STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Central Hudson Gas & Electric Corporation for Electric Service	Case 05-E-0934
Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Central Hudson Gas & Electric Corporation for Gas Service	Case 05-G-0935

POST-HEARING BRIEF OF

THE NEW YORK STATE CONSUMER PROTECTION BOARD

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This case provides the Public Service Commission ("PSC" or "Commission") an important opportunity to address the impact on consumers of near-record high commodity prices and the largest delivery percentage rate increases to be proposed for any major energy utility in more than a decade. The impact of these difficult circumstances on consumers can be reduced by adopting the Consumer Protection Board's ("CPB") recommendations to modify various provisions of the April 19, 2006 Restated Joint Proposal supported by Central Hudson Gas & Electric Corporation ("Central Hudson" or "the Company"), Staff of the New York State Department of Public Service ("DPS Staff"), Multiple Intervenors ("MI") and the U.S. Department of Defense and All Other Federal Executive Agencies ("Joint Proposal" or "JP").

This is one of the most important cases to come before the Commission in recent years. It is the first rate case for one of the state's large energy utilities since energy commodity prices increased substantially, and provides an opportunity for the Commission to take action to help consumers address those high commodity prices. This case also involves the largest percentage delivery rate increases for a major energy utility to come before the Commission in more than a decade, and

provides an opportunity for the PSC to address ratemaking practices that may have been appropriate in an era of generally stable delivery and energy rates, but must now be modified to appropriately address significant upward pressure on those prices.

Unfortunately, in our view, the JP does not satisfactorily address either of these important issues. Regarding the impact of higher commodity prices, the JP is virtually silent and would provide consumers no additional tools to help manage their energy bills. Similarly, in many respects, the JP does not provide for measures that would properly respond to today's circumstances. For example, the JP would inappropriately permit the utility to retain ratepayer funds instead of using them to mitigate the impact of price increases, and would provide funding for projects that are not necessary for safe and reliable service. Overall, the CPB opposes the JP since it does not adequately reflect consumer interests and we recommend that the Commission improve the JP in the manner we suggest herein.

In Point I, we demonstrate that the JP does not satisfy the Commission's Settlement Guidelines, since it contains several provisions that are not in consumers' interest, it is not supported by a spectrum of normally adverse parties, and it would not likely have been the result of a litigated proceeding. In Point II, we further explain that because of high energy commodity prices, very large proposed delivery price increases should be carefully reviewed to determine whether policies and practices that may have been common in an era of stable and lower energy prices, are appropriate now.

We explain in Point III, that although the JP contains some positive elements, overall, it is not in consumers' interest. In Point IV, we show that the JP should be modified to provide consumers additional tools to help manage high commodity prices. We demonstrate that it should be revised so that Central Hudson offers both electricity and natural gas to its residential and small commercial customers at a fixed price, and to ensure that the utility conducts outreach and information regarding the reason for high commodity prices, actions that consumers can take to manage and reduce their energy bills and how consumers may obtain assistance in paying their utility bills.

In Point V, we demonstrate that the Joint Proposal should be revised so that ratepayer funds currently held by the Company are used to moderate the proposed rate increases. This recommendation alone would reduce the amount of the electric delivery rate increases by more than $6 million in each of the three years of the rate plan. In Point VI, we identify three programs included in the JP that are not required for Central Hudson to offer safe and reliable service, and explain why they should be postponed or downsized. This recommendation would make approximately $2 million to further mitigate the size of the rate increases.

We address provisions concerning electric reliability in Point VII. We explain that several modifications are required to protect consumers. In Point VIII, we address other revenue requirement and financial issues, including return on equity, the discount rate used in pension and OPEB expenses, defined benefit pension plans and policies for recovering manufactured gas plant site remediation costs. Lastly, in Point IX, we explain that the Commission has another tool at its disposal to help mitigate the price increases that would result from approval of the JP.

I. THE JOINT PROPOSAL DOES NOT SATISFY THE COMMISSION'S SETTLEMENT GUIDELINES.

The CPB fully explained in its testimony that the JP does not satisfy the Commission's Settlement Guidelines since it does not provide adequate benefits for ratepayers nor does it achieve a result that the CPB would expect following a litigated proceeding. (Exhibit 102) The JP completely ignores the CPB's fixed price commodity option proposal despite the fact that it was presented in testimony in November 2005 and was not opposed or rebutted in testimony filed in this proceeding by any party. Similarly, the JP would resolve several revenue requirement issues in a manner that would not have been expected in a litigated proceeding. For example, rate increases under the JP are premised on capital expenditure projections that are larger than any party recommended in their initial testimony. Similarly, the JP reflects right of way maintenance expenditures as proposed by the Company in initial testimony, with only a minor adjustment, which results in a projected increase of

126% beyond 2005 levels, far outside the range of reasonableness. The JP is also based on electric sales forecasts that are lower than any party proposed in testimony. Further, the JP permits the Company to retain ratepayer-contributed funds, expands existing programs and includes new programs that are not necessary for safe and reliable service at a time when all reasonable means should be used to minimize the size of rate increases.

In addition, the JP has not earned the support of normally adverse parties. It is not supported by the CPB, the sole state agency that is charged by the State Legislature and the Governor with representing the interests of the state's consumers before the PSC. Nor is it supported by the Public Utility Law Project ("PULP"). Moreover, although Multiple Intervenors, which represents large industrial customers, supports the JP, its Statement in Support cites almost exclusively electric revenue allocation, electric rate design, gas balancing and gas revenue allocation issues. (Exhibit 63) Moreover, the support by the U.S. Department of Defense is due to the JP's resolution of disputes regarding gas delivery service to one customer. Thus, no party representing solely the interests of mass market customers supports the JP. We urge the PSC to give substantial weight to this fact.

II. THE COMMISSION SHOULD CAREFULLY CONSIDER THE CONTEXT OF THIS JOINT PROPOSAL.

The record shows that prices for electricity and natural gas commodity services have increased substantially in recent years, resulting in Central Hudson's customers paying gas prices this past winter as much as double the price in the previous winter, and paying electricity prices in the fall of 2005 that were 87% higher than at the same time the previous year. (Exhibit 102)

The record also conclusively demonstrates that commodity prices are expected to be at high levels for the next several years. The CPB testified that gas prices through the winter of 2008 – 2009 are currently forecast to be the highest prices ever paid by Central Hudson customers, with the exception of portions of the winter of 2005 – 2006. Electricity commodity prices are also expected to be extremely high relative to historical levels, through 2009. (SM 710-1)

The CPB explained that in these difficult circumstances, the Commission should reject the "business as usual" approach reflected too often in the JP, such as denying customers the opportunity to purchase commodity from the utility at fixed prices when such options are generally not available from ESCOs at just and reasonable rates, enabling the utility to retain ratepayer funds for unspecified purposes and unspecified periods of time, requiring ratepayers to fund projects that are not necessary for safe and reliable service and permitting unreasonably large increases in certain expense categories. (Exhibit 102) Such policies are inappropriate at this time.

DPS Staff has asserted that the delivery rate increase under the JP "are acceptable" based on its calculation of the impact of those increases on customers' total energy bill. (Exhibit 66, p. 16) The facts are that, ignoring commodity costs, the JP would increase electric delivery rates by approximately 10% for three consecutive years and increase gas delivery rates by approximately 19% and 12% in the first two years. (SM 702-3) Including commodity costs, the JP would compound steep energy bill increases paid by customers in recent months. The Commission should carefully consider the impact of high commodity costs on consumers, in evaluating the JP.

III. THE JOINT PROPOSAL CONTAINS SOME POSITIVE ELEMENTS, ALTHOUGH OVERALL, IT IS NOT IN CONSUMERS' INTEREST.

The CPB has thoroughly evaluated the JP. As the CPB testified, the JP represents an improvement in several areas over the Company's original filing and contains some elements that are in consumers' interest. (SM 767-8; 804) For example, as explained by the CPB Panel, some revenue requirement adjustments, the phase-in of rate increases, the low income program and the fact that the JP properly excludes several recommendations made by some parties in direct testimony, are noteworthy and positive attributes of the JP that should be retained by the Commission. However, the CPB Panel testified at length that the positive elements do not overcome the negative provisions of the

JP, and that overall, the JP is not in consumers' interest. The CPB's specific concerns are fully explained in this brief.

On cross examination of the CPB Panel, Central Hudson attempted to challenge the CPB's position on this matter, implying that it was contrary to the position taken in a case involving Consolidated Edison Company of New York, Inc. ("Con Edison"). (SM 808-811) There is no contradiction. The CPB did not support the Joint Proposal in that case. Nevertheless, we submitted a statement "to help identify and explain the pro-consumer provisions" of that JP, and recommended that the Commission consider the context of the proposed rate increases, in particular, that Con Edison's base electricity rates had not increased since 1994. (Exhibit 49, p. 2) The CPB Panel in this proceeding provided similar testimony, explaining that the JP contained several important pro-consumer provisions (SM 767-8) and the fact that Central Hudson's base delivery rates had not increased in many years should be considered as part of the context of the JP. (SM 810) However, the Panel also clearly explained that the benefit of past rate freezes cannot properly be considered to be a benefit of this JP (SM 810-1), and the presence of some pro-consumer provisions does not mean that overall, the JP is in the public interest. (SM 821)

IV. THE JOINT PROPOSAL SHOULD BE MODIFIED TO PROVIDE CONSUMERS TOOLS TO HELP MANAGE HIGH AND VOLATILE ENERGY PRICES.

The CPB conclusively demonstrated that consumers should be provided new tools to help them manage high and volatile energy prices: (1) the opportunity to purchase electric and gas service at a fixed price from the utility and (2) reliable information from the utility on the reasons for high prices, conservation and other consumer tips, and the availability of assistance programs. (SM 713) The JP would provide neither. The record contains no justification for the absence of these important tools. Having failed to identify any factual or policy explanation for these deficiencies in the JP, the

Proponents asserted only that the CPB's fixed price commodity proposal is procedurally infirm. (SM 776-7) That claim is without merit.

A. Fixed Price Commodity Options

Threshold Legal Issues - Based on arguments made at the hearing, Central Hudson and DPS Staff are expected to assert that: (1) the Commission directed Central Hudson to terminate its fixed price option and (2) this issue cannot be relitigated in this proceeding. (SM 776–7; 781-2) Judge Phillips denied the Company's motion to strike the CPB's testimony regarding fixed price options, and provided an opportunity for parties to further address whether it is legally proper to raise the fixed price issue at this time, as well as the merits of the CPB's proposal. (SM 1618) We demonstrate in this section that New York State Public Service Law and relevant New York State case law indicate that there is no legal prohibition against considering the CPB's fixed price proposals in this proceeding.

As a threshold matter, at the hearing, the Company and DPS Staff asserted that the CPB's proposals regarding both an electric fixed price option and a gas fixed price option, were procedurally infirm. They failed to recognize[1] that the Commission Order directing the Company to terminate its fixed price option to which they refer, applies only to gas. No such order applies to an electricity fixed price option offered by Central Hudson, and neither the Company nor DPS Staff provided any basis at the hearing for applying their arguments to the CPB's electric fixed price option. The issue of whether the provision of adequate electric service by Central Hudson requires that it offer a fixed price option for electricity has not been litigated before the Commission. It is therefore entirely proper for the CPB's proposals regarding the electric fixed price option to be considered by the Commission in this proceeding.

[1] Either "deliberately or inadvertently," to borrow a phrase from Company Counsel. (SM 893)

The FPO as a Central Issue in this Case - Pursuant to 16 NYCRR, §61.2, any issue pertinent to the rates, rules and regulations of a utility in effect at the initiation of a proceeding will not be presumed to be just and reasonable. Therefore, consideration of this issue in this proceeding is entirely proper.

16 NYCRR §61.2 (2006) states in its entirety:

> The rates, rules and regulations relating thereto that are in effect when the proceeding is initiated will not be presumed to be just and reasonable.

Under 16 NYCRR §61.2, when Central Hudson filed its rate case, all of its rates, rules and regulations became open to reconsideration, no matter how recently they were adopted. The CPB may face a difficult burden in overcoming the recent precedent set by the Commission's decision in the gas FPO case, but it is not precluded from making the effort. Indeed the very history of the FPO "issue" indicates the folly of the company's argument. The Commission previously ordered LDC's to offer their "core customers a fixed price offer for gas supply services for the 1997-98 heating season."[2] Subsequently, in a second FPO order, LDCs were granted the option of providing such a service.[3] In March 2005, the Small Customer Marketer Coalition ("SCMC") petitioned the Commission to order Central Hudson to stop offering a FPO. (SM 718) By the Company's logic, the SCMC Petition should never have been considered because the issue had already been determined in a previous order. Of course, logic dictates that the Commission, as a policy making entity, always has the discretion to examine and modify policies as it sees fit, and its regulations for rate cases make it explicitly clear that it can do so as to any rate, rule or regulation of the utility.

The CPB's Proposal Addresses a New Issue – Claims by the Company and DPS Staff that the CPB's testimony regarding fixed price options cannot be considered in this proceeding are based on the erroneous assumption that the CPB is attempting to relitigate an issue previously decided by the

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[2] Case 97-G-0600, Proceeding on Gas Cost Volatility and Alternate Gas Purchasing Mechanisms, Order Requiring the Filing of Proposals to Ameliorate Gas Price Volatility and Requiring Comments, June 5, 1977.

[3] Case 97-G-0600, Statement of Policy Regrding Gas Purchasing Practices, April 28, 1998.

Commission. The Company is attempting to utilize principals of collateral estoppel to prevent CPB testimony from consideration. However, this doctrine can only be utilized by a party after the establishment of certain thresholds found in the relevant caselaw. The elements necessary in all cases for issue preclusion are well known and are spelled out below via references to case law:

1. Issues to be precluded must be identical:

> It is required that an issue in the present proceeding be identical to that necessarily decided in a prior proceeding, and that in the prior proceeding the party against whom preclusion is sought was accorded a full and fair opportunity to contest the issue (Schwartz v Public Adm'r, 24 NY2d 65, 71; Ryan v New York Tel. Co., 62 NY2d 494, 500-502).

In administrative proceedings the burden of identifying the issues as identical lay with the proponent of its application, in this case Central Hudson. In Ryan, the Court held that "in the application of collateral estoppel with respect to administrative determinations, the burden rests upon the proponent of collateral estoppel to demonstrate the identicality and decisiveness of the issue, while the burden rests upon the opponent to establish the absence of a full and fair opportunity to litigate the issue in prior action or proceeding. (Cf. Schwartz v. Public Administrator, at p. 73)" The court continued "this apportionment of the burdens is both fair and necessary. Otherwise much of the value of collateral estoppel will be lost." (Id.)

In a 1987 case the Commission held that, with regard to a CPB proposal concerning the proper allocation of certain plant costs for NYSEG that was in fact "identical in concept and theory, to that made by the CPB in NYSEG's last rate proceeding and rejected there by the Commission." The moving party, in this case MI, relied on tenent of res judicata (claim preclusion) and stare decisis to suggest that the CPB be estopped from relitigating these issues. The Commission found that MI was "wrong to suggest that parties are estopped from relitigating previously rejected positions." (Id., at 59) The Commission did note that a party will "not ordinarily prevail by simple repetition." (Id.) The CPB contends that facts and issues have changed since the issuance of the July Order and therefore the

CPB is not relitigating a previously argued issue and in accord with relevant case law and statute should be heard on this matter.

2. The Doctrine is more flexible in the context of administrative proceedings:

> While issue preclusion may arise from the determinations of administrative agencies, in that context the doctrine is applied more flexibly, and additional factors must be considered by the court Staatsburg Water Co. v. Staatsburg Fire Dist., 72 NY2d 147. These additional requirements are often summed up in the beguilingly simple prerequisite that the administrative decision be quasi judicial in character (See Ryan v. New York Telephone Company at 500).

In Consumer Protection Board v. Public Service Commission (Consumer Protection Board v. Public Serv. Comm'n, 97 AD2d (3rd Dept 1983), the Appellate Division found that the doctrine of collateral estoppel applies to administrative agency determinations only when the agency is acting in a judicial or quasi judicial capacity, and not when it is acting in ratemaking capacity, which is legislative. The Appellate court held that when the PSC determines an issue solely for the purpose of setting a utlility's rates, relitigation of the issue in a subsequent proceeding is proper because the PSC ratemaking decisions are legislative as opposed to quasi judicial. The court in Allied Chemical v. Niagara Mohawk Power Corp., determined that it is within the "PSC's statutory mandate to act adjudicatively"[4] and further builds on the CPB decision by elaborating on the meaning of judicial acts of the PSC as opposed to those of a legislative nature. The Court concludes that the formality of proceedings surrounding the PSC determination is not dispositive, instead

> issue preclusion has not been applied to ratemaking proceedings because the reasonableness of a rate depends on economic conditions, and numerous policy considerations, all of which invariably change over time, requiring a utility's rate be susceptible to reconsideration. Because a ratemaking agency must be free to reassess the reasonableness of rates, it would be illogical, and inconsistent with the agency's function, to give preclusive effect to prior ratemaking determination, and the courts have refused to do so. (See Allied Chemical at 278.)

The court in Consumer Protection Board v. PSC, found that the CPB was not estopped "from attacking the PSC's treatment" of certain utility costs by an opinion of the PSC issued in a prior case

[4] Allied Chemical, an Operating Unit of Allied Corporation, Appellant, v. Niagara Mohawk Power Corporation et al., Court of Appeals of New York, 72 NY 2d, 271, May 26, 1988, HN 5.

dealing with the electric rates of one of the utilities in which the CPB appeared…" The Court reiterated the point made above, namely that issues can only receive preclusive effect when the Commission is acting in a quasi judicial manner, not legislatively. The CPB contends that the determination made in the July Order is related to the ratemaking function of the Commission and as such any determination therein can not be granted preclusive effect. Most if not all PSC "rate cases", as is the subject proceeding, are titled as proceedings on motion as to the rates, charges, rules and regulations of the particular utility. The fixed price issue clearly fits into this paradigm and as such should not be precluded from consideration.

The Need for Fixed Price Options – The record shows that consumers have a strong preference for fixed price energy products when they are available. (SM 623, 714) For example, evidence from NYSEG's service territory indicates that more than 75% of customers, who affirmatively chose a commodity option, selected a fixed price option from the utility. Further, a recent academic study confirms conventional wisdom that unanticipated home energy bill increases cause hardship on low income households. That study found that consumers without substantial financial assets decrease spending on items such as food, personal care, and other household expenditures by 40 cents for each unanticipated dollar increase in their home energy bill. (SM 717-8) The CPB Panel testified that the availability of reasonably priced fixed price products would provide low income customers a valuable tool to help avoid the need to substantially reduce their expenditures on food and other personal care items if the price of energy increases unexpectedly. (SM 718)

The events of this past heating season further demonstrate the need for customers to have the opportunity to purchase electricity and natural gas at a fixed price. For example, the gas supply charges paid by Central Hudson customers increased from an average of $.83 per Ccf in the winter of 2003-2004, to a high of $1.7075 per Ccf in November 2005. For electricity, the average price was $.06193 per kWh in 2004, and peaked in 2005 at $.12593 per kWh. (SM 714-5) At the same time, the percentage of the Company's electric supply portfolio from sources other than fixed price contracts of

6 months or longer in duration, increased from 46% in 2004 to 63% in 2005, increasing the exposure of customers to spot market purchases. (SM 715)

The CPB Panel explained that by purchasing fixed price products, consumers' energy bills will not necessarily decline. (SM 919-20) Instead, fixed price products are mainly a tool to help consumers manage the volatility of energy bills. Such products should be available to all consumers at just and reasonable prices, and would be expected to be particularly highly valued by customers on fixed incomes and low-income customers, since these products would facilitate household budgeting.

The Absence of Competitive FPOs - The record also incontrovertibly demonstrates that ESCOs are not offering fixed price electricity or gas products to mass market customers at just and reasonable prices. At the beginning of the heating season, only one ESCO in Central Hudson's service territory was offering electricity to residential customers at a fixed price, while four ESCOs were offering them gas at a fixed price, but at a price that was substantially higher than what Central Hudson would have been able to offer. (SM 623-5) Further, the record shows that products that are identified by those ESCOs as "fixed price products," may in fact permit the ESCO to increase the price without recourse by the customer. (SM 929-31, Exhibit 101)

Further, the record shows that even residential customers with a strong preference for fixed price products have not been satisfied with ESCO offers. Of the 8,504 customers who subscribed to the natural gas fixed price option from Central Hudson when that option was terminated on October 1, 2005, only 21% had chosen ESCO service six months later. As the CPB Panel testified, the vast majority of fixed price customers in Central Hudson's territory determined that they would rather pay the utility's variable price, even while those prices were spiking to unprecedented levels, than take service from an ESCO. (SM 716)

Dr. Elfner explained that in view of these facts, the retail market for fixed price products for small customers in Central Hudson's service territory cannot be considered to be competitive by any measure typically used by economists, including those evaluating the structure, conduct and/or

performance of markets. (SM 922-3) Therefore, there is no basis to conclude that the prices of fixed price products for residential and small business customers in those markets are just and reasonable.

Consistency With PSC Orders – The CPB demonstrated that our FPO proposal is not inconsistent with the Commission's orders on retail competition. The record shows that the competitive market has not responded adequately to the elimination of the utility-provided FPO and that Central Hudson can be distinguished from other utilities that do not offer an FPO. This gives the Commission new facts and circumstances to consider in evaluating the CPB's FPO proposal.

Moreover, contrary to DPS Staff assertions (Exhibit 66, pp 9, 19) there is no Commission directive against utilities offering fixed price products, as demonstrated by the fact that NYSEG and RG&E offer those products to their customers and the Commission has praised the flexibility of its flexible administrative approach. (Case 00-M-0504, Statement on Policy on Further Steps Toward Competition in Retail Energy Markets, August 25, 2004, p. 3)

Policy Recommendations - The CPB recommended that in view of the facts and circumstances cited above, Central Hudson be required to offer fixed price electric and natural gas commodity service to mass market customers, in a program similar to its recent gas FPO, on terms that assure that program costs are not subsidized by other customers. (SM 914) The prices of those products should be approved by the PSC at levels that are projected to cover all costs of offering the service, with no profit to the Company. The program would have one enrollment period each year, and would be designed to provide the Company certainty as to the number of participating customers. Based on that information, the Company could secure commodity at a known price, with its only risk being the uncertainty of weather. (SM 916-7) The gains or losses resulting from deviations from normal weather would be reflected in the following year's fixed price, flowed through to FPO customers or shared with the Company. (SM 917-8)

The CPB's proposal addresses the realities of the retail energy market in Central Hudson's territory. It would ensure that customers who want to purchase a fixed price commodity product have

the opportunity to do so, at a just and reasonable price. It would also be simple to implement and easy for consumers to understand, since it is very similar to the FPO that Central Hudson offered for gas customers through August 2005. ESCOs would still have the opportunity to beat the utility's fixed price, offer a product with a fixed price for a duration of longer than 1 year, and offer a 1-year fixed price product continuously throughout the year.

B. Outreach and Education Regarding High Energy Prices

The JP, and the direct testimony of the JP's Proponents, is completely silent on outreach and education that the Company would conduct for purposes other than retail competition. In response to an information request, Central Hudson stated that it conducts such outreach, but it could not quantify the expected expenditures on those activities, and did not identify plans to conduct any outreach on issues related to high commodity prices. (SM 722)

The CPB Panel demonstrated that the JP should be revised to correct this deficiency, particularly since high energy prices are expected to continue through the term of the JP. Consumers should be provided accurate and timely information on: (1) the cause of high energy prices, (2) actions they can take to manage their energy bills, and (3) how to obtain assistance in paying their bills. The record demonstrates that the CPB and the Department of Public Service played key roles in delivering that information to consumers this past winter, in part, as a result of the PSC augmenting its normal winter energy outreach and education efforts. (SM 855) These efforts also demonstrate that information can be delivered to consumers without interfering with the Commission's competitive agenda, contrary to a suggestion by the Company on cross examination. (SM 852-3) Utilities can, and should, be instrumental in providing this important information to consumers, particularly because there is no guarantee that the PSC will take action to provide this information to consumers this year.

In these circumstances, the CPB recommends that Central Hudson's budget for outreach and education on these issues be augmented with $175,000 that is currently planned for the "Competition education Campaign."[5]

V. RATEPAYER FUNDS CURRENTLY HELD BY THE COMPANY SHOULD BE USED TO MODERATE THE PROPOSED RATE INCREASES.

The CPB Panel testified that in an environment of high energy prices and a proposed series of large delivery rate increases, ratepayer funds held by Central Hudson should be used to moderate rate increases. (SM 766) The Panel advanced two specific proposals, neither of which was addressed in the Statements in Support by any of the Proponents nor challenged on cross examination. Under these proposals, the amount of the electric delivery rate increases would be reduced by more than $6 million in each of the three years of the rate plan, without affecting Company earnings.

The Proponents may claim that these funds should not be used to moderate the proposed rate increases since such use would set the stage for rate increases after the funds expire. We disagree. In these circumstances, there is no better use for ratepayer funds than to mitigate the proposed delivery rate increases. In addition, assuming the Proponents are correct, a thorough review of the Company's rates in three years may be beneficial, especially given the results of the current rate plan under which Central Hudson enjoyed excess earnings on its electric operations in each of the years 2001 – 2005.

A. Electric Depreciation Reserve Surplus

The CPB Panel testified that funds available in the electric depreciation reserve should be used to mitigate the electric delivery rate increases in this case. (SM 766) Under the JP, approximately $20 million of excess electric depreciation reserve would be available. (JP, Appendix G, Schedule 3) The JP identifies two potential uses for this surplus: (1) to fund the AMR pilot if competitive metering funds are no longer available and (2) to fund the cost of electric backout credits through June 30, 2007.

[5] The numerous reasons for reducing the amount of spending on retail competition "education" programs are discussed in Point VI (C).

For the reasons explained in Point VI, the AMR pilot should not be conducted at this time. The cost of electric backout credits is not expected to be substantial, since even the JP's Proponents concede that the growth of retail markets has "long lagged."[6] Thus, the record shows that the vast majority of the excess depreciation reserve surplus would be available to be used for customer benefit under the JP.

B. Ratepayer Funds Reserved for Metering

The JP specifies that funds that are currently reserved for metering initiatives, will be maintained and reserved for that purpose. (JP, Section X(C)(2)(c)) The CPB Panel provided a detailed history of Commission action regarding these funds. (SM 751-5) Overall, for approximately four years, no legitimate use of ratepayer money held for competitive metering was identified. Then, the PSC broadened the potential uses of those funds to include spending on software intended to assist Central Hudson's large customers. At this time, $466,000 is projected to remain at the end of the current rate plan. (SM 755)

The CPB Panel testified that permitting the Company to retain that long-held ratepayer money instead of using it to mitigate the large rate increases that are expected in this proceeding, would be untenable. It demonstrated that the JP should be modified so that this ratepayer money is finally put to good use. (Id.)

VI. PROGRAMS THAT ARE NOT REQUIRED FOR SAFE AND RELIABLE SERVICE AT THIS TIME SHOULD BE POSTPONED OR DOWNSIZED.

The CPB testified that in the current environment of high energy prices and a proposed series of large delivery rate increases, the Commission should carefully consider the appropriateness of funding for projects that are not necessary for safe and reliable service. (SM 594-5) The Panel identified three such projects and fully explained why these programs should not be funded, or the

[6] Exhibit 66, p. 25.

funding provided under the JP should be reduced substantially. This detailed testimony was not challenged on cross examination by any party.

A. Automated Meter Reading Pilot Program

Under the JP, Central Hudson would develop an Automated Meter Reading ("AMR") pilot proposal at a cost of up to $1.5 million, funded from the unused competitive metering funds held in the Benefit Fund, or the excess depreciation reserve. (JP, Section XV(B))

The record unambiguously demonstrates that this program should not be implemented at this time. The AMR proposal was not supported by testimony of any party in this case. Instead, the record shows that this program: (1) is not necessary to provide safe and reliable service, (2) is not supported by any cost benefit analysis, (3) would require ratepayers to pay the cost of the program yet permit the Company to retain the resulting cost savings, and (4) may be inconsistent with the PSC's competitive metering agenda. (SM 756-7) Accordingly, the CPB recommends that it not be conducted at a time of high energy costs and likely delivery rate increases.

The Proponents asserted that the AMR program is reasonable because it would "allow the utility to experiment." (Exhibit 66, p. 41) This is not the time to experiment with ratepayers' money. The CPB Panel also noted that a similar AMP pilot program is being conducted by at least one other utility in New York State, and the results of that pilot could be shared with all New York State utilities, avoiding the need for "experimentation" here. (SM 756) The Proponents also asserted that ratepayers would not see any bill impacts from the AMR proposal. (Exhibit 66, p. 41) That proposal, however, would remove $1.5 million from funds that could be used to mitigate the rate increases in this proceeding.

B. Retail Access Issues

The JP includes and expands programs intended to facilitate retail competition in the Company's service territory. It also contains several retail-access-related provisions that are detrimental to consumers, including requiring a two-tiered Merchant Function Charge ("MFC") that confuses customers, further delaying the implementation of cost-based backout credits or MFCs thereby imposing additional costs on customers, and modifying existing Commission Orders applicable to Central Hudson, by providing that incremental costs of the ESCO Referral Program incurred before the effective date of the JP, be deferred for future recovery from ratepayers. (SM 759) Meanwhile, retail competition for mass market customers has not grown as expected.[7]

As explained by CPB witnesses, the JP does not quantify the costs of these programs, with the exception of the "Competition Education Campaign." (SM 761-2) Accordingly, the CPB recommends that the ALJs direct the Proponents to identify the revenue requirement impact of these provisions. That information is necessary to provide the CPB, other parties and ultimately the Commission, information to determine whether the provisions are in the public interest at this time, or whether they should be modified or rejected. Cross examination of Company witnesses also identified some questionable use of ratepayer money for renting hotel rooms or venues, renting tables and chairs for marketers and providing "trays of cookies." (SM 1023-4)

Absent this information, we recommend that the retail access-related requirements imposed on Central Hudson be curtailed considerably, and that the Company's revenue requirement be reduced by $100,000 each year. CPB witnesses explained that a revenue requirement reduction of this amount would represent a much better use of scarce ratepayer dollars at this time than these retail access

[7] The CPB Panel testified that the Company's ESCO Referral Program, scheduled to begin February 1, 2006, had been postponed due to a lack of interest by ESCOs. (SM 761) Cross examination at the hearing indicated that this program began on April 12, 2006. (SM 1020-1) The eventual interest in this program by at least two ESCOs does not change the CPB's point that retail energy markets for mass market customers in the Company's service territory are far weaker than expected.

programs and would help begin the transition in Central Hudson's territory, away from ratepayer subsidization of functions that could and should be conducted by ESCOs. (SM 762)

C. Competition Education Program

The JP includes an allowance of $350,000 for each of the three rate years for a "competition education campaign aimed at promoting customer migration." The record shows that several modifications are required to this provision.

Program Budget - The CPB testified that the JP should be revised so that ratepayers fund no more than $175,000 annually of retail competition outreach and education programs, or one-half of the amount reflected in the JP. (SM 765) As explained in Point IV(B), the remaining $175,000 should be spent on outreach and education programs to inform consumers of the reason for high energy prices and action they can take to help manage their energy bills.

The record contains no reference to any analyses or studies demonstrating that Central Hudson's previous ratepayer-funded outreach and education efforts regarding retail competition have been cost effective. (SM 763) Moreover, there has been a noteworthy lack of ESCO interest in the much heralded ESCO referral program in Central Hudson's territory, and in the matters being addressed in this proceeding, as evidenced by the fact that no ESCOs filed testimony and none entered an appearance at the hearing. In these circumstances, ratepayers' subsidization of advertising, promotion and other customer acquisition activities that could and should be conducted by ESCOs, should decline substantially.

Program Objective - The competition education campaign in the JP is intended to "promot[e] customer migration." (JP, Section XVI(G)) As explained by CPB witnesses, the purpose of ratepayer funded competition education programs should be to provide balanced information on retail competition to consumers, including an accurate assessment of the potential benefits and risks associated with obtaining service from an ESCO. (SM 764) It is inappropriate to use ratepayers'

money to finance one-sided "education" campaigns designed only to promote migration, especially in an environment of high energy prices and large delivery rate increases and where ESCOs have generally not met the needs of Central Hudson's residential customers. The Joint Proposal should be revised to reflect this concern.

Program Participants - The Joint Proposal specifies that the program would be developed by the Company "in collaboration with Staff and interested ESCOs." (JP, Section XVI(G)) The CPB testified that this provision is not in the public interest since it would prohibit input and participation by parties that represent the interests of the consumers who fund the campaign, such as the CPB, is not in the public interest, and it would be contrary to PSC policy. (SM 764)

On questioning from ALJ Phillips, the Proponents appeared to retreat from this provision, saying that "I never saw those words in the Joint Proposal," (SM 1032) and input from parties such as the CPB would be "welcome at any time." (SM 1603) The CPB appreciates this clarification of the Proponents' intentions. Based on this testimony, we understand that, consistent with a recent Commission Order, all interested parties including the CPB "shall have exactly the same right to participate upon request"[8] in the development of the competition education campaign, regardless of the language of Section XVI(G) of the JP.[9]

VII. SEVERAL PROVISIONS OF THE JOINT PROPOSAL REGARDING RELIABILITY SHOULD BE MODIFIED TO PROTECT RATEPAYERS.

It is incontrovertible that the reliability of Central Hudson's electric system requires improvement. Despite a long-term rate plan that the Commission found provided sufficient resources for the Company to provide safe and reliable service, excess earnings on its electric operations in each

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[8] Case 04-E-0572, 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 Adopting Three-Year Rate Plan, March 24, 2005, p. 105.

[9] Nevertheless, the language of the JP needs to be modified.

of the last five calendar years, and PSC authorization to use additional ratepayer funds from the Benefit Fund to improve reliability, the Company still failed to meet minimum reliability thresholds in 2002, 2004 and 2005. The PSC should take steps in this case to ensure that the reliability of the Company's electric system improves.

However, in attempting to address these reliability concerns, the JP appears to reflect a philosophy of giving the Company all that they request and then leaving them to their own devices, instead of actively overseeing the Company to ensure that they spend ratepayer money in an appropriate fashion. Specifically, several provisions of the JP related to reliability are illogical, unbalanced, and not in consumers' interest. Why should the JP provide more ratepayer funding for capital expenditures than even the Company requested? Why should the JP provide ratepayer funding for right of way ("ROW") maintenance expense that is more than double the amount the Company actually spent in the most recent year? Why should the JP permit the Company to profit if it does not spend its large rate allowance for distribution ROW maintenance, if the goal is to improve reliability? And why should the JP reflect the costs of these additional reliability expenditures, but none of the anticipated benefits?

The testimony of the CPB's experts demonstrates that the JP should be modified to address these concerns. Most of those recommendations were based on the extensive expertise on ratemaking and regulatory policy of the CPB Panel. A detailed review of the cost benefit analyses of each project was not conducted by the Panel, nor is such analyses required as a basis for the CPB's recommendations, contrary to Central Hudson's suggestions on cross examination.[10] (SM 858-9)

The CPB's recommendations regarding capital expenditures and ROW maintenance expenditures include reducing the spending levels reflected in rates, but allowing the Company to defer any spending above those levels, subject to certain safeguards. ALJ Phillips questioned whether, under

[10] The fact that the JP reflects ratepayer funding for capital expenditures at a higher level than the Company even requested, also suggests that none of the other Proponents conducted a meaningful review of the cost benefit analyses of those potential projects.

the assumption that the Company actually spends the amounts reflected in the JP, consumers would benefit since they would have to fund carrying charges on deferred amounts. (SM 931-2) The CPB's proposal could still benefit consumers in that situation, since it would help avoid large delivery rate increases at a time of high commodity prices. More importantly, however, the CPB is concerned that all of the projected spending is not necessary, and that the Company may not spend the projected amounts in an efficient manner. As the CPB Panel testified, the magnitude of these spending increases raises serious questions about whether they can be implemented in an efficient and cost effective manner and whether they are properly prioritized. (SM 932-3) The need to ensure cost effective spending on capital projects was one of the key reasons why the parties in the Con Edison case, and the Commission, adopted the the same type of approach that we recommend here.

A. Capital Expenditures

Central Hudson's revenue requirement under the JP is based on projections of capital expenditures that far exceed actual spending by the Company in recent years. (SM 724-7) Under the JP, capital expenditures would increase by $16.6 million (27.6%) in the 18-month period between calendar year 2005 and the 2006 rate year, July 2006 through June 2007, representing an annual percentage growth of 18.4%. In recent years, however, the Company's capital spending has been relatively constant, and in the first three months of 2006, capital spending was less than in the corresponding period of 2005. These recent trends belie the claim that the substantial spending increases included in the JP are necessary for the Company to provide safe and reliable service, particularly since the Company's electric system earnings exceeded the sharing thresholds in each year 2001 - 2005. (Exhibit 47, Response to MI IR 7-8)

Nevertheless, to ensure that the Company has the resources to provide safe and reliable service while protecting ratepayers, the CPB proposed a balanced approach similar to that recently approved for Consolidated Edison (SM 729-30), the state's largest electric utility. We recommended that the JP

be revised to reflect much more reasonable projections of capital expenditures, based on recent historical spending with a reasonable allowance for growth. Under our proposal, Central Hudson would be permitted to defer for potential future recovery, the revenue requirement impact of capital expenditures beyond those reflected in rates. The Company would also be required to file annual comprehensive status reports on capital expenditures, including project costs, explanations of expenditure variations, and justifications for new projects, to help ensure that the parties and the Commission have information necessary to determine whether Central Hudson's actual capital spending is reasonable and is being conducted in a cost effective manner. (SM 729-30)

B. Right of Way Maintenance Expenditures

There was considerable discussion at the hearing of the historical numbers for ROW maintenance expenditures.[11] It appears that information provided in Exhibit 55 is complete, although it includes Company labor, materials, supplies and transportation. The JP presumes that the Company will spend $9.991 million on ROW maintenance expense in Rate Year 1, $10.361 million in Rate Year 2 and $10.748 million in Rate Year 3 (SM 731), amounts that do not include Company labor, materials, supplies and transportation, since those costs are reflected elsewhere in the revenue requirement calculations. For meaningful comparisons of historical and projected data, those other costs, which averaged $352,983 in 2000 – 2005, must be removed from the historical data. (Calculated from Exhibit 47, response to CPB IRs 39, 87) After removing those costs, the data indicate that Central Hudson spent an average of $5,169,309 on ROW maintenance from 2000 – 2005, $6,786,952 when including the additional tree trimming funded by the Benefit Fund, which the Company accounts for separately. In 2005, the Company spent a grand total of $4,419,554 on ROW maintenance.

[11] The CPB's November 21, 2005 testimony, and its May 1, 2005 testimony, explained our understanding of historical ROW spending, based on information from the Company. We learned at the hearing that Central Hudson believes that the data used by the CPB for the 2000 – 2004 period are incomplete, in that they do not consider spending on tree trimming that was funded from the Customer Benefit Fund and not included in the Company's normal accounts. We are disappointed that the Company chose not to inform the CPB of this fact until the hearing, despite opportunities through discovery, rebuttal testimony, in settlement discussions, or professional discourse.

The JP therefore reflects a projected increase of $5.571 million (126%) in annual ROW maintenance spending beyond 2005 levels. This is only approximately 2% less than the Company's request in initial testimony. The CPB testified that an expenditure increase of this magnitude may not be necessary, may not be spent in a cost effective manner, or may not be spent at all. (SM 733) To address this concern, we have two recommendations.

ROW Maintenance Expense Reflected in Rates - The revenue requirement in the JP should be revised to reflect projected ROW maintenance expenditures that are much closer to recent historical spending levels. (SM 734-5) A reduction in projected ROW maintenance expenditures of $3 million would provide an increase over total amounts spent in the six years 2000 – 2005 including expenditures funded from the Benefit Fund, and an increase of 58% over actual spending in 2005. The Company should also be permitted to defer any ROW maintenance expenditures beyond the amount reflected in rates, with reporting requirements, similar to our recommendation for capital expenditures.

Ratepayer Safeguard - We also recommend that the JP be modified to include a ratepayer protection should actual distribution ROW maintenance expenditures fall short of the rate allowance. This measure is necessary because of the magnitude of the projected spending, even under the CPB's proposal, and the high degree of uncertainty concerning the appropriate level of such spending, and is fair to the Company and ratepayers. (SM 735)

The Proponents asserted that such a measure is not needed because ROW maintenance "is a routine part of [the Company's] business" (SM 1031-2) and "the levels contained in the Joint Proposal are of the same magnitude as recent expenditures." (SM 1603) Those assertions are simply not true. The facts above demonstrate that when left to its own devices as it was in 2005, the Company chose to spend less on ROW maintenance than it had in any year since before 2000, even when it had excess earnings and failed to meet minimum reliability standards in 3 of the last 4 years. Further, the fact is that the JP would provide the Company with an increase of 126% above its actual ROW maintenance

expenditures in the most recent calendar year. It is noteworthy that DPS Staff testified that “there is no disadvantage” to the ratepayer safeguard proposed by CPB. (SM 1601)

C. Storms Expense

Although the revenue requirement in the JP is based on substantial additional expenditures, it completely ignores the expected cost savings and additional revenue that would result from a reduction in the number and duration of outages. This mismatch of costs and benefits is inconsistent with proper ratemaking principles and causes the revenue requirement in the JP to be overstated. Rates under the JP are based on projected storms expense of $5.197 million, $5.311 million and $5.428 million for the three rate years, respectively. (SM 737) Those projections were derived by use of the four-year average of historical expenditures adjusted to calendar year 2005 data, and then inflated. They are not adjusted to reflect the reduced costs that are anticipated to occur as a result of increases in capital expenditures or ROW maintenance expense.

Central Hudson questioned whether the CPB had calculated the cost savings that would result from these expense increases. (SM 861-6) The proponents of a settlement have the burden of proof. If they do not have a cost/benefit anlysis that shows the benefits offsetting the costs, they have failed in their burden and some reasonable level of benefits must be imputed by the Commission. CPB had no obligation to provide a cost benefit analysis and the proponents cannot shift their burden to us.

CPB witness Mr. Larkin testified that storms expense should be set at the level experienced in the 12-month period of the test year April 2004 – March 2005. (SM 668, 871) That approach is consistent with standard ratemaking principles. Central Hudson appears to suggest that storms expense reflected in the JP should be revised to reflect data through the first quarter of 2006. (SM 871, Exhibit 53) Data provided by the Company show that storm expense in January 2006 was almost 50% higher than in the next highest single month in the last four years. The Company characterized this expense

as “unprecedented.” (SM 1029–30) As Mr. Larkin explained, proper ratemaking normally excludes unusual, non-recurring events. (SM 870) Therefore, the Company’s suggestion should not be adopted.

D. Reversal of Reliability Penalty

The Company has not met maximum targets for the duration and frequency of service outages in 2005 and has already recorded a deferred ratepayer credit of $758,000, pursuant to its existing rate plan. (SM 757-8) Approval of the JP would authorize the Company to reverse that ratepayer credit. (JP, Section XIV, (C)) The CPB testified that this provision of the JP would essentially ignore the fact that the Company did not meet the electric reliability targets in its current rate plan, and would be unlikely to have occurred in a litigated proceeding. (SM 758)

The Proponents challenged the CPB’s position on this matter in cross examination. They appear to assert that a related provision of the JP, under which the Company would withdraw its Petition for Rehearing regarding a PSC Order requiring a ratepayer credit since the Company did not meet its reliability targets in 2002 and 2004, provides an offsetting consumer benefit. (SM 899-903) We disagree. In our view, it is unlikely that the Commission would have reversed its Order regarding the 2002 and 2004 penalty, but the JP would guarantee that the Company could avoid any consequences for its failure to meet applicable standards in 2005.

VIII. ADDITIONAL CHANGES TO THE REVENUE REQUIREMENT AND FINANCIAL PROVISIONS OF THE JOINT PROPOSAL ARE REQUIRED. VIII.ADDITIONAL CHANGES TO THE REVENUE REQUIREMENT AND FINANCIAL PROVISIONS OF THE JOINT PROPOSAL ARE REQUIRED.

A. Manufactured Gas Plant Site Remediation

Under the JP, ratepayers would generally be responsible for 100% of manufactured gas plant (“MGP”) site remediation costs. CPB witnesses explained in detail that shareholders should bear some portion of these costs. Ratepayers were not responsible for the Company incurring those costs; the

expenses at issue are extremely large; it is important to constrain rates in this proceeding' and the Company should be provided an incentive to seek recovery of these expenditures from other responsible parties. (SM 649-63; 738-42)

The CPB Panel testified that in similar circumstances, the PSC required the utility to share 20% of MGP site investigation and remediation costs. (SM 740) State regulators throughout the country have also required utilities to bear some portion of these costs.[12] To be conservative, the CPB recommended that the JP be modified to require the Company to absorb 10% of MGP site investigation and remediation costs that it incurs. No party challenged that proposal on cross examination.[13]

The JP would also modify existing PSC policy applicable to Central Hudson regarding deferred MGP costs by eliminating "consideration of an incentive mechanism to ensure proper cost controls," discarding several tests that are currently applied to determine whether the Company could recover such deferred costs, and increasing the carrying charges that would accrue on deferred MGP balances from 4.75% to 10.01%. The Proponents brush off the significance of these changes, characterizing them as "consistent" with prior practice.[14] They are not. They are one-sided changes from current Commission policy that advantage the Company at the expense of ratepayers.

B. Pension and OPEB Discount Rate

The revenue requirement under the JP reflects pension and OPEB expense that is less than actual expense for calendar year 2005, consistent with the Company's actuarial estimates as of

[12] E.g., Public Service Commission of North Carolina, 156 PUR4th 384 (N.C. 1994); Kansas Public Service, 146 PUR4th 123 (Kan. S.C.C. 1993); Wisconsin Power & Light Company, No. 6680-UR-108, 1993 Wisc. PUC LEXIS 64 (Wisconsin Public Service Commission, September 30, 1993).

[13] Central Hudson claimed that that the CPB's November 21, 2005 testimony that charging ratepayers for MGP site remediation would be retroactive ratemaking is inconsistent with CPB's May 1, 2006 testimony, line 39 (SM 873). That claim was addressed, and shown to be invalid, by the CPB Panel (SM 873-74).

[14] Exhibit 66, pp. 26-27.

December 2005. (Exhibit 50) Those expense projections are based on assumptions including a projected discount rate of 5.5%, used to determine the present value of accumulated pension and other post employment benefits ("OPEBs"). The CPB Panel testified that based on the principles of Financial Accounting Standard 87, a discount rate of 5.75% should be used in setting rates. (SM 742-3) That discount rate is based on the most recent Moody's Aa Corporate Bond index available to the CPB, as of March 10, 2006, of 5.68%. It also considers the fact that interest rates have been increasing and may increase further in the future, and that utilities may use a discount rate in projecting pension and OPEB expense that differs somewhat from the most recent Moody's Aa Corporate Bond Index. (SM 744) Use of a 5.75% discount rate is expected to reduce Central Hudson's overall revenue requirement by more than $1 million per year.

The Company challenged this CPB proposal on cross examination, apparently attempting to show that the 5.75% discount rate is not supported by the Company's actuarial report based on information as of October 1, 2005. We do not dispute the fact that this actuarial report uses a 5.5% discount rate. However, that discount rate should not be used in setting rates for delivery service, since it ignores current information.

Central Hudson's actuaries apparently update their reports and projections of pension and OPEB expense infrequently, and the December 31, 2005 analysis cited by the Company does not reflect interest rate increases since that time. The Commission should establish rates based on current information at the time of its decision, which in this case, would require replacement of the 5.5% discount rate with, as testified by CPB, 5.75%. That recommendation is conservative. Significantly, on May 10, 2006, the Federal Reserve increased the federal funds rate by .25%, an act that is expected to lead to increases in other interest rates including on Corporate Bonds. Revising the JP to reflect the discount rate at the time of the PSC's decision, but no lower than 5.75%, would not harm the Company, since Commission policy continues to ensure that pension and OPEB expenses that are higher than reflected in rates will be recovered. (SM 744)

C. Defined Benefit Pensions for Management and Executive Employees

Pension and OPEB costs including the effects of a related rate base credit reversal, account for 59% of the electric increase originally proposed by the Company and about two-thirds of its originally proposed electric rate increase. (SM 748) The Proponents assert that large pension and OPEB expenses are "inevitable." (Exhibit 66, p 14) However, the JP does nothing to prevent such a situation from recurring.

The CPB testified that Central Hudson is one of at most a few utilities in New York State that offers a defined benefit pension plan to all of its management and executive employees. The record also shows that many employers have replaced their defined benefit plan with other plans, or have begun the transition away from defined benefit plans, including Verizon, General Motors, and IBM, which is Central Hudson's largest customer and one of the leading employers in the Company's service territory. (SM 748-9)

Despite this trend, if the Company transitions away from defined benefit pension plans in the next three years as expected, it would retain all associated savings under the JP. The CPB explained that the JP should be modified to provide ratepayers two-thirds of any net savings that result from transitioning away from the current defined benefit pension plan for Central Hudson's management and executive employees over the term of the rate plan. (SM 749-50) CPB witnesses testified that this recommendation is consistent with the outcome in competitive markets, is fair to the Company since it provides a financial incentive for it to pursue cost reductions, and would help reduce the likelihood that Central Hudson will request another large rate increase based primarily on the "inevitable" need to fund employee pensions. (Id.)

D. Return on Equity

Rates under the JP are premised on a return on equity of 9.6%. (JP, Appendix H, Schedule 1) The equity return in the JP was developed using the 8.7% recommended by the CPB and DPS Staff in

their initial testimony, and making several adjustments. The CPB does not dispute adjustments to account for interest rate changes since the direct testimony was filed (14 basis points, SM 745) or to reflect 2005 as the starting point for calculating the stock valuation adjustment. (10 basis points, SM 1572) However, the other adjustments should not be adopted. Use of well-established PSC methodologies would result in a cost of equity for Central Hudson of approximately 8.95% in this proceeding.

Miscellaneous Adjustments - Removing CH Energy Group from the proxy group artificially increased the cost of equity by 25 basis points. (SM 1572) The record shows, however, that parties typically do not exclude the utility whose return is being estimated from their proxy group, this adjustment was not made in the Generic Finance case and both Central Hudson and DPS Staff included CH Energy Group in their proxy groups in this proceeding. (SM 745-6))

Similarly, there is no basis for changing the weighting of the Traditional and Zero-Beta Capital Asset Pricing Model ("CAPM") from 75/25 to 50/50, which artificially increases the cost of equity by 8 basis points. (SM 1572) That change is contrary to the approach taken in the Generic Finance case, which has been used in most cases approved by the Commission. Central Hudson also used a 75/25 weighting in its pre-filed testimony. (SM 746)

Stayout Premium - 38 basis points should not be added for a three-year stay-out premium. The reason for a stayout premium is to recognize the additional risk that the Company is taking in agreeing to a multi-year settlement as compared to a one-year rate case. However, the revenue requirement calculations under the JP are essentially equivalent to three one-year rate cases, since both the electric and gas revenue requirements reflect projections of higher labor costs, other operations and maintenance expenses, taxes and other expenses in each rate year. Therefore, the Company is not absorbing the risk that its return may decline after the first year and the stayout premium provides no value to ratepayers in these circumstances. (SM 746-7)

On cross examination, the Company attempted to show that the stayout premium was justified based on the Return on Equity Consensus Document from Case 91-M-0509 that it introduced as Exhibit No. 54. (SM 877-78) However, as Mr. Niazi demonstrated, the stay-out premium is not based on the Return on Equity Consensus Document (Exhibit No. 54) or the Recommended Decision in the Generic Finance Case (91-M-0509). (SM 877 – 91) Exhibit No. 54 clearly indicates that the initial year ROE in a multi-year agreement should be based on the first year equity return.[15] Then, the equity return should be re-calculated in each succeeding year of the settlement agreement. Finally, it leaves open the possibility of the ROE falling back to the initial equity return if the subsequent year calculation drops. None of these essential features from the Return on Equity Consensus Document are contained in the JP.

The Recommended Decision in the Generic Finance Case sheds further light on this issue. It clearly shows the different treatment for a multi-year plan involving a rate freeze versus a multi-year plan where rates are adjusted each year as in the JP. In describing the proposal of the Electric/Gas Group, it said the following:

> In a multi-year plan involving a rate freeze, the allowed return premiums would be based on a five-year historical analysis of the interest rate spread between one-year treasury securities and treasury securities maturing in two, three, four, and five years. The utilities would be allowed to increase their return at the inception of the rate freeze by one-half of those historical five year spreads.
>
> * * *
>
> In a multi-year plan where rates are adjusted each year, <u>no</u> stayout premium would be allowed initially, in the base, generically-determined return on equity. However, if the indicated generic return on equity were to increase in the subsequent years, the rate of return would be updated by increasing it by what the stayout adjustment would have been, had the plan involved a rate freeze, plus one-half of any additional increase in return. In the case of falling interest rates, however, the allowed return would not be decreased below the original generically-determined return on equity. (Recommended Decision, Case 91-M-0509 Generic Finance Case, p. 74)

In ruling on this issue, the Recommended Decision in the Generic Finance Case said the following:

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[15] It does refer to adding business risk adjustment, however, in the Joint Proposal there was no calculation or even a discussion of business risk.

> Annual updating of the allowed return appears to be the process that best meets the need to accommodate this change, and should serve as the normal expectation, absent other agreement. As Multiple Intervenors proposes, the parties should be free to propose other methods of updating, partial updating, or fixing the returns, but the operating assumption should be that, in a multi-year agreement, rate of return will be updated annually. (Recommended Decision, Case 91-M-0509, p. 81-82)

It appears that the JP used the method specified in the Generic Finance Case for rate freezes rather than that for multi-year plans where rates are adjusted each year. Accordingly, the Commission should reject the stay-out premium proposed in the JP.

Other Issues Raised on Cross Examination – Central Hudson devoted considerable effort on cross examination exploring Con Edison's equity return. (SM 812-22) As Mr. Niazi clearly explained, that return resulted from a settlement agreement, which cannot be compared to allowed returns based on analysts' recommendations.[16] (SM 819)

The Company also tried to establish that Con Edison is less risky than Central Hudson. (SM 812-3) However, as pointed out by Mr. Niazi, both Consolidated Edison and Central Hudson are A-rated companies, fall in the same general risk group, and were rated exactly the same by both Moody's and Standard & Poor's as A2 and A respectively, indicating that rating agencies consider them to have exactly the same risk. (SM 813)

In addition, the Company questioned whether Mr. Niazi verified the reasonableness of his 7.24% long-form ROE for Consolidated Edison by some other means. (SM 814) As Mr. Niazi replied during cross-examination, there was nothing suspect about the data or any other indicator about Consolidated Edison that merited such an approach. (SM 816-17) The Company's suggestion that Con Edison be removed from the proxy group, has no basis, since only companies with significant unregulated operations, those involved in mergers or companies that suspend dividend payments are appropriately excluded from the proxy group. Notably, neither DPS staff, CPB nor the Company

[16] Central Hudson also appeared to question why the CPB did not strongly oppose to the JP in the recent Con Edison case since it included a return on equity of 10.3%. (SM 820) As discussed further in Point III, both that JP and the JP in this case contain some elements that benefit consumers, although neither merited the CPB's support.

excluded Consolidated Edison from their proxy groups in this case, and Value Line and other investment services that were the source of all the data used for the DCF analysis did not identify anything anomalous for Consolidated Edison. Mr. Niazi testified that removing the results of Consolidated Edison and two other companies from Central Hudson's DCF estimate in these circumstances, as the Company did, was completely arbitrary and served no other purpose but to inflate the Company's estimates. (SM 817-18)

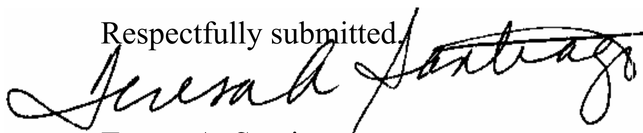
IX. ADDITIONAL MEASURES TO MITIGATE THE RATE INCREASES ARE AVAILABLE AND SHOULD BE CONSIDERED.

The CPB fully explained in the November 21, 2005 testimony of Mr. Larkin and in its Panel testimony, that the PSC could further mitigate the rate increases by extending the amortization of large and unusual losses that Central Hudson incurred in 2001 and 2002 on its retirement plan assets. (SM 643-5; SM 766-7) Actuarial losses of approximately $100 million and $60 million were incorporated into the Company's net periodic pension accruals in 2002 and 2003, respectively. These losses would be amortized over 10 years under the Commission's Pension Policy Statement. The Commission has the authority to modify the application of that Policy Statement to this proceeding, by extending the amortization for an additional 10 years. Such action would reduce the electric rate increase by approximately $5,228,866 and reduce the gas rate increase by approximately $1,211,952. (SM 644) This proposal should be considered if additional rate mitigation is appropriate.

CONCLUSION

For the reasons set forth herein, the recommendations of the Consumer Protection Board with respect to the Joint Proposal in this proceeding should be adopted by the Commission.

Respectfully submitted,



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Dated: May 12, 2006
Albany, New York