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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 99-S-1621 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Steam Service.

Statement of the Department of Public Service Staff in Support of Steam Settlement Agreement

Introduction

Most of the parties to the proceeding involving a rate filing made by the Consolidated Edison Company of New York, Inc. (Con Edison or the company) to increase its steam rates have reached a settlement. Instead of the substantial rate increase proposed by the company ($60 million over four years) the settlement provides for a 4.4% base rate increase in the first year and then a three year rate freeze. The plan also would reflect the savings likely from the company's overhauls of its power plants. After fuel adjustment clause impacts are considered, the mitigated bill impacts are expected to be 3.4% in year one and essentially zero in each of the following years. The settlement would also end the subsidization of the steam system by electricity customers and introduce rate design changes, as well as new backup and transportation services that were agreed to by the company, Staff, and the two groups of customers represented in the proceeding.

Procedural History

On November 19, 1999 Consolidated Edison Company of New York, Inc. filed with the Commission revised steam tariff leaves designed to increase steam rates by $52.8 million, or 13.9% of total steam revenues, to take effect following the December 30, 2000 expiration of the current steam rate settlement. The company also proposed a four year rate moderation plan for steam operations that would permit it to increase rates ratably each October 1st of the four year period covered by its plan.

Con Edison, the Staff of the Department of Public Service, the New York State Consumer Protection Board, the City of New York, the New York Energy Buyers Forum, the Owners' Committee on Electric Rates, Inc., and Utility Workers Union of America filed testimony. All parties to the proceeding were subsequently notified in writing of the pendency of settlement negotiations, prior to the commencement of those negotiations, and notice of the impending negotiations was filed with the Secretary of the Commission on April 14, 2000. Settlement Conferences were held in April, May, and June of 2000 and have resulted in a Settlement Agreement in this proceeding. The Settlement Agreement has been executed by the Union, Buyers Forum, Owners Committee, the company and staff. The State Consumer Protection Board has not signed the Settlement but does not oppose it. The City of New York opposes the Agreement. Westchester County chose not to participate in the proceeding and did not attend any meetings but sought party status on June 8, which was granted.[1]

A request by New York City for air conditioning rebates has been treated separately. The City's request, made on February 14, 2000 was issued for comment by the Commission on March 6, 2000 and tariff amendments providing for contracts to allow air conditioning discount rates were approved on May 26.[2]

Related Orders

In Con Edison's last steam rate case the Commission approved a Settlement Agreement and ordered a base rate increase of about $16 million, or 4.1%, that went into effect on October 1, 1997 and essentially froze base rates at that level through September 30, 2000.[3] In addition to establishing base rates, that opinion required that Con Edison submit a long range plan for the future of its steam system and develop back-up, supplemental, and standby rates, so those rates recover at least some of the fixed costs of the system.

The Steam System Plan was filed on April 15, 1998 and, while the Commission concluded that implementation of the plan would result in the avoidance of significant rate increases while ensuring the continued provision of safe, adequate and reliable steam service, it

1 Case 99-S-1621,Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Steam Service Ruling on Motion to Intervene. (issued July 10, 2000).

2 Case 99-S-1621, Proceeding on Motion of the commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Steam Service, Memorandum to the Commission from the Office of Electricity and the Environment, dated May 9, 2000 (approved as recommended and so ordered, May 26, 2000).

3 Cases 96-S-1065, et al., Consolidated Edison Company of New York, Inc.- Steam Rates, Opinion No. 97-15 (issued September 25, 1997).

also decided that the plan lacked a complete discussion of the future structure of the steam business, certain details related to the divestiture of steam-electric plants and an adequate analysis of the impact of steam air conditioning customers converting to electric service. The Commission therefore directed Con Edison to file a Phase II report addressing these issues.[4]

The Steam System Plan Phase II report was filed on July 22, 1999. It addressed the issues that were of concern to the Commission. The Commission reviewed the plan, as well as the parties' comments upon it. Several of the conclusions are not directly and immediately relevant to the issues in the steam rate case. The Commission concluded, for example, that a competitive steam market is not feasible in New York City at this time [5] and that the formation of a separate steam business unit should assist in optimizing the service provided to steam customers.[6] More directly relevant to the current rate case is the Commission's discussion of the Waterside divestiture and the East River repowering. That discussion is considered in a subsequent subsection of this statement.

Settlement Guidelines

The proposed settlement should be adopted because it is in the public interest as defined by the Commission. The Commission has determined that

> In determining whether or not a proposed settlement is in the public interest, the following standards shall obtain:
> a. A desirable settlement should strive for a balance among (1) protection of the ratepayers, (2) fairness to investors and (3) the long term viability of the utility; 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 that would likely have arisen from a Commission decision in a litigated proceeding.
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> b. In judging a settlement, the Commission shall give weight to the fact that a settlement reflects the agreement by normally adversarial parties.[7]

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4 Cases 96-S-1065 et. al., Order Concerning Phase II Steam Plan Report (issued December 2, 1999).

5 Id.,p. 6.

6 Id.,p. 8.

7 Cases 90-M-0255 et al., Procedures for Settlements and Stipulation Agreements, Opinion No. 92-2 (issued March 24, 1992) p. 8.

The settlement strikes a reasonable balance among the interests identified by the Commission. As explained below, it keeps the rate increase to a minimum while providing Con Edison a reasonable opportunity to recover relevant costs and ensuring the long term viability of the steam system. It is consistent with the sound policies of the Agency and the State and it reflects an agreement among parties that have normally adversarial interests. In addition, the settlement was arrived at fairly in full compliance with all Commission rules and all parties had an opportunity to, and did, participate.

The Settlement's Revenue Requirement

The settlement recommends that the Commission authorize a $16.6 million rate increase for the first rate year, the twelve month period ending September 30, 2001, (Settlement Agreement, p. 3), and provides that Con Edison's overall base steam rates would not be changed, except in extraordinary circumstances, during the following three years. (Settlement Agreement, pp. 19-22) The total cumulative effect of the base rate increase is expected to be offset by fuel related savings from the company's East River Repowering Project. The net result is expected bill impacts as follows:

Years	Bill Impacts
First Year	$12.8 million
Second Year	$(3.0) million
Third Year	$(0.9) million
Fourth Year	$0

This mitigation of the rate increases is significant. It is about $60 million less than the increase proposed by the company.

The Settlement's Treatment of the Company's Steam/Electric Plants

74th Street and 59th Street Plants

Since the 1970s, common costs of combined steam/ electric facilities have been borne by electric customers. Steam production has been assigned only incremental costs, i.e., fuel, processing charges, and interdepartmental rents to cover steam-related capital costs.

Elimination of electricity production at two plants will cause steam to bear common costs that it has heretofore escaped. The most significant cost element contributing to the required increase in the steam revenue requirement is the transfer of the 74th Street generating station from steam/electric operations to steam operations only. Con Edison asserted that the effect on revenue requirement is $18.2 million, comprised principally of operation and maintenance expenses at the station, property taxes, and corporate overheads such as payroll taxes and fringe benefits (the plant is fully depreciated so there are no capital costs that need to be transferred to the steam system). These costs are currently included in the rates established for electric ratepayers under the terms of Con Edison's current five-year electric rate plan, which ends on March 31, 2002. The retirement of the company's 59th Street station poses analogous issues.

East River Repowering

The Commission authorized Con Edison to begin the process of obtaining all necessary regulatory approvals for the East River Repowering, which is designed to minimize both steam and electric rates by replacing an old, inefficient, cogeneration unit with a state of the art facility.[8] Thus, instead of divesting East River, the Commission determined that Con Edison should retain ownership of and repower the plant to replace the steam output of another facility (Waterside) and add about 200 megawatts of in city electric capacity, net of Waterside's electric capacity. The repowered East River plant is anticipate to be operational in April, 2002. The repowering will add in-city electric generation and will lower steam production costs. The repowering project is expected to produce net benefits to steam operations that are in the same amount as the 74th Street and 59th Street costs that will transfer from electric operations to steam operations at the time the repowered East River Station becomes operational.

The Settlement's Ratemaking Treatment of These Plants

We agree with Con Edison that the costs of the 74th Street plant and 59th Street plant should be recovered from steam customers because those customers cause those costs to be incurred. Instead of increasing base rates however, the settlement essentially proposes a netting of those increased costs against projected fuel savings from the East River Repowering project.

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8 Phase II Report Order, p. 12.

(Settlement Agreement, p. 9) In the event the East River Repowering goes into service as projected by the company it seems likely that the project's benefits will offset the recognition of the 74th Street and 59th Street costs as steam charges to be recovered in the steam fuel adjustment and would result in a small decrease in those charges. The Settlement provides that if the East River Repowering is not in service, the costs of 74th Street and 59th Street plants will continue to be collected through existing electric rates. The Agreement provides that upon the actual in service date of the East River Repowering Project the electric charge will end and the actual costs of the 74th Street and 59th Street plants will become a steam fuel charge.

The Settlement provides that when East River's repowering is completed and in service all net benefits allocable to steam will be passed through the fuel adjustment clause. The non-fuel operating costs of the 74th Street and 59th Street steam stations will continue to be reflected in Con Edison's electric rates, and not be transferred to and included in steam rates, until such costs can be offset by the net benefits from the East River Repowering Project.

However, the Article X certification process has the potential to delay the completion date of East River's repowering. The Settlement's linkage of the 74th Street and 59th Street costs recognition to East River's repowering completion assures the intended timing of benefits and costs to achieve rate stability.

The Settlement further provides that Con Edison will submit to the Commission, with an opportunity for review and comment by the parties, a method for calculating the net benefits of East River and will also provide periodic filings setting forth the actual net benefits and the actual non-fuel operating costs of the 74th Street and 59th Street Stations that are passed through the fuel adjustment. Con Edison also acknowledges its responsibility for meeting the East River construction schedule with respect to those factors within its control. Should the completion of East River's repowering be delayed be delayed as a result of the company's imprudence or mismanagement with respect to the construction schedule, the company will forgoe recovery of the transferred costs for the 74th Street and 59th Street steam stations during the period of delay.

Waterside Divestiture

As with the 74th and 59th Street stations, steam customers only pay incremental costs associated with producing steam at Waterside, thereby creating an electric to steam subsidy of about \$58 million. Repowering of East River will allow Con Edison to retire Waterside, thus eliminating the subsidy. Additionally, Con Edison proposes to sell the Waterside site, along with other properties, for real estate development, and use the proceeds from the sale, in part, to write off the book cost of Waterside .[9] In the Phase II steam order the Commission determined that the sales should go forward and that there was no need to determine the allocation of the proceeds at that time, but that the issue should be addressed after the winning bid is announced and an application pursuant to Public Service Law §70 is filed.[10] The expected net gain from the sale is to be used, in part, to offset an existing depreciation reserve deficiency (discussed below under "Depreciation").

Steam Earnings Recovery Mechanism

The Settlement provides that Con Edison will share with customers one-half of its earnings in excess of 11% in equity for any rate year. However, if the company's East River Repowering Project is not completed by the last day of the second rate year, the third rate year or the fourth rate year, then customers will be credited with one-half of steam earnings in excess of 10.5% for any such rate year. (Settlement Agreement, p. 5) All earnings amounts credited to customers in any rate year will be deferred and credited to customers after September 30, 2004. The excess earnings provisions of the Settlement are in the public interest as they provide Con Edison with a profit incentive to become more efficient while at the same time providing additional impetus to complete the East River Repowering Project as soon as possible.

The Settlement provides that the calculation of return on equity will be computed from the company's books except that the shareholder's share of the synergies resulting from the

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9 More precisely, the company intends to sell four properties located on 1st Avenue in the borough of Manhattan (the "First Ave. Properties;" 685 1st Avenue (a parking lot); 708 1st Avenue (an office building); 616 1st Avenue (former Kips Bay steam generating station); and the Waterside generating station (a current steam/electric generating facility). Con Edison refers to these properties as the "1st Avenue properties" and bundled them for sale because, according to Con Edison, prospective buyers indicated that Waterside would be a more valuable commodity if packaged with the other three parcels.

10 Phase II Order, p. 11.

Con Edison/Orange and Rockland merger, Commission approved incentive benefits such as property tax refunds and the net revenue effect of steam sales increases related to colder than normal weather will be excluded. (Settlement Agreement, p. 5) The exclusion of the shareholder synergy and incentive benefits from the calculation is consistent with the intent of the Commission's treatment of these items. The exclusion of the effects of colder-than-normal weather is in recognition that the company is required to bear the net revenue effect of sales shortfalls due to warmer-than-normal weather.

Depreciation

The settlement provides for the discontinuation of the current amortization of depreciation reserve deficiency. (Settlement Agreement, p. 6) The sale of four properties located on 1st Avenue in the Borough of Manhattan is expected to result in a net after-tax-gain. The net gain from the sale of the 1st Avenue Properties allocable to steam operations will be used to offset, or to partially offset if the Commission so chooses, the deficiency determined by a study that will be conducted when the East River Repowering Project is completed. The need to increase depreciation rates will be addressed then.

The Settlement anticipates that the portion of the net gain to offset the deficiency in the accumulated reserve for depreciation will result in a substantial rate base reduction. This rate base reduction should fully offset the revenue requirement for the fourth year of the rate plan plus the impact of any depreciation rate charges. In the event that the rate base reduction related to the net gains allocable to steam operations are insufficient to fully offset the revenue requirement in the fourth rate year, depreciation rates will be adjusted as necessary to achieve that offset. Depreciation rates may be increased should the rate base reduction allow for the recognition of additional expense.

The parties could not agree on the level of deficiency in the accumulated reserve for depreciation or on how much of the net real estate proceeds should be applied to offset such a deficiency. The Settlement resolves the conflict by establishing the time as to when a reserve deficiency study will take place and gives the Commission the discretion to decide how much of the net real estate proceeds allocable to steam should be used to offset the reserve deficiency. The provisions also deal with these issues in a manner that both mitigates rate-increasess now and promotes rate stability in the future.

Reconciliations

The Settlement provides for limited reconciliations in those areas where costs are beyond the company's control.

a. Property Taxes

The Settlement provides that if the level of actual expenditures from property taxes varies from $27,814 million in the first rate year, $29.205 million in the second rate year, $30.665 million in the third rate year or $32.198 million in the fourth rate year, then 86% of the variance will be deferred and recovered or credited to customers after September 30, 2004. Staff believes that the sharing provision provides an incentive to Con Edison to minimize its property taxes and adequately balances the risks and rewards between Con Edison and its customers.

b. Interference Costs

Steam mains share the space under the streets with many other facilities including water lines owned by the City of New York. When the City performs work Con Edison must bear all the costs incurred to move, replace, support and protect its facilities affected. The costs that the company incurs when the City interferes with the company's steam facilities are referred to as interference costs. The Settlement provides that non-labor interference expenses for each of the four rate years will be subject to reconciliation. For the first rate year, non-labor interference expense will be reconciled to $2.438 million. For the second, third and fourth rate years, the non-labor interference expense will be reconciled to $1.937 million. Variations will be deferred and recovered from or credited to customers after September 30, 2004. Given the difficulty in forecasting these costs, due to several City projects having been delayed for years and the loss of a joint bidding program with the City, Staff believes that the reconciliation provided for these costs in the Settlement is reasonable.

Steam Variance

"Steam variance" is the amount of steam lost through leakage in the system, i.e. the difference between steam production and steam sales. The last Settlement reflected a steam variance of 10.9% in base rates but allowed for reconciliation of actual steam losses through the fuel adjustment clause up to a maximum of 13.5%.[11] Our direct testimony reflected a $4.9 million adjustment to reflect what we viewed as the company's proposal to reduce the steam variance from 13.5% to 10.9%. (Settlement Agreement, p. 8)

Sewer Charges

The Settlement provides that cost increases for New York City sewer charges will be recovered through the fuel adjustment clause if and when incurred. Tariff-based charges for electricity used at the steam generating stations, if and when incurred and to the extent not already in steam base rates, will be recovered through the fuel adjustment or deferred for recovery at a later time, as determined by the Commission. (Settlement Agreement, p. 11)

Fuel Volatility

In the interest of reducing steam fuel cost volatility the Settlement provides that the company will, subject to consultation with Staff, develop a strategy for hedging price variations for a portion of steam produced each year. (Settlement Agreement, p. 12)

Studies

The Settlement provides that Con Edison will perform and submit to the parties an analysis of the cost of replacing the currently existing 74th Street High-Pressure boilers with new package boilers. The analysis will compare the total cost of replacement boilers with the incremental costs of the continued operation of the 74th Street High Pressure boilers. The parties have the right to submit the company's analysis, with their comments to the Commission. (Settlement Agreement, p. 17)

Con Edison will also submit a work plan and study for the analysis of possible future uses of the 74th Street, 59th Street and Hudson Avenue steam plant sites. The objective is to identify potential future uses of the plants and sites that maximize economic efficiency while minimizing steam costs. The study will consider various possibilities for steam production technologies as well as relocation of steam capacity to facilitate divestiture of underutilized

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11 Case 91-S-1621, supra, Opinion No. 97-15, pp. 13, 19.

properties. Con Edison will submit its findings to the Commission and the parties. The parties have the right to file comments on the submission.

The 74th Street plant as a steam only plant is very expensive. Several of the parties questioned the decision to continue to operate the 74th Street plant as a steam only facility. Similar economic concerns were also raised over the 59th Street Annex and Hudson Avenue Plants. The studies required in the Settlement provides the means to thoroughly evaluate the concerns raised.

Weather Normalization Clause

Con Edison proposed that the Commission adopt a weather normalization clause for its steam service. Several parties, including Staff, opposed the imposition of a weather normalization clause, asserting that it added undue complexity to rates.

By the Settlement Agreement, the company accedes to Staff's position on the weather normalization clause and agrees not to implement it.

Special Steam Contracts

The Settlement provides for negotiated steam contracts to be offered to retain and attract customers with viable competitive alternatives to Con Edison's steam services. Revenue shortfalls from the tariff rates, net of base fuel, associated with any rate discounts will be shared 80% by customers and 20% by the company, with the customers' portion deferred until the end of the four year plan (Settlement Agreement, p. 16.) This sharing mechanism will also apply to the discounted steam air conditioning rate approved by the Commission separately. The agreement requires that all the rates would at least cover the company's marginal costs and that any shortfall below those costs would be borne by the company.

Rate Design

The settlement provides that rate design and revenue allocation will generally follow the method proposed by Con Edison, however, the company is permitted to submit a revenue-neutral rate design and/or a Weather Normalizaton Clause subject to Commission approval. The company also agrees to provide for a backup/supplementary service rate that would be applicable to customers that use an energy source other than steam purchased from the company's steam system. The settlement also provides that Con Edison will, for the first time, establish a steam transportation rate to increase the economic utilization of its steam system without impairing system reliability. (Settlement Agreement, p. 12)

Commission Authority

The Settlement Agreement also contains the by now standard clause that recognizes that the Commission reserves the authority to act in the event that unforeseen circumstances render the company's return unreasonable or insufficient for the provision of safe and adequate service at just and reasonable rates. (Settlement Agreement, p. 21.)

Northeast Utilities Merger

Con Edison is in the process of obtaining the necessary approvals for a merger and stock acquisition with Northeast Utilities. The merger would result in estimated savings for the new corporate entity of approximately $1 billion dollars, net of implementation costs over a ten-year period. The allocation of the savings to the steam system would be approximately $2 million per year. We anticipate that all approvals will be obtained prior to a decision in the steam rate case. Although the settlement agreement does not provide for any rate treatment of these savings for the steam system, we recommend that the savings be used to offset the proposed increase in the first rate year. Should approvals not be obtained prior to a decision in the steam rate case, we recommend that a determination be made on the ratemaking treatment for the merger savings at the same time as the Commission decides on the ratemaking disposition of the proceeds from the divestiture of Waterside.

Comparison to a Litigated Outcome

The Settlement compares favorably with a likely litigated outcome. As shown on the table in the appendix, our direct case contemplated a revenue requirement of $6.9 million and the increased amount of $12.8 million contemplated by the Settlement Agreement is comprised principally of the correction of our misunderstanding of the steam variance (discussed above p. 9) and an increased return on equity to reflect the recent increase in interest rates. These two adjustments alone would increase Staff's direct case to the settlement amount, so we could not have produced a better result, even if all of our other adjustments were adopted. Additionally, the settlement provides numerous benefits -- such as not implementing a weather normalization clause -- that we might loose in litigation.

Conclusion

For the foregoing reasons, the Staff of the Department of Public Service requests that the Commission consider the Settlement Agreement in determining Con Edison's rates for steam service.

Respectfully submitted,

Peter Catalano
Staff Counsel

Dated: Albany, N.Y.
August 2, 2000

APPENDIX

Consolidated Edison Company of New York, Inc.
Reconciliation of Staff's Litigated Revenue Requirement vs
Settlement for the Rate Year 12 months ending September 30, 2001
($ in Millions)

Staff's Litigated Revenue Requirement		$6.9
Facts Contributing to the Charge:		
A.	Revenues	
	Reflect Company's Original Sales forecast	.8
B.	Operating Expenses and Taxes	
	1. Correct misunderstanding of company's treatment of base rate allowance for fuel associated with steam variance.	5.3
	2. Reflect 59th Street Gas Conversion savings.	(.2)
	3. Pension/OPEBs update.	(3.6)
	4. Update Amortization of deferred property taxes.	.3
C.	Rate Base (Not Included Above)	
	Reflect removal of gas conversion costs no longer to be incurred.	(.1)
D.	Cost of Money	
	Updated Return on Equity (using Generic Finance Method with a risk premium)	4.4
E.	Rate Moderation Clause	2.4
Base Rate Charge Per Settlement		16.6
F.	Fuel Savings - Other	(3.8)
Mitigated Bill Impact Per Settlement		$12.8