STATE OF NEW YORK

PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of National Fuel Gas Distribution Corporation for Gas Service.	Case 07-G-0141

INITIAL BRIEF

OF THE

NEW YORK STATE CONSUMER PROTECTION BOARD

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Dated: August 15, 2007
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This proceeding was initiated by the New York Public Service Commission ("PSC" or "Commission") in response to a January 29, 2007, filing by National Fuel Gas Distribution Corporation ("NFGD" or "Company") in which the Company requested a major rate increase of approximately $52 million. That filing also proposed a number of tariff modifications affecting existing services, various rate design changes, and the continuation of certain provisions of the Company's current rate plan that would otherwise expire at the end of this year. NFGD also sought authorization for a new program for the promotion of energy efficiency, dubbed the Conservation Incentive Program ("CIP"), which would be accompanied by a revenue decoupling mechanism ("RDM") intended to protect the Company from conservation-induced loss of throughput.

On June 7, 2007, the Consumer Protection Board ("CPB") filed the direct testimony of its witness, Dr. Douglas W. Elfner, which addressed a number of issues raised by NFGD's filing. Direct testimony was also filed by the Staff of the

Department of Public Service ("DPS Staff"), and by Direct Energy Services, LLC ("Direct Energy"). NFGD filed rebuttal testimony on June 28, 2007, and hearings were held before Administrative Law Judge William Bouteiller on July 24 and 25, 2007. The CPB participated fully in those hearings.

In this Initial Brief, the CPB addresses a number of contested issues on which Dr. Elfner submitted testimony. The absence of discussion in this brief of any particular item should not be construed as support for, or opposition to, the Company's position. Rather, we reserve the right to comment further in our reply brief on the positions articulated by the parties in their initial briefs.

I. REVENUE REQUIREMENT

A. General Matters

NFGD requested an increase in delivery rates that would produce an additional $52 million in revenue, representing an approximately 19.4% increase over current levels (Exhibit 44, MI-1).[1] This request comes at a time when consumers are already facing very high gas costs. Under such circumstances, it is critical that the Commission closely scrutinize every element of NFG's filing in an effort to minimize the ultimate impact on customers' bills.

CPB Witness Dr. Elfner did not conduct a comprehensive review of every element of the Company's proposed revenue requirement. The DPS Staff has performed a more in-depth inquiry into the filing, and we strongly support their efforts. The record shows that the adjustments proposed by the CPB, and those

[1] For brevity, information request responses included in admitted exhibits will be referred to by the exhibit number followed by the information request identifier.

proposed by DPS Staff, are necessary to establish just and reasonable rates while enabling the Company to provide safe and reliable service.

B. Depreciation

NFGD requests an increase in the amount allowed in rates for depreciation expense of just over $9 million. (Exhibit 64, RLT-1, Sheet 1). The primary reasons for this increase are a change in depreciation methodology from the whole-life method to the remaining life method, accounting for $1.75 million in additional expense, and a decrease in the service life applicable to plastic mains, costing an additional $4.1 million. (Exhibit 20, JJS-3) The balance of the increase results from modifications to service lives and salvage values for other components of depreciable plant. These changes should be rejected.

As Dr. Elfner testified, a change in depreciation expense producing an adverse rate impact of the magnitude proposed by NFGD cannot be justified in the absence of clear evidence showing that existing depreciation rates are manifestly inadequate to provide for the Company's recovery of its capital costs. (Tr. 593) The choice of depreciation methodology and service lives have no impact on that decision.

Both the remaining life and whole life methods provide appropriate depreciation rates based on the current understanding of average service lives and salvage values for defined asset groups. Neither automatically adapts those rates to changing data. Both must be reset periodically to adjust for updates to earlier forecasts. Whether a company is in an over-accrued or under-accrued situation at any time is completely independent of the depreciation methodology. If, as Company witness Spanos suggests, NFGD is in an under-accrued position today (Tr. 333) that is not the result of the use of the whole life method in prior years.

While Mr. Spanos clearly prefers the remaining life method, the Commission does not share that preference. As Dr. Elfner pointed out, the Company has acknowledged that it is not aware of any case in which that methodology was approved by the Commission for ratemaking purposes for a major gas utility. (Tr. 593) DPS Staff's Gas Rates Panel concurs, stating that it "is not aware of any approved use by the *C*ommission of the remaining life technique for gas plant accounts." (Tr. 474) Indeed, the matter was directly addressed less than a year ago, with the Commission finding that the utility involved had not demonstrated a sufficient reason "to move abruptly away from the 'whole life' depreciation method that has previously been used to the 'remaining life' method that the Commission has not favored."[2] The same conclusion should be reached in this case.

The issue of the average service life to be adopted for plastic mains has been well-addressed by DPS Staff. As its Gas Rates Panel explains, NFGD acknowledges that it lacks sufficient retirement history for the plastic mains account to permit it to establish a survivor curve. Instead, it relied on the

[2] Case 05-E-1222, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corporation for Electric Service, "Order Adopting Recommended Decision with Modifications," issued August 23, 2006, p. 68 ("NYSEG Rate Order").

judgment and estimates of other companies to come up with its recommendation for a reduction in service life from 70 to 55 years. (Tr. 477)

This estimate is drastically out of line with those the Commission has adopted for other gas utilities in this State. As demonstrated by the DPS Staff Gas Rates Panel in Exhibit 41 (GRP-2, page 1), both the mean and median service lives approved by the PSC for accounts that include plastic mains is over 70 years. The only lower approved life is 65 years on the National Grid system. In the absence of any concrete data to show that conditions on NFGD are substantially different from those on other State utilities, DPS Staff's recommendations concerning service lives for depreciation purposes should be adopted.

C. SIR Expense – Insurance Proceeds

NFGD proposes to amortize $8,652,000 in unrecovered expenses for site investigation and remediation ("SIR") of former manufactured gas plant sites over a five-year period. To begin this process, it has included an allowance of $1,731,000 in revenue requirement for the rate year. (Tr. 1279) Staff witness Luthringer testifies that the rate allowance for SIR expense should be eliminated. He says that insurance proceeds received by NFGD's parent through settlements with its liability carriers were inappropriately allocated among the holding company's subsidiaries. Based on SIR expenses incurred, NFGD should have received 85.41% of the total of $36.9 million in proceeds, or $31.6 million, compared to its actual allocation of $16.9 million. (Tr. 1290-1291) The additional

$14.7 million allocation is more than enough to pay the unrecovered SIR expenses, eliminating the need for a rate allowance.

The Company contends that its insurance proceeds allocation was "reasonable on its face" when it was made. (Tr. 1565) That is irrelevant. It should not be necessary for ratepayers to postulate, much less prove, the existence of bad faith or a conspiracy in order to raise an issue of inappropriate allocation. The benefit of shifting cost responsibility from unregulated to regulated subsidiaries is the elephant in the corner of the room that cannot be ignored when a holding company makes decisions concerning cross-subsidiary cost and benefit allocations. Consciously or unconsciously, explicitly or implicitly, it will be considered.

In this case, the Company acknowledges the existence of "a longstanding Commission practice that encouraged, and indeed promoted environmental remediation." (Tr. 1565) It knew that recovery of SIR expenses prudently incurred by NFGD were virtually certain to be recoverable in rates. Consequently, it had every incentive to allocate as much of the insurance proceeds received as possible to unregulated subsidiaries whose recovery of environmental expenses from customers might well be precluded by competitive forces.

The Company also argues that the DPS Staff was made aware of the allocation methodology when it was adopted and gave "tacit agreement" to it when they failed to voice any objections. (Tr. 1575) Aside from the fact that concluding silence means consent should be as questionable in a regulatory context as it is in contract law, this argument is also not relevant.

The insurance proceeds allocation decision made by the Company is not merely an accounting issue. It involves a judgment as to how those proceeds can best be applied to offset expected expenses. Like any such judgment made by utility management, it is subject to review by the Commission for prudence.

Normally, the Commission does not make prudence determinations in advance. It leaves management decisions to the utility's managers, subjecting their decisions to scrutiny only after the fact. When the results are in, it becomes feasible to make a judgment as to whether a particular decision was prudent based on the information available at the time it was made.

In this case, the use of a pre-determined allocation factor did afford some protection for ratepayers against the possibility that much or all of the coverage afforded by the Aegis policy could have been exhausted by claims from unregulated subsidiaries. (Tr. 1567) In the absence of any other relevant information, it might well have been reasonable for the Company to decide to allocate insurance proceeds on the basis of premiums paid, but it is implausible that no such information was available. Evidence in this record indicates that the Company should have expected that at least 64% of the environmental remediation expenses incurred by its subsidiaries was likely to come from the New York utility. (Tr. 1601-1602) Given that information, and the fact that subsidiaries other than NFGD ultimately incurred less than 15% of overall SIR costs, it is hard to believe that the Company could have considered an allocation of only 46% of insurance proceeds to be reasonable. Under the circumstances, Mr. Luthringer's adjustment is entirely appropriate and should be adopted.

The CPB considers this to be an extremely important issue for consumers because it highlights, starkly, the dangers inherent for ratepayers in the holding company structure of utility ownership that has become, and is likely to remain, ubiquitous. Because the holding company will inevitably decide direct allocation issues in the manner that provides the greatest benefit for shareholders, the PSC should maintain a countervailing presumption in favor of an allocation favoring ratepayers. Because that presumption has not been overcome here, the adjustment recommended by Staff should be adopted.

D. Health Care Cost Inflator

In forecasting rate year expenses for health care, the Company applies an inflation rate of 12% to test year costs, rather than the GDP deflator that is used for the general inflation pool. The Company's rationale is that the cost of health care has historically risen much more rapidly than the other components of the broader price indices. (Tr. 1514-1515) While this observation comports with the general perception of the current trend, it is not dispositive for ratemaking purposes.

Again, in the NYSEG Rate Order, the Commission addressed this issue directly. It concluded that:

> the standard ratemaking practice that applies a general inflation factor to health care costs, and other cost categories, remains valid

> in today's circumstances and prevailing conditions. We find no basis or any reason to alter this approach for NYSEG at this time.[3]

There is also no basis or reason for taking a different approach with NFGD.

Dr. Elfner underscored that if a separate inflation rate were used for health care costs, the effect of health care cost inflation would have to be removed from the GDP Deflator before it is applied to the general inflation pool. (Tr. 594-595) Otherwise, inflation for the general pool would be overstated. The Company acknowledged this effect on rebuttal and agreed that its adjustment for health care cost inflation should be reduced by a little over 10%. (Tr. 1555) But that overture would be only the beginning.

In disputing the notion that the GDP provides a reasonable proxy for the sum of the individual cost category inflation rates that the Company experiences, NFGD argues that many categories included in the index do not "significantly impact" the Company. (Tr. 1554) As examples, it cites housing, food, clothing and shoes, and farming inventory (Id.) According to Exhibit 65 (RLT-7), page 2, those categories contributed a total of 0.83% to the inflation rate, 1.6 times more than medical care costs. Logically, then, a substantial downward adjustment to inflation for the general pool would be required to account for the inapplicability of these categories to NFGD as well.

Unless the aggregate effect of variances in the importance of all cost categories to the GDP inflator and to the Company is calculated, singling out one category for special treatment is inappropriate. But avoidance of the need for constructing and maintaining such company-specific inflation rates is exactly

3 Id., p. 55.

what the Commission accomplishes by relying on a simple, public, readily available index such as the GDP Inflator. In the absence of clear evidence that the index generates an allowance for inflation that is unfair <u>in the aggregate</u>, it should be applied to medical costs as well as the general pool.

II. NON-REVENUE REQUIREMENT ISSUES

A. Revenue Sharing – Off-System Sales and Capacity Release

Like all gas utilities, NFGD contracts for gas supply, pipeline capacity and storage sufficient to meet the needs of its customers on the coldest day of the year, as well as system requirements for balancing and various other contingencies. On every other day, some portion of these assets is unnecessary to meet the utility's operational requirements. Properly managed, these excess assets can generate substantial revenue through capacity release transactions and off-system sales.

As described by the DPS Staff Capacity Panel (Tr 497), capacity release involves the temporary transfer of the right to use pipeline transportation capacity to a third party. The amount paid for such use by the third party is realized by NFGD as a credit on its bill from the pipeline – hence the term "capacity release credits." Off-system sales, as the name implies, involve the sale of temporary surplus gas supplies to parties who are not attached to the Company's distribution system. These sales may be made at a point, or effectuated through the use of excess pipeline capacity and/or storage.

From 2001 through 2006, the total of net revenues from off-system sales and capacity release credits generated annually by NFGD ranged from a high of $7.4 million to a low of $3.7 million, and averaged over $5.3 million. (Exhibit 44, CPB-33) Under the rate plans in effect during that period, the first $1 million in annual net revenues generated were credited to the Cost Mitigation Reserve ("CMR"). The CMR provides funds which the Company may apply, with Commission authorization, to pay costs for which it would otherwise seek recovery in rates. (Tr. 597) Thus, in effect, the first $1 million in off-system sale and capacity release revenues generated annually was applied, in its entirety, for the benefit of ratepayers. (Id.) All additional revenues were shared, with 15% retained by the Company and 85% flowed back through the Gas Adjustment Clause ("GAC") to lower gas costs for customers. (Tr. 596-597)

In its initial filing, NFGD proposed no change to the current sharing system, other than to recommend that the CMR be made permanent. (Tr. 668) CPB witness Dr. Elfner also called for a continuation of the CMR, but recommended an increase from $1 million to $2 million in the threshold amount credited to the CMR prior to sharing, and an 80%/20% split between customers and the Company beyond the threshold. (Tr. 598) In its rebuttal testimony, the Company stated that it would be willing to accept the CPB proposal. (Tr. 826)

DPS Staff opposed continuation of the CMR and recommended that all off-system sales and capacity release revenues be shared between customers and the Company on an 85%/15% basis. (Tr. 516) In contrast to the CPB's proposal, this appeared to be a losing proposition for ratepayers whose share of the first $1 million in revenues would be reduced by $150,000. On cross-examination, however, it became clear that DPS Staff's primary concern was that the purposes for which CMR funds could be utilized were currently undefined, raising the possibility of an inter-class subsidy if revenues generated from assets paid solely by firm sales customers were used to offset costs that would otherwise be borne in part by transportation customers. (Tr. 520-522)

The CPB agrees with this concern. Accordingly, we would amend our proposal to provide that off-system sales and capacity release revenues credited to the CMR be applied solely for the benefit of firm sales customers, or that the first $2 million in such revenues annually be flowed through the GAC as a credit.[4] If the former approach is adopted, the Company should be required within 90 days of an order in this case to propose an appropriate mechanism for accomplishing the intended objective, and the parties to this case should have an opportunity to comment on the proposal.

The purpose of Dr. Elfner's recommendations in this case was to begin the process of updating a revenue sharing mechanism that the Commission itself considered to be nothing more than a "reasonable placeholder" when it adopted it nearly 13 years ago. (Tr. 599-600) In 1994, utilities were just beginning to be comfortable with their obligation to separately contract for and maintain portfolios of gas supplies to match their inherited pipeline capacity. (Tr. 598) Today, the pursuit of opportunities to reduce gas supply costs through capacity release and off-system sale transactions is a fundamental function of a utility gas supply

[4] As we state at page 26 of this brief, the CPB would also be willing to consider proposals to use CMR revenues to fund the CIP.

department. Both Company witness Polka (Tr. 843) and the DPS Staff Capacity Panel (Tr. 515) confirmed this assessment of a utility's gas supply management obligation.

There is no longer a good reason for ratepayers to provide utilities an incentive from "dollar one" to perform a basic management function, and even less justification for returning to such an arrangement for NFGD where a sharing threshold has been in place for years. The CPB's recommendation that the threshold be increased to $2 million is a reasonable step forward, is acceptable to the Company, and should be adopted by the Commission.

Beyond the threshold, however, incentives continue to play an important role. Ratepayers benefit disproportionately as capacity release and off-system sales revenues rise, while the risk/reward ratio for the utility steadily increases as it exhausts the "low-hanging fruit" and must pursue more complex or lower margin transactions in order to continue to generate revenue. The 80%/20% sharing formula proposed by the CPB is intended to give NFGD's gas supply department an incentive to keep moving forward. Based on the 2001-2006 results discussed above, this change would generate additional revenue for the Company only if it exceeds its historic average performance, generating increased credits for ratepayers.

Accordingly, Dr. Elfner's proposal for the sharing of revenue from capacity release and off-system sales transactions should be adopted by the Commission.

B. “No Harm, No Foul” Rule

The large customers who receive transportation service under NFGD’s service classification 13D (“SC 13D”) have a daily balancing requirement. They must deliver no less than 90% and no more than 110% of their actual consumption for the day. If they are outside this “tolerance band,” they are subject to being “cashed out,” that is, having the Company purchase their surplus deliveries, or sell them supplies to cover their delivery deficiencies. Cash-out prices are established by tariff at levels that are intentionally punitive to the out-of-balance customer. What has come to be known as the “no harm, no foul rule,” is a tariff provision which states that if the sum of the imbalances for all SC 13D customers on any day is within the tolerance band, then no customer will be cashed out regardless of its actual ratio of deliveries to consumption.

In its initial filing, NFGD proposed to eliminate the rule. (Tr. 669) It contended that, as a practical matter, whether the service class as a whole is in balance is dependent upon the deliveries of the largest marketer, which naturally has the strongest incentive to be in balance because it has the most to lose from being cashed out. (Tr. 670) Smaller marketers become “free riders,” ignoring their balancing obligations with impunity, or even “gaming” the system by shorting their deliveries when prices are high and overdelivering when prices are low. (Id.)

Dr. Elfner supported the Company’s recommendation, both for the reasons stated by its witness, and because the rule stifles competition among marketers to achieve operational efficiency in ways that may ultimately translate into better prices for consumers. With the rule in place, large marketers have no incentive to expend resources reducing their imbalances further because they cannot gain any competitive advantage over the free riders. (Tr. 596) The free riders have no incentive to do anything except support continuation of the rule.

In its direct testimony, DPS Staff opposed the Company's proposal, contending that continuation of the rule was necessary because there is no imbalance trading mechanism in place for daily balancing as there is for end-of-month imbalances. (Tr. 500) DPS Staff also disagreed with the Company's assertion that the rule promotes "gaming" by smaller marketers, (Tr. 501) noting that it was unaware of any complaints about abuse of the rule. (Tr. 502) On cross-examination, however, the Staff Capacity Panel did acknowledge that such activity was "possible." (Tr. 530)

The notion that any significance should be attached to the absence of complaints about abuse of the rule was succinctly put to rest by the rebuttal testimony of company witness Clark. (Tr. 685-686) As he noted, marketers have no access to information concerning the deliveries and imbalances of others. Consequently, large marketers have no basis for lodging any complaints, and smaller marketers have no reason to "kill the goose that lays the golden eggs."

DPS Staff's argument concerning imbalance trading is also unpersuasive. At the end of the month, SC 13D customers must eliminate their accumulated imbalances completely. (Tr. 535) The tolerance band is zero. Consequently, customers are provided an opportunity to trade imbalances to help them avoid cash-outs.

For daily imbalances, as Staff notes, development of a trading mechanism may be impractical. (Tr. 500) Therefore, in lieu of an opportunity to trade, customers are given a very broad target to hit. They can avoid cash-outs if their deliveries come in anywhere between 90% to 110% of consumption. It is this tolerance band at the daily balancing level, not the “no harm, no foul rule,” that performs the function of imbalance trading at the monthly level. The rule is superfluous; a gift to the least competent suppliers. Given that marketers receive three meter readings during each delivery day and have four opportunities to revise their nominations to match expected usage, (Tr. 688) requiring them to hit the tolerance band without the help of other, more responsible, suppliers is not asking too much.

Multiple Intervenors did not submit testimony, but cross-examination by its counsel clearly revealed an antipathy toward the possibility that without the rule, a marketer who was badly out of balance could be subject to being cashed out, even though NFGD itself was in balance and suffered no penalties from its pipelines or suppliers. (Tr. 532) Of course, that could happen even if the entire SC 13D class were out of balance, given its small size in relation to the total system load. But, more importantly, the purpose of cash outs as Dr. Elfner noted, is to influence marketer behavior (Tr. 596), not to reimburse NFGD for any losses it may sustain. It is sound performance from marketers that ultimately avoids problems for the Company. The rule only detracts from that fundamental objective.

Elimination of the “no harm, no foul rule” is a very small, but positive step towards a more responsible and competitive market. Therefore, it should be approved.

C. Winter Only Collection of Demand Charges

NFGD proposes to modify its tariff to provide for the recovery of all purchased gas demand charges during the winter months only. (Tr. 611) The Company's rationale for the change is that these costs -- mostly pipeline demand charges -- are incurred primarily to meet cold weather demands. (Tr. 1663) Therefore, recovering them during the winter only better matches cost recovery with cost causation. Consumers then receive a more accurate price signal, perhaps encouraging them to heat their homes during the summer instead of the winter.

The CPB and DPS Staff both oppose the change, pointing out that the Company pays demand charges throughout the year and has no compelling need to recover all of its costs during the winter. (Tr. 612; Tr. 556) For customers, on the other hand, the change would pile on additional costs when bills are already at their highest levels, but will not produce a change in price significant enough that it is likely to have any impact on thermostat settings. (See discussion at Tr. 556-558)

Whatever may be said for this proposal as a matter of economic theory, it is one which unnecessarily adds to customers’ cost burden when they can least afford the increase. It should be rejected by the Commission.

D. Minimum Charge for SC-1 Customers

NFGD proposes to raise the minimum charge for residential customers from its current level of $13.54 per month to $20.13 in the winter and $20.01 in non-winter months, an increase of nearly 50%. (Exhibit 45, TJC-12, Schedule 1) According to its witness, Mr. Clark, the change would help provide revenue and earnings stability for the Company. (Tr. 646-648)

DPS Staff agrees, in principle, that it is appropriate to continue to move the minimum charge towards the level of customer-related costs, (Tr. 551) but points out that the Company's proposal would actually set a charge that exceeds those costs, which Staff places at $19.12. (Tr. 550) DPS Staff also notes that the desire to move rates in the direction of costs must be tempered by consideration of the impact of such changes on customers. (Tr. 551) Accordingly, it recommends that the increase in this case be reduced to $3.30, (Id.) or roughly 60% of the difference between the current charge and Staff's assessment of customer-related costs.

For the CPB, Dr. Elfner argues that the large increase in the minimum charge will be burdensome for low-usage customers, whose bills are dominated by the charge, and will be completely unnecessary for NFGD if the Commission approves its proposal for a revenue decoupling mechanism ("RDM"). (Tr. 613) Given that the Commission has ordered all utilities to file RDM proposals,[5] it

[5] Case 03-E-0640, Proceeding on Motion of the Commission to Investigate Potential Electric Delivery Rate Disincentives Against the Promotion of Energy Efficiency, Renewable Technologies and Distributed Generation; Case 06-G-0746, In the Matter of the Investigation of Potential Gas Delivery Rate Disincentives Against the Promotion of Energy Efficiency, Renewable Technologies and Distributed Generation, "Order Requiring Proposals for Revenue Decoupling Mechanisms," issued April 20, 2007, ("RDM Order").

seems highly likely that some form of mechanism will be adopted in this case. As Dr. Elfner notes, an RDM will ensure that NFGD receives projected weather normalized revenues, thereby eliminating the Company's concerns about revenue stability. Its risk that fixed costs will be under-recovered through volumetric rates is effectively eliminated by the RDM, making an increase in the minimum charge superfluous from a revenue standpoint. (Id.)

If, because of its interest in eliminating intra-class subsidies, the Commission nevertheless concludes that the minimum charge for residential customers should be raised toward embedded cost, the CPB would argue that closing 60% of the gap in one jump, as proposed by DPS Staff, is too much. We recommend that the increase be limited to $1.86, one-third of the difference between the current minimum charge and Staff's estimate of embedded cost. The resulting charge of $15.40 would still be one of the highest in the State.

E. Retail Access

As Dr. Elfner testified, the CPB fully supports the proposal of NFGD to discontinue many of its current programs aimed at promoting retail competition. (Tr. 608-609) That proposal is fully consistent with the PSC's most recent order on the subject in which it concluded that it may be time "to review these [retail access] programs and practices to determine their effectiveness."[6] The Commission noted that "some programs or practices may have outlived their

[6] Case 07-M-0458 - Proceeding on Motion of the Commission to Review Policies and Practices Intended to Foster the Development of Competitive Retail Energy Markets, "Order on Review of Retail Access Policies and Notice Soliciting Comments," issued April 24, 2007, p. 6.

usefulness and could be allowed to expire. In other cases, the costs of programs or practices might be shifted from ratepayers to market competitors."[7] That is exactly what Company witness Meinl concluded about the programs proposed for termination, (Tr. 1675-1676) and the CPB concurs.

However, two issues raised by Direct Energy Services, LLC, witness Kallaher deserve comment. First, Mr. Kallaher argues that NFGD's purchase of receivables program ("POR") should become a "permanent feature" of the Company's retail access program. (Tr. 408) NFGD responds that it should be allowed to retain the option, currently in its tariff, to terminate the program, on one year's notice, if it concludes that its continuation is no longer of benefit to its customers. (Tr. 1698)

The CPB fully supports continuation of the POR program, but also agrees that the Company, or other parties, should be able to call for its termination if they find that it is no longer effective and necessary. That type of continual review of program effectiveness is fully consistent with the Commission's views cited above. Furthermore, if NFGD ever decides that the POR program should come to an end, the one-year advance notice required will give all affected parties ample opportunity to bring any concerns they may have before the Commission long before the Company's decision takes effect.

Direct Energy also recommends that NFGD's existing marketer referral program ("MRP") be expanded to give customers the option of choosing an ESCO supplier at the time of service initiation. (Tr. 411) The program would give consumers opening new accounts with NFGD the ability to select

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[7] Id.

commodity service from an ESCO without having to first become a commodity customer of the utility – a one-step process rather than two.

A program of the type proposed by Direct Energy, referred to as an "ESCO Introduction Program" was recently incorporated in a joint proposal adopted in a proceeding involving New York State Electric & Gas Corporation.[8] The CPB supported that proposal (there was no opposition), and we would support a similar program in this case, provided that the costs of implementation and administration of the program are borne by ESCOs without guarantee or subsidy from ratepayers (See Dr. Elfner's testimony at Tr. 610). The program should, however, stand on its own. We agree with the Company's proposal to discontinue the MRP.

Direct Energy's ESCO introduction program proposal understandably contains few details, as these generally need to be worked out on a utility-specific basis. We recommend that the Commission direct NFGD, within 30 days of an order in this case, to initiate a collaborative in which all interested parties may participate in developing the terms of the program.

F. Conservation Incentive Program

NFGD proposes to implement a Conservation Incentive Program ("CIP") designed to promote the more efficient use of energy by its customers. The program would cost $12 million annually, and would be administered by the

[8] Case 07-E-0479, Tariff Filing of New York State Electric & Gas Corporation to Offer Customers a Single Fixed Supply Service. The joint proposal has not yet been acted upon by the Commission.

Company. (Tr. 600) This, NFGD argues, would take advantage of its unique knowledge of its service territory and its customers. (Tr. 1656)

The Company's proposal consists of three principal components: a low-income usage reduction program ("LIURP"), modeled after a successful initiative in its Pennsylvania service territory, on which it proposes to spend $2.6 million; a residential and small commercial appliance rebate program costing $4.8 million; and a $4.6 million multi-media communication initiative to provide customers information designed to encourage them to conserve and to educate them on specific energy efficiency programs offered by the Company. (Tr. 600)

The CPB strongly supports both the objectives and the scope of the Company's proposal, and believes that, if properly implemented, it will provide substantial economic and environmental benefits to consumers. (Tr. 601) As Dr. Elfner testified, we also agree that the Company is generally in the best position to administer and implement energy efficiency programs for its customers. (Id.) Dr. Elfner did, however, recommend certain changes to the program design which will improve it further.

First, Dr. Elfner recommended that the Commission direct NFGD to initiate a collaborative, approximately three months into the rate year to examine the details of the CIP – which are fundamentally impractical to develop through litigation – and to consider whether additional programs, or a shift in emphasis among the proposed programs, would enhance the overall package. (Tr. 601-602) In particular, the CPB is interested in involving NYSERDA, which already operates successful energy efficiency programs throughout the State, and has considerable data and expertise that may be helpful to the utility in operating its program effectively.

The DPS Staff Energy Efficiency Panel made a nearly identical recommendation for an energy efficiency collaborative to be held in the spring of 2008. (Tr. 852). The Company had no objection to the proposals of CPB and DPS Staff. Its only concern was that the collaborative await a final determination in this case, either through litigation or settlement. (Tr. 1692) Accordingly, this recommendation appears to be uncontroversial, and should be adopted.

Next, Dr. Elfner recommended that the proportion of the total funding for the CIP devoted to outreach and education ("O&E") be re-examined. (Tr. 602-603) He noted that the CPB agrees that consumers should be provided information to increase their awareness of the benefits of conservation and enable them to make better decisions about their energy consumption. (Tr. 602) His concern was with the magnitude of the proposed expenditures for this purpose, over 38% of the total CIP budget. Thus, he recommended that the Company work with NYSERDA, perhaps through the proposed collaborative, to determine whether more cost-effective means of achieving the intended objectives were available. In the interim, Dr. Elfner proposed that the Commission hold the level of CIP funding for outreach and education to no more than 10% of the program total, or approximately $1.2 million. (Tr. 603)

The DPS Staff Energy Efficiency Panel expressed the same concern with the Company's proposed O&E funding. It recommended that the amount allocated for this function be reduced to $2.94 million by means of a reduction in the overall program cost from $12 million to $10.8 million, (Tr. 851) and a reallocation of funds to the LIURP and appliance rebate programs. (Tr. 852)

NFGD opposes any change to its O&E program, arguing that it was carefully crafted to optimize the benefits of the Company's advertising spending and was developed in concert with media consultants having long experience in the field. (Tr. 1018) It also suggests that higher expenditures for the O&E function may be necessary at the beginning of the CIP in order to raise customer awareness of the availability of programs. (Tr. 1693)

The Company's arguments do no alleviate the CPB's concerns that the amount budgeted for O&E in the CIP is very large in relation to the overall scope of the program. Those funds might be better applied to the implementation of more concrete energy efficiency measures, or at least utilized more effectively for O&E after consultation with NYSERDA and other parties through the proposed collaborative. Accordingly, we recommend that Dr. Elfner's recommendations be adopted by the Commission.

Dr. Elfner also expressed concern that the Company's proposal to measure the performance of its appliance rebate program through customer surveys is inadequate. (Tr. 603) He contended that monitoring, accountability and program evaluation were critical for any ratepayer-funded energy efficiency program, but particularly so here, given the Company's limited experience with major elements of the CIP. (Tr. 603-604) He recommended that, for at least the first year, quarterly reports on expenditures, deliverables and resulting benefits measured in therms, should be prepared and made available to the Commission and the parties. (Tr. 604)

The DPS Staff Energy Efficiency Panel also called for quarterly and annual status reports concerning the progress of the CIP. (Tr. 877) NFGD had no objection to these recommendations, and suggested that the details of the reporting schedule and the standards for performance measurement be worked out in the proposed collaborative. The CPB supports this suggestion and recommends that the Commission adopt it.

Dr. Elfner also addresses two issues related to the funding of the CIP. First, he argues that the program costs should be recovered through a surcharge to customers' bills, rather than through base delivery rates. (Tr. 605) This would be similar to the System Benefits Charge on bills rendered by electric utilities for the funding of energy efficiency programs administered by NYSERDA. A surcharge has the significant advantage that it can easily be modified monthly to match revenue and expenditures as closely as possible, and to accommodate changes in the size of the CIP. (Id.)

DPS Staff also recommended use of a surcharge for recovery of CIP costs, noting that energy efficiency programs for gas utilities were relatively new and that their funding levels might be subject to change as Commission policy evolves. (Tr. 878) The Company stated that it had no problem with this recommendation. (Tr. 1689) It should be adopted.

Finally, as did DPS Staff (Tr. 879-880), Dr. Elfner supported the Company's proposal to recover the cost of the CIP from all customers. (Tr. 604)

He noted that although the specific measures included in the program are aimed at residential and smaller commercial customers, the conservation and environmental improvements achieved will inure to the benefit of all customers. Furthermore, energy efficiency activities for large customers have been funded by the general body of ratepayers for years, and will continue. It is perfectly equitable that the general body of ratepayers should fund the CIP. (Tr. 605)

On rebuttal, NFGD suggested that the incremental cost of the CIP to ratepayers be mitigated through the use funds in the CMR, and funds due to be returned to customers as a result of overcollections of state income taxes. (Tr. 1690-1691) The CPB supports this recommendation, with the proviso that only funds in the CMR at the start of the rate year be committed to the CIP initially. If the Commission approves the CPB's recommendation that Company contributions to the CMR from off-system sales and capacity release revenues be continued and expanded, the manner and extent of the use of those incremental funds for the CIP should be considered by the parties in the proposed collaborative.

G. Revenue Decoupling Mechanism

The Company's RDM proposal anticipated the Commission's RDM Order and is conceptually consistent with the order's requirements. Dr. Elfner did, however, recommend several modifications to help ensure that the mechanism operates in a manner consistent with consumer interests.

First, he expressed concern that reconciling normalized usage-per-account on an annual basis only might result in large accruals, the amortization of which could have a substantial impact on customer bills. (Tr. 607) He recommended that accruals be calculated monthly and that every six months they be quantified and refunded or surcharged if they exceed 1% of actual delivery revenues for the period.

The Company responds that significant accruals are unlikely. (Tr. 1695) It does not, however, indicate why the additional insurance of a more frequent true-up would be burdensome or costly. The CPB continues to recommend that this option be examined further by the Commission.

Both Dr. Elfner and DPS Staff recommend that all residential service classes be included in the RDM. (Tr. 608; Tr. 889) The Company agreed that this was reasonable. (Tr. 1694)

Dr. Elfner further recommended that the volumetric benchmarks used in the RDM calculation should be based on the usage forecasts underlying the Commission's revenue requirement determination in this case. (Tr. 607) On cross-examination, Company witness Meinl seemed to confirm that this was the Company's intention. (Tr. 1706-1707) That understanding should be confirmed in the Commission's order.

Finally, Dr. Elfner testified that the methodology used to calculate changes in usage-per-customer should be readily verifiable through a transparent methodology utilizing directly observable data not unduly affected by anomalous events such as billing adjustments. Operation of the RDM should then be closely monitored to identify implementation concerns that require addressing. Dr. Elfner recommended that this type of evaluation be included on the agenda for the CIP collaborative.

The Company did not respond directly in its rebuttal testimony to these recommendations. The CPB continues to consider these issues important, requiring resolution to protect consumer interests.

CONCLUSION

The Consumer Protection Board recommends that the Public Service Commission adopt the proposals identified herein.

Respectfully submitted,

s/

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Chairperson and Executive Director

Douglas W. Elfner
Director of Utility Intervention

David Prestemon
Intervenor Attoney

Dated: Albany, New York
August 15, 2007