectfully requests that the exceptions opposed herein be rejected or modified for the reasons stated.

Respectfully submitted,

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