STATE OF NEW YORK

PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Orange and Rockland Utilities, Inc. for Gas Service	Case 05-G-1494

STATEMENT OF THE NEW YORK STATE CONSUMER PROTECTION BOARD REGARDING JOINT PROPOSAL

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On June 21, 2006, Orange and Rockland Utilities, Inc. ("Orange and Rockland"), Staff of the New York State Department of Public Service ("DPS Staff"), Multiple Intervenors ("MI") and the Small Customer Marketer Coalition submitted a Joint Proposal ("JP") for consideration by Administrative Law Judge Elizabeth H. Liebschutz and the New York State Public Service Commission ("PSC" or "the Commission"). That JP would resolve all major contested matters in this proceeding through October 31, 2009, including Orange and Rockland's revised request for a $20.6 million (26.3%)[1] increase in natural gas delivery revenues effective November 1, 2006. The JP would authorize the Company to increase gas delivery revenues by $6.5 million (8.3%)[2] on November 1, 2006, by another $6.5 million on November 1, 2007 and by $1.8 million along with a one-time surcharge of $4.5 million, on November 1, 2008. (JP §3) Under the JP, residential customers would receive delivery rate increases of 11.51%, 8.43% and 6.55% in the three years,

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1 Calculated as $20.6 million divided by projected delivery revenues at current rates of $78.3 million. (Response to Information Request ("IR") ALJ-1)

2 Calculated as $6.5 million divided by projected delivery revenues at current rates of $78.3 million. The impact would differ according to service classification. (Id.)

respectively. (Response to IR ALJ-1)

In this Statement, the Consumer Protection Board ("CPB") evaluates the JP and explains how it should be enhanced for the benefit of consumers. Overall, the JP represents a substantial improvement over the Company's proposals in direct testimony. It reflects many of the revenue requirement adjustments proposed by the CPB in testimony and includes several other provisions that would benefit consumers. Nevertheless, for the reasons identified in detail herein, it does not merit our support.

In Part I, we explain that the JP does not satisfy the PSC's Settlement Guidelines. Some of its provisions would not likely have resulted from a litigated proceeding. In addition, it is not supported by any party charged with representing the interests of all consumers.

In Part II, we explain that it is particularly important that the PSC carefully review the JP to ensure that rates are no higher than necessary, because of the customer impact of high energy commodity prices and a series of delivery rate increases for Orange and Rockland gas customers.

We explain in Part III that the JP contains some important positive elements that should be retained. These include adjustments to the Company's proposed revenue requirement, the phase-in of rate increases and the absence of a retail access migration incentive.

In Part IV, we address revenue requirement and other financial issues. The CPB recognizes that a natural gas delivery rate increase is necessary in this proceeding. However, in several respects, the JP should be revised to help reduce the amount of the rate increase and the financial impact on consumers, while still enabling the Company to provide safe and reliable service. We identify specific recommendations that would achieve that objective.

In Part V, we identify several non-financial aspects of the JP that should be modified. We explain why it is in the interests of consumers and competition that a fixed termination date for the PowerSwitch program be specified. We also explain why the JP should be revised to require the Company to spend $50,000 annually on outreach and education regarding the cause of high natural gas prices, actions consumers may take to reduce and manage their energy bills and the availability of programs to assist consumers.

I. SETTLEMENT GUIDELINES

The PSC assesses the reasonableness of any proposed settlement and determines whether it is in the public interest by comparing its terms against standards specified in the Commission's "Settlement Guidelines."[3] The relevant provisions of those Guidelines are:

> 1. A desirable settlement should strive for a balance among (a) protection of the ratepayers, (b) fairness to investors, and (c) the long term viability of the utility, and should be consistent with sound environmental, social and economic policies of the Agency and the State: and should produce results that were within the range of reasonable results from a Commission proceeding.[4]
>
> 2. …give weight to the fact that a settlement reflects agreement by normally adversarial parties.[5]

[3] Cases 90-M-0255 and 02-M-0138, Opinion No. 92-2, March 24, 1992.

[4] Id., p. 30.

[5] Id., pp. 30 -31.

Several provisions of the JP are not consistent with what would have been expected in a litigated proceeding. For example, the JP establishes rates based on a return on equity that exceeds that which would have resulted from strict application of PSC policy. (See Point IV (A)) Similarly, provisions of the JP regarding the Gas Expansion Pilot Program appear to be inconsistent with current PSC policy. (See Point IV (B)) In addition, the JP would provide the Company an incentive based on customer awareness and understanding of energy deregulation, although no party proposed such an incentive in their testimony and the record contains no evidence that such an incentive is necessary or appropriate. (See Point IV (D))

The JP is not supported by the CPB, the sole state agency that is charged by the New York State Legislature and the Governor with representing the interests of consumers before the PSC. Multiple Intervenors, a representative of industrial customers, supports the Agreement. However, the main issue of concern to the CPB in this proceeding – the Company's revenue requirement and overall rates for gas delivery service – was not addressed in MI's testimony in this case. No party that testified on revenue requirement issues, other than the Company and DPS Staff, supports that aspect of the JP. The Commission should give substantial weight to the fact that the Joint Proposal is opposed by the CPB in determining whether it should be modified.

II. THE CONTEXT FOR EVALUATING THE JOINT PROPOSAL

The record shows that high prices of natural gas are expected to continue into the rate year. In particular, Orange and Rockland expects gas commodity charges to exceed $11.00 per Dth for each month in the 2006-2007 heating season, a price that would be higher than ever previously experienced by Orange and Rockland customers except for several months in the 2005 – 2006 heating season. (Testimony of CPB Witness Mr. Niazi, p. 4) In addition, gas delivery rates increased by $9.25 million in 2003, $9.275 million in 2004 and $5.00 million in 2005 and would also increase in each of the next three years if the JP is approved. In these circumstances, the PSC should use all available means to help alleviate the burden on consumers of high fuel prices and repeated natural gas delivery price increases.

III. POSITIVE ELEMENTS OF THE JOINT PROPOSAL

The CPB submitted testimony in this proceeding to help ensure that Orange and Rockland's gas delivery rates are "just and reasonable" and "in the public interest"[6] and that other important consumer benefits are secured. The JP achieves some of those benefits, as explained below. These results are important and should be approved by the Commission.

A. Revenue Requirement Adjustments

Orange and Rockland initially requested a delivery rate increase of $23.7 million. The CPB submitted testimony that demonstrated that the Company's rate increase request was excessive, and identified several areas in which specific revenue requirement adjustments should be made. The JP essentially reflects the vast majority of those proposals, and represents an important step in reducing the size of the rate increase that could occur in this proceeding. In particular, the JP reflects the full amount of CPB

6 Public Service Law ("PSL") §§72, 65(1) and 65(5).

proposals to remove management incentive compensation costs from revenue requirement and reduce the rate allowance for manufactured gas plant site remediation costs. It also reflects a considerable portion of CPB proposals to increase the forecast of late payment revenues, change the amortization of pension and OPEB deferred balances, reduce labor costs to reflect more accurate workforce projections and reduce projections of property taxes.

However, as explained in Point IV, more could be done to further reduce the delivery rate increases and the financial burden on consumers that would result from the JP.

B. Phase-in of Rate Increase

The JP reflects a revenue requirement increase of $12.0 million effective November 1, 2006, or 15.3% of delivery revenues. (Calculated from the response to IR ALJ-1) It also includes revenue requirement increases of $0.7 million and $1.1 million effective November 1, 2007 and November 1, 2008, respectively. In partial recognition of the impact on consumers of a 15.3% delivery rate increase, the JP would phase-in the revenue requirement increases so that revenues would increase $6.5 million on November 1 of each year 2006 through 2008. (JP, §3)

The phase-in reflected in the JP is necessary and appropriate in view of the proposed delivery revenue increases and should be approved by the Commission.

C. Absence of Retail Migration Incentive

In testimony in this proceeding, Orange and Rockland recommended that it be provided a financial incentive for encouraging retail access that includes both the migration of new customers to ESCOs and the retention of customers who already receive service from ESCOs. (Initial Testimony of Company Witness Ms. Quin, pp. 9-11; Rebuttal Testimony of Ms. Quin, pp., 14-18) DPS Staff testified that the Company should have a migration incentive with a retention component, but recommended changes to some of the parameters of that incentive. (Testimony of DPS Witness Ms. Tuczinski, pp. 17-23) The CPB was the only party to oppose such an incentive in our direct testimony. (Testimony of Mr. Niazi, pp. 23-5) The CPB explained that such an incentive is not necessary to facilitate retail access and is not required for the Company to provide safe and reliable service. Moreover, a retail migration incentive does not necessarily align utility interests with those of customers who would fund that incentive, and is therefore not in the public interest. (Id.)

The JP omits such a mechanism. The absence of such a migration incentive is a positive element of the JP and should be preserved. Omitting this ratepayer-funded incentive is particularly important in this case, in view of the high energy costs faced by ratepayers and the delivery rate increases proposed in this proceeding.

IV. REVENUE REQUIREMENT AND FINANCIAL ISSUES

A. Return on Equity

Rates under the Joint Proposal are premised on a return on equity of 9.8%. (JP, Appendix A, p. 3) CPB witness Mr. Niazi testified on March 30, 2006 that Orange and Rockland’s cost of equity is 8.62%. (Testimony of Mr. Niazi, pp. 5 – 16) DPS Staff testified at that same time that the Company’s cost of equity is 8.9%. (Testimony of DPS Staff Witness Mr. Jeffery S. Hogan, pp. 21 – 50)

According to DPS Staff, the 9.8% cost of equity in the JP was developed by modifying the 8.9% estimate in Staff's testimony for three reasons. (DPS Staff response to CPB IR 1, included in the Attachment) First, the 8.9% ROE was increased by 29 basis points to 9.19% to account for changes in U.S. Treasury bond yields, stock prices and a more recent estimate for market return. We do not oppose this adjustment, as it is Commission practice to update the return estimate at the time of its decision.[7]

Second, DPS Staff increased this 9.19% updated estimate by 36 basis points to reflect a three-year stay-out premium. A stay-out premium is intended 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. It is important to note that the revenue requirement calculations under the JP are essentially equivalent to three one-year rate cases. In particular, the gas revenue requirements reflect projections of higher labor costs, other operations and maintenance expenses, taxes and rate base, in each rate year. Gas delivery rates under the JP include an additional $0.7 million of revenue requirement in Rate Year 2, and another $1.1 million of revenue requirement in Rate Year 3. (JP, §3) The Company is not agreeing to freeze delivery rates for the term of the multi-year plan, and is therefore not absorbing the risk that its return may decline if rates were fixed. Instead, ratepayers are being asked to commit now, to fund projected cost increases in each year of

[7] However, it is noteworthy that the 9.19% return on equity under the JP, before adjustments for stay-out premium and business risk, is approximately 20 basis points higher, on a comparable basis, than the result in the recent Recommended Decision for NYSEG's electric operations. (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, Recommended Decision, June 9, 2006) The RD found that NYSEG's return on equity should be 9.3%, based on updated information as of June 2006, approximately the same time as the equity return estimate underlying the JP was developed. NYSEG's bonds are rated BBB+, whereas bonds of Consolidated Edison Company are A-rated. There is a difference of approximately 30 basis points in the yields of utility bonds of these credit ratings (Case 05-E-1222, SM 3039), so that the recent Recommended Decision is equivalent to a 9.00% return on equity for an A-rated Company such as Con Edison or Orange and Rockland. The 9.19% return on equity for a one-year rate case is approximately 20 basis points higher than this result.

the multi-year plan, whether or not those cost increases materialize. The 36 basis point stay-out premium therefore provides no value to ratepayers in these circumstances. DPS Staff asserts that the stay-out premium is justified based on Case 91-M-0509, the Generic Finance Case. (DPS Staff Response to CPB IR 1) However, the stay-out premium as calculated and applied by DPS Staff is not based on the Return on Equity Consensus Document[8] or the Recommended Decision in that case,[9] which have been the basis of PSC policy on this matter for fifteen years. In fact, both of those documents indicate an entirely different treatment for a stay-out premium for a multi-year plan where rates are adjusted each year, as is the case under the JP.

The Return on Equity Consensus Document says:

> For utilities operating in multi-year agreements in which the rates are reset the allowed ROE for the first year will be set at the generic results plus any business risk adjustment. The allowed ROE in succeeding years of the multi-year agreement will be the same as the allowed ROE in the initial year of the agreement unless the ROE calculated by the formula in the succeeding years including any business risk adjustment is greater than calculated by the formula for the initial year.
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> * * *
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> In all cases the return adjustment will be calculated with reference to the difference between the initial return of the rate plan and the return produced by the ROE formula (plus the business risk adjustment, if any) for each year. This assures that the return in the later years of the rate plan can, after upwards adjustments, fall back to the initial ROE in the event the generic ROE falls. (Return on Equity Consensus Document, p. 19-20)

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[8] Case 91-M-0509, Proceeding on Motion of the Commission to Consider Financial Regulatory Policies for New York State Utilities, Return on Equity Consensus Document, June 2, 1993.

[9] Case 91-M-0509, Recommended Decision, July 19, 1994.

The Return on Equity Consensus Document clearly indicates that the initial year ROE in a multi-year agreement should be based on the first year equity return. Second, the equity return should be 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 underlie the equity return 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.
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> * * *
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> 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, p. 74)

The Recommended Decision concluded:

> 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)

The return on equity in the JP was calculated using 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 Joint Proposal since it is inconsistent with established PSC policy and provides no value to ratepayers.

Third, DPS Staff adjusted its estimate of equity return filed in testimony by an additional 25 basis points, "to recognize the specific business risk contained in the Joint Proposal." (DPS Staff response to CPB IR 1) As an example, DPS Staff points to the risk of higher expenses if health care and labor costs were to rise faster than agreed upon in the rate plan. We believe that DPS Staff has looked at only one side of the coin. Expenses could easily be lower, or revenues could be higher, than the levels agreed to in the JP. Settlements by their nature require all parties to attempt to agree to the best estimate and then take their chances. In addition, the three-year revenue requirement projections in the JP reflect projections of cost increases that are apparently acceptable to the Company. Adding 25 basis points for "business risk" ignores the risk to ratepayers that expenses could be lower, or revenues higher, than agreed in the rate plan. No evidence has been provided that any risk premium in this case should be positive, instead of negative.

DPS Staff also points out that the Generic Finance Case recognized business risk. (Id.) Although there was a discussion of business risk in the Generic Finance Case, there was no agreement among the parties regarding its applicability, and it was left to individual proceedings or to a broader Commission determination. The Generic Finance Case also pointed out that:

> In general, we believe that most of the recent multi-year plans approved to date by the Commission have not fundamentally altered the energy utilities' basic business risk relative to the business risks in one year rate cases. (Return on Equity Consensus Document, p. 15)

To the best of our knowledge, there has been no Commission determination regarding business risk since the Generic Finance case. In addition, our understanding is that the Commission has not specifically recognized business risk in any multi-year Settlement Agreement.

Overall, based on the methodologies developed in the Generic Finance Proceeding and adopted in numerous Commission decisions over the past fifteen years, the return on equity included in the Joint Proposal is excessive. It should be reduced to remove the effect of the 36 basis point stay-out premium and the 25 basis point adder for business risk.

B. Gas Expansion Pilot Program

The JP would authorize Orange and Rockland to implement a Gas Expansion Pilot Program under which ratepayers would fund extension of its gas mains, if certain conditions are satisfied, where such expansion would normally be considered uneconomic. (JP, §20; JP, Appendix H) Potential gas main expansion projects that are not expected to generate supporting revenue would be eligible for inclusion in this Pilot Program. Projects that satisfy selection criteria would be funded by ratepayers up to 50% of the revenue requirement necessary to support the Company's rate of return and carrying costs, and completed projects would be included in rate base.

The CPB strongly supports cost effective expansion of Orange and Rockland's gas system, as well as the Company's efforts to proactively work with municipalities to facilitate economic development. However, we are concerned that as currently structured, the Pilot Program may be detrimental to Orange and Rockland's customers.

The JP does not specify how proposals will be reviewed. Instead, it states that the projects will be evaluated based on the overall goal of "promoting capital investment and job creation," and identifies ten "criteria that shall be considered" in evaluating proposed projects. However, the list of criteria is not exclusive and the JP does not specify how those criteria will be used in the evaluation process. The Company will provide its financial evaluation of proposed projects, along with additional relevant materials, to DPS Staff.

The absence of specified evaluation criteria is of particular concern because this Pilot Program addresses only projects that are not economically justified based on traditional analyses. The CPB is concerned that the amount of carrying charges on approved projects that customers would have to pay under the JP may far exceed any benefit those customers obtain in the future as a result of spreading fixed costs over more customers. The evaluation criteria applicable to projects under the Pilot Program must ensure that ratepayers benefit from the projects and do not subsidize uneconomic expansion of Orange and Rockland's gas system. A program that imposes uneconomic costs on current customers, particularly at a time of high energy prices and annual delivery rate increases, is not in the public interest.

Because of the absence of a specified evaluation methodology, it would not be in the public interest for other interested parties, such as the CPB, to be excluded from the review of specific proposals, a result that would appear to occur under the JP. We therefore appreciate Orange and Rockland's agreement to provide CPB copies of the materials submitted to DPS Staff. (Orange & Rockland response to CPB JP IR, Set 1, #1, included in the Attachment) In addition, however, the PSC should confirm that interested parties have the opportunity to seek PSC review, during the term of the JP, of the appropriateness of ratepayer funding of carrying charges on projects under the Pilot Program, if projects are not in ratepayers' interest.[10]

C. Outreach and Education on Retail Competition

The JP provides funding of $300,000 annually for incremental retail choice programs and retail access outreach and education. (JP §22) As the CPB testified, all ratepayer-funded spending by utilities should be scrutinized to ensure that it is cost effective and in consumers' interest, especially in this environment of high commodity prices and annual delivery rate increases. (Testimony of Mr. Niazi, p. 28-9)

The record contains no evidence that Orange and Rockland's past retail access outreach and education efforts or marketer incentive programs have been cost effective (Id.), or that spending of this magnitude in the future, approximately ten years after retail competition began, is in the public interest. In these circumstances, ratepayers' subsidization of advertising, promotion and other customer acquisition activities that could and should be conducted by ESCOs, should decline substantially.

Accordingly, we recommend that the JP be revised so that the Company's rates reflect $150,000 in annual spending on these retail access-related outreach and education

[10] It is noteworthy that the Company testified that it is "committed to a Commission review that will involve the full collaborative efforts of the Company and other interested parties." (Rebuttal Testimony of Mr. Arnold, p. 9)

programs, or one-half of the amount proposed in the JP. As explained in Point V(B), $50,000 of this amount should be used to fund outreach and education efforts regarding high energy prices. The Company's revenue requirement under the JP should therefore be reduced by $100,000.

D. Incentive for Customer Understanding

Under the three-year term of the JP, the Company could "retain up to a total of 60 basis points (20 basis points per year) of earnings before the calculation of any customer sharing provisions" by meeting thresholds that allegedly illustrate a specific level of customer understanding regarding energy deregulation. (JP, §17; JP, Appendix G) The value of 20 basis points is approximately $234,000.[11] The CPB has six main concerns regarding this proposed incentive. For these reasons, we oppose this provision of the JP and recommend that the Commission delete it in its entirety.

1. The Incentive is Not Required for Just and Reasonable Rates

As the CPB has consistently explained throughout this proceeding, increases in natural gas commodity prices and substantial gas delivery rate increases for six consecutive years if the JP is approved, require that the PSC carefully examine all aspects of the JP to ensure that delivery rates are no higher than necessary. The proposed incentive for customer understanding is simply not required for the Company to offer safe and reliable service at just and reasonable rates, and should be rejected at this time.

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[11] Company response to CPB JP IR Set 1, #11, included in Attachment.

2. The Absence of Record Support

As explained in Point III (C), the Company originally proposed that it be provided an incentive for customer migration to ESCOs, and retention by ESCOs. DPS Staff made a similar proposal, and the CPB testified in opposition to such incentives. Neither the Company nor Staff submitted any testimony advocating an "incentive" based on customer awareness and understanding of energy deregulation.[12] Moreover, there is no evidence that renewed focus on customer awareness or understanding is justified because it has declined in recent years. In fact, the data indicate that both awareness and understanding have increased from 2004 to 2005.[13] Similarly, there is no evidence that ESCOs should not be responsible for increasing awareness and understanding above current levels, approximately ten years after retail competition was introduced. As such, it is virtually inconceivable that an incentive linked to customer understanding of energy deregulation would have resulted from a litigated proceeding in this matter.

3. Ratepayers Would Essentially Pay Twice For The Same Program

As explained in Point IV (C), the JP would require ratepayers to fund $300,000 annually "to develop and implement customer outreach and education programs and materials to increase residential and commercial customers' awareness and understanding

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[12] In fact, DPS Staff Witness Ms. Tuczinski testified with regard to the awareness and understanding surveys that "The Company should continue to conduct the surveys annually and provide the Office of Retail Market Development with a copy of the findings and raw data when the survey and analysis is completed." (Testimony of Ms. Tuczinski, p. 10)

[13] DPS Staff response to CPB IR, Set 1, #6. (These documents are not attached to this Statement due to their length.

of retail access."[14] (JP, Appendix I) In addition, the JP would require ratepayers to fund $150,000 annually for outreach and education on issues ostensibly not related to retail access, including educating customers on Orange and Rockland's obligations in the restructured energy industry. (See, JP Appendix J, Goals and Objectives) Comparison of the goals and objectives of the outreach and education characterized as "not related to retail competition," reveals significant overlap with the issues covered by the proposed awareness and understanding survey.

After requiring ratepayers to fund those programs, the JP would then require ratepayers to fund an incentive for Orange and Rockland that would appear to be easily achieved.[15] Requiring ratepayers to pay for a program, then pay again if the program achieves its objectives, is inappropriate in all circumstances, but particularly egregious at a time when parties, and the PSC, should be doing all they can to reduce energy costs for consumers.

4. Represents Previously Abandoned Regulatory Policy

Shortly after retail competition was introduced in New York's energy markets, several utility rate plans included incentive mechanisms for customer awareness or understanding of the restructured energy market of the type included in the JP in this case. However, regulatory policy in New York State has evolved considerably since that time. For example, Orange and Rockland's current rate plan does not include any incentive for customer awareness or understanding of retail competition. In addition, the Company's previous rate plan, applicable from November 1, 2000 to October 31, 2002, contained only

[14] The CPB's argument in this section continues to apply if the PSC adopts our recommendation that the JP be revised to reduce spending on outreach and education related to retail competition.

a relatively small incentive for retail access awareness and understanding, involving only approximately 13% of the total incentive related to retail access.[16] As a general matter, the PSC has moved away from incentive mechanisms based on customer awareness or understanding of deregulated energy markets. In our view, that evolution is entirely proper, since there is little that is different today about energy restructuring in Orange and Rockland's territory than ten years ago, and at this point, ratepayers should no longer have the same level of financial responsibility for increasing customer awareness and understanding of this issue.

Further, in other recent or concurrent cases for major energy utilities, the parties have not even proposed any type of incentive for customer awareness, understanding or migration to ESCOs. For example, the PSC is currently considering a Joint Proposal for Central Hudson Gas & Electric Corporation, supported by DPS Staff, which does not include a retail access related incentive of any type.[17] Similarly, in NYSEG's current electric rate case, neither the Company nor DPS Staff even proposed any retail access related incentive.[18] The parties in those cases properly recognize that such incentives are unnecessary and inappropriate in an environment of high energy costs.

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15 This point is explained further in Part IV (D) (5).

16 Case 99-G-1695, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Orange and Rockland Utilities, Inc. for Gas Service, Opinion No, 00-13, Opinion and Order Adopting Terms of Settlement, November 20, 2000, p. 3.

17 Cases 05-E-0934 and 05-G-0935, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Central Hudson Gas & Electric Corporation for Electric and Gas Service, Joint Proposal, April 19, 2006.

18 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. See, e.g., Recommended Decision, June 9, 2006.

Overall, the customer awareness and understanding incentive in the JP represents a return to regulatory policy that had been, in CPB's view, properly abandoned, without any evidence whatsoever that such backtracking is necessary or appropriate.

5. The "Incentive" is Illusory

The "incentive" which would be created by the proposed mechanism is illusory, since the Company would essentially be rewarded for past performance. Customer awareness and understanding surveys including the identical questions that would be used as a basis for the incentive in the JP, have been conducted for several years. The results of these surveys conducted by Eagle Bay Consulting, Inc. ("Eagle Bay Survey") show that 77% of those surveyed from the pool to be used in the proposed incentive were aware of natural gas deregulation, and 73% of the residential dual use and 75% of the total dual use customers understood energy deregulation.[19] However, under the JP, the full 20 basis point incentive would be provided each year if the score for "understanding" of residential customers is at least 71% in Rate Year 1, 72% in Rate Year 2, and 73% in Rate Year 3. Thus, O&R would earn the maximum "incentive" award in each year if current levels of understanding are maintained.

Further, in our view, the level of "understanding" required for Orange and Rockland to earn the incentive does not appear to require substantial effort by the Company. In particular, customers are deemed to "understand" deregulation if they obtain a score of 7, 8 or 9 out of nine questions. Tellingly the Eagle Bay Survey from 2005 indicates a relatively large population of those surveyed in 2005 either received

[19] DPS Staff response to CPB IR Set 1, #6.

"passing" scores or answered 4, 5 or 6 questions correctly, thus placing them right on the precipice of the understanding range.[20]

Moreover, consumers may acquire an understanding of deregulated energy markets in any number of ways, such as through activities by ESCOs, word of mouth and Op Ed pieces in local newspapers. Long after the industry has been restructured, it is reasonable to assume that these sources would become the primary vehicles for informing consumers of energy deregulation. There is no reason for ratepayers to fund an incentive for utility shareholders based on activities conducted by ESCOs, friends and family, and the media.

In addition, only customers who have demonstrated an awareness of energy deregulation, would be surveyed. (JP, Revised Appendix G, p. 2) By limiting the sample to customers who pass this threshold test, the actual percentage of customers who understand energy deregulation by this measure is artificially understated.

Finally, the "understanding" targets under the JP increase by only 1% each year. At that rate, it would take 30 years for all customers to be considered to understand energy deregulation by this measure. A 1% increase in this measure each year reflects too little progress to merit an incentive.

6. The Survey Design and Methodology is Deficient

The survey instrument, and the survey methodology, have several obvious deficiencies. First, the survey would exclude customers who demonstrate an awareness of gas deregulation, but not electric deregulation. This is not appropriate if the purpose is to

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20 Id.

measure understanding of gas deregulation.

In addition, only two of the nine questions in the survey relate only to natural gas service. Consumers who answer both of those questions incorrectly, but correctly answer at least six of the remaining seven questions, would be deemed to have an understanding of natural gas deregulation and would lead to an incentive award for the Company. In our view, it would be inappropriate for gas customers to fund an incentive that would reward the Company when customers cannot demonstrate an understanding of any issues in the survey applicable only to gas.

Moreover, the survey is designed so that the correct answer for each and every question is “agree.” This is a plain violation of the most fundamental principles of survey design.

V. OTHER CONCERNS WITH THE JOINT PROPOSAL

A. Absence of Sunset for PowerSwitch Program

The JP would continue indefinitely Orange and Rockland’s PowerSwitch program, under which the Company performs marketing, call center, and customer acquisition services for ESCOs. That program has been in place in Orange and Rockland’s service territory since 2000, longer than for any other utility in New York State, and under the JP, would be in place for a total of 9 years. It has far outlived its original purpose as a transitional measure to give customers a chance to gain experience in trying service from an ESCO and is now being relied upon by ESCOs in lieu of competing and innovating in the provision of marketing and customer acquisition services. Consistent with the movement to a competitive retail market, the JP should be modified to include a firm sunset date for the PowerSwitch program.

The CPB testified that PowerSwitch has helped ESCOs over the initial hurdle of obtaining a “critical mass” of customers, and has given customers a chance to gain experience in shopping for energy and interacting with an ESCO. (Testimony of Mr. Niazi, pp. 26-27) However, it is now such a fixture in the energy landscape in Orange and Rockland’s service territory that ESCOs are incorporating it into their long-term business plans. As a result, there is little if any incentive for ESCOs to compete by developing innovative marketing and customer acquisition measures, to the detriment of consumers.

At some point, ESCOs must participate fully in the unsubsidized competitive marketplace. The PSC has recognized that programs such as PowerSwitch should be temporary. In particular, in its August 24, 2004 Statement of Policy on Further Steps Toward Competition in Retail Access Energy Markets in Case 00-M-0504, the Commission stated that programs such as PowerSwitch are

> a good transitional model that will help residential customers get acquainted with obtaining energy supply from a non-utility provider. In the long run, however, we believe that ESCOs should no longer need the support of the utilities to provide customer care services and should ultimately provide all customer services associated with the provision of commodity. (p. 16)

Ample time has been provided for customers to “get acquainted with obtaining energy supply from a non-utility provider.” In addition, the Commission has terminated programs that are beneficial to customers, such as fixed-price commodity programs, with the expectation that they will become available in the marketplace. However, the PSC has not yet taken the first step to place any limitation on the duration of any “temporary”

PowerSwitch-type program, which prolongs ESCO's reliance on utilities and utility ratepayers. This proceeding, which establishes rates, terms and conditions for gas service for three years for the utility in New York State for which this "transitional model" has been in place for the longest period of time, represents an ideal opportunity for the Commission to take further steps to provide consumers the benefit of innovation and competition.

Establishing a firm termination date for this program will benefit consumers, since it will require ESCOs to innovate in the provision of marketing and customer acquisition services that comprise PowerSwitch. Competition among ESCOs in the provision of these services should be expected to lead to new offerings, thereby allowing ESCOs to differentiate their services from others, and from the utility. Accordingly, the JP should be modified to include a firm termination date for PowerSwitch, which the CPB recommends to be 1 year after the PSC issues an Order in this proceeding. This would provide ample time for ESCOs, who will have had their customer acquisition costs subsidized by Orange and Rockland ratepayers for more than 7 years, to transition to the unsubsidized competitive marketplace.

In its rebuttal testimony, Orange and Rockland opposed this CPB proposal, saying that PowerSwitch should continue until enrollment becomes negligible. (Testimony of Ms. Quin, p. 20) We disagree. Without a firm termination date to this ratepayer funded program, ESCOs do not have an adequate incentive to develop new customer acquisition strategies. The absence of a firm commitment date denies consumers the benefit of innovation and delays the transition to competitive retail energy markets.

B. Outreach and Education For Programs Other Than Retail Access

Under the JP, rates would be set to provide $150,000 of annual funding for the Company's outreach and education on customer services, programs and information not related to retail competition. (JP §23; JP Appendix J) The JP, however, would not require the Company to provide any information to consumers regarding the cause of high natural gas prices, actions consumers may take to reduce and manage their energy bills, and the availability of programs to assist consumers. (Company response to CPB JP IR, Set 1, #6; included in Attachment) The CPB recommends that the JP be revised to require the Company to spend up to $50,000 annually for this purpose.

As explained above, Orange & Rockland's customers are facing extremely high natural gas commodity prices, have endured gas delivery rate increases in each of the last three years, and are facing proposed delivery rate increases in each of the next three years. CPB Witness Niazi demonstrated that consumers should be provided accurate and timely information regarding the cause of high natural gas prices, actions they can take to manage their energy bills, and how to obtain assistance in paying their bills. (Testimony of Mr. Niazi, pp. 28-30) The CPB and the Department of Public Service played key roles in delivering that information to consumers this past winter. In addition, the PSC augmented its normal winter energy outreach and education efforts (e.g., PSC Press Release, Commission Expands Winter Outreach and Education Efforts, Press Release, September 21, 2005). However, there is no guarantee that the PSC will take such action again next winter. Utilities can, and should, also be instrumental in providing this important information to consumers.

The JP requires Orange and Rockland to spend up to $150,000 annually on outreach and education that is not related to retail competition, but it does not require the Company to spend any amounts on the cause of high natural gas prices, actions consumers can take to manage their energy bills and how to obtain assistance in paying those bills. Moreover, the requirement that the Company "file with Staff a general Outreach and Education plan" each year (JP, Appendix J), does not satisfactorily address our concerns.

The JP should be revised to require Orange and Rockland to spend up to $50,000 annually on these issues. This would include direct mail, bill inserts, information on the Company's web site, and participating in public events. The $50,000 in funding for this purpose should be diverted from planned spending on outreach and education for retail competition, as explained in Point IV (C).

CONCLUSION

The Consumer Protection Board recommends the Public Service Commission modify the Joint Proposal in this proceeding as indicated herein.

Respectfully submitted,

Teresa A. Santiago,
Chairperson and Executive Director

Douglas W. Elfner,
Director of Utility Intervention

John M. Walters,
Intervenor Attorney

Tariq N. Niazi
Chief Economist

Dated: July 7, 2006
Albany, New York

ATTACHMENT

CPB JP IR Staff Set #1, Response #1

CPB JP IR Company Set #1, Response #1

CPB JP IR Company Set #1, Response #6

CPB JP IR Company Set #1, Response #11

Information Requests of the Consumer Protection Board
Regarding the Joint Proposal in Case 05-G-1494 – Staff Set #1

Date of Request: Wednesday, June 21, 2006

1. In general terms, and without violating PSC Rule 3.9(d), please explain the derivation of the 9.8% cost of equity in the Joint Proposal using the cost of equity in DPS Staff's March 30, 2006 testimony as the starting point. Identify and quantify the impact (in basis points) of each of the major factors that comprise the difference between these two ROE estimates (e.g., update to reflect more recent data, effect of change in methodology (explain), stayout premium, etc.)

Responding Witness: Jeffrey S. Hogan

Response: The 9.8% cost of equity found in the Joint Proposal was derived by updating my testimony position (8.9% ROE for a one-year case) to reflect the most recent data as well as adding an appropriate stayout premium given the term and of the Joint Proposal and the level of risk assumed by the company.

Updating my ROE methodology to reflect data (Treasury bond yields, stock prices, and a new estimate of the market return) through the end of May 2006 produces an ROE of 9.19%, an increase of 29 basis points over my March 30, 2006 testimony. There was no change in the underlying methodology itself.

In the Generic Financing Case (GFC), the need to compensate for the risks involved in a multi-year rate case was recognized. This risk was seen as comprising two parts. First, it was acknowledged that there is a risk that an ROE set in such a case could become "stale". This was addressed by adding a premium to the ROE tied to the spread between Treasury bond yields for one year bonds and those whose maturity is equal to the duration of the rate plan (e.g., three-year Treasury bonds for a three-year rate plan).

In the GFC, the average spread between Treasury bond yields over the previous five-year period were calculated, and half of this difference was used as the portion of the stayout premium related to the risk the ROE might become "stale". Replicating that methodology for the latest five years shows that the average difference between one- and three-year Treasury bonds has averaged 73 basis points. Half of this is approximately 36 basis ponts.

Date of Request: Wednesday, June 21, 2006

STAFF SET #1, RESPONSE #1 (CONT'D) (HOGAN)

The need for such a premium can be seen in the fact that the ROE calculated by my methodology, which relies on the basic framework of the GFC, has increased by nearly 30 basis points over a period of just three months. Further, interest rates have continued to increase, with the 10-year Treasury bond yield increasing 13 basis points since the end of May.

The GFC also recognized that there are specific business risks in each multi-year rate plan. Given the uniqueness of each rate plan, the GFC said that the level of such risk should be determined in each individual rate plan. Given the terms of the Joint Proposal, the company has accepted additional risk above-and-beyond what would be found in a series of one-year rate cases. For instance, the company is at risk for expenses for such things as health care and labor increasing faster than what was agreed to in the rate plan. In addition, the company's ability to retain earnings in excess of certain levels has been decreased, as has the company's ability to defer costs if its earnings are above certain levels. I have added 25 basis points to the ROE to recognize the specific business risk contained in the Joint Proposal.

Finally, it must be remembered that the ROE is just one component of the Joint Proposal. The overall reasonableness of the Joint Proposal depends on the whole of its terms.

Information Requests of the Consumer Protection Board
Regarding the Anticipated Joint Proposal in Case 05-G-1494
Company Set #1, Response #1

1. Please elaborate on the process for review of potential projects under the Pilot Project summarized in Appendix I. Is it the Proponents' intention to permit all interested parties to review the Company's evaluation of potential projects and provide all interested parties an opportunity to comment on that analysis?

Response:

The Company is agreeable to providing CPB with copies of the semi-annual reports to the NYSDPS, as well as project specific evaluations and supporting information as outlined in Appendix H to the Joint Proposal. The Company expects that CPB will have an opportunity to comment on project specific evaluations before the NYSDPS authorizes the Company to proceed with specific projects.

Information Requests of the Consumer Protection Board
Regarding the Anticipated Joint Proposal in Case 05-G-1494

6. The Joint Proposal would require the Company to spend up to $150,000 annually on Customer Outreach and Education for issues not related to retail access, as further detailed in Appendix K.

a) Please quantify the Company's actual annual Customer Outreach and Education expenditures on these issues for each of the last five years.

b) Would the Company be required under the Joint Proposal to spend any specific amount of the $150,000 annually on issues related to the reasons for high energy prices, how consumers can better manage their energy bills (e.g., budget billing, energy efficiency programs) and the availability of programs to assist customers having difficulty in paying their energy bills? If so, please explain and quantify the amount of such spending.

c) Please provide an estimate of the Company's outreach and education expenditures on the issues identified in the preceding part of this question, for each of the last five years.

<u>Response</u>:

(a) The Company estimates it spent the following amounts on Customer Outreach and Education for each of the last five years:

2005 -- $102,000
2004 -- $123,000
2003 -- $118,000
2002 -- $116,000
2001 -- $106,000

(b) No.

(c) The Company is unable to provide this estimate because it does not track expenditures according to the issues identified in Question 6 (b). Rather, the Company budgets according to the various media used (e.g., consumer publications, advertising, Web site) to execute its outreach and education program. A single edition of the Company's consumer publication, @home, for example, carries education and outreach messages for multiple issues. The Company, however, does not allocate the costs for producing this publication to the specific messages contained in this publication.

Company Name: O and R Utilities, Inc.
Case Description: ORU Gas Rate Increase
Case: 05-G-1494

Response to CPB Interrogatories – Set 1
Date of Response: 06/22/2006
Responding Witness: Kane, Richard A

Question No. :11
Please quantify what the available 10 and 20 Basis Points, in the Retail Choice Customer Understanding Incentive, equals in dollar amounts.

Response:
10 Basis Points would be equivalent to net income of approximately $117,000 from Gas Operations. 20 basis points would twice that amount or $234,000 of net income from Gas Operations