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STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

THREE EMPIRE STATE PLAZA, ALBANY, NY 12223-1350

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June 30, 2006

VIA HAND DELIVERY

Hon. Rafael Epstein
Administrative Law Judge
New York State Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

Re: Case 05-S-1376 - Consolidated Edison Company of New York, Inc. -
Steam Rates.

Dear Judge Epstein:

Enclosed please find the Department of Public Service Staff's Statement in Response to the Statements in Opposition to the Joint Proposal. Copies of this Statement are being served on the active parties by electronic and first class mail.

Sincerely,

Dakin D. Lecakes
Assistant Counsel

Enclosure

cc: Active Parties in Case 05-S-1376

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CASE 05-S-1376 – 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
NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE STAFF
IN RESPONSE TO THE STATEMENTS IN OPPOSITION
TO THE JOINT PROPOSAL**

KEVIN M. LANG
Managing Attorney

DAKIN D. LECAKES
Assistant Counsel
Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350
(518) 474-4536

Dated: June 30, 2006
Albany, New York

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 05-S-1376 – 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.

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SERVICE STAFF IN RESPONSE TO THE STATEMENTS IN OPPOSITION
TO THE JOINT PROPOSAL**

INTRODUCTION

On June 19, 2006, Department of Public Service Staff (Staff), Consolidated Edison Company of New York, Inc. (Con Edison), and other parties to the above-captioned proceeding filed statements supporting the Joint Proposal filed on June 2, 2006. TransGas Energy Systems LLC (TransGas) filed a statement opposing one section of the Joint Proposal. The County of Westchester (Westchester) filed testimony opposing a number of aspects of the Joint Proposal. TransGas' contentions are erroneous and without merit, and Westchester's claims are nothing more than a restatement of the same arguments it has made, and which have been rejected by the Public Service Commission (Commission), in prior steam proceedings. Neither party's comments warrant revision or rejection of the Joint Proposal.

TRANSGAS' OBJECTIONS

Con Edison's current steam rate plan requires the company to conduct "an investment-grade study of long-term steam production options" in coordination with Staff and New York City (NYC; collectively, the Core Team) and with input from members of the Steam Business Development Task Force (Task Force).¹ The rate plan sets forth general parameters for the study but provides that its specific scope will be developed by the Core Team, with input from the Task Force. Put simply, the purpose of the study is to evaluate company and third party steam production options for the steam system.

¹ Cases 03-G-1671 & 03-S-1672, Consolidated Edison Company of New York, Inc. – Gas and Steam Rates, Order Adopting the Terms of a Joint Proposal (issued September 27, 2004), Rate Plan Section H.8 (2004 Steam Rate Order).

The Core Team developed a detailed scope of work for this project and selected an independent engineering firm to perform the analysis. Due to the complexity of the assignment, the project was split into two phases. In phase one, the engineering firm would perform a detailed screening analysis of numerous repowering and replacement options for Con Edison's existing steam production facilities and evaluate proposals submitted by interested third parties that comply with Con Edison's operating and technical requirements. Based on the phase one analysis, a small subset of options would be selected for phase two, in which each would be subjected to an investment-grade analysis. Completion of the phase one analysis has taken longer than expected, due to reasons not relevant to this proceeding, and the phase one report should be filed no later than August 2006.

During the course of this proceeding, some parties sought to restate and revise the requirements for the steam production study, and in particular, the scope and nature of the phase two analysis. The modifications are set forth in Section I.1 and I.2 of the Joint Proposal and discussed in Staff's, Con Edison's, and NYC's statements in support. TransGas opposes these modifications, in large part because it believes it will be individually disadvantaged in its efforts to secure a steam contract with Con Edison. In other words, its opposition is not that the provisions are not in the public interest or just and reasonable; its opposition is that its private, commercial interests could be adversely effected. Its understanding of the proposed modifications is flawed, and its contentions do not justify modifying or rejecting the Joint Proposal.

TransGas contends that Section I must be rejected because it is inconsistent with the provisions of the current rate plan. TransGas ignores, however, that the Commission may revisit and revise its prior Orders as it deems appropriate, provided it sets forth a rational basis for its decision. Because the phase one analysis is evaluating numerous repowering and replacement options, an in-depth analysis of the costs, impacts, and benefits of the most preferable of those options is needed before Con Edison will be in a position to make a final decision on its future steam production needs and before Staff and the Commission could evaluate the company's decision. Accordingly, Section I.1.d of the Joint Proposal sets forth eight areas to be included in the investment-grade evaluation.² Even a cursory examination of these areas reveals that they do

² Staff notes that the eight enumerated areas are the same as those set forth in phase two of the scope of work for the steam production study developed by the Task Force.

not and cannot apply to third-party alternatives. For example, one area is "major equipment requirements." Under a third-party alternative, Con Edison would enter into a contract with another entity for the provision of steam. For purposes of comparing a company option to a third-party option, the inquiry as to the latter would be focused in large part, if not entirely, on price and other contract terms. The equipment used by the third-party to produce the steam is not relevant for purposes of the evaluation of its proposal. The same argument holds true for all of the other seven areas of analysis. For this reason, there is no need to conduct a second study of the third-party alternatives as part of the investment-grade evaluation beyond the analysis that will be included in the phase one report.

As to TransGas' concern with Con Edison overseeing the investment-grade evaluation, based on Staff's involvement with the Core Team and the development of the phase one analysis, Staff concluded that the process was prone to delays and inefficiencies, which led to higher costs, extra work, and extensions of the due date of the report. To avoid repeating these problems, and because the ultimate decision on addressing Con Edison's steam production needs rests with Con Edison, Staff determined that the company should be responsible for completing the investment-grade evaluation.³ The other signatories apparently agreed with this position, as evidenced by their execution of the Joint Proposal.

TransGas complains about the manner in which its proposed project is being addressed in the phase one analysis. Such complaints are not relevant to this proceeding and certainly do not provide any basis for revising or rejecting the Joint Proposal. Moreover, since the phase one analysis is not yet complete and it is not yet known exactly how the engineering firm will analyze TransGas' alternative, it is premature to even consider TransGas' complaints. Similarly, TransGas' complaints about its treatment in the last steam rate case and in its pending Article X proceeding are irrelevant to whether the Joint Proposal should be approved or adopted. They do, however, demonstrate that TransGas' opposition is not related to the public interest or just and reasonable rates, but rather to its private interests as a power plant developer.

³ Although its statement is not entirely clear on this issue, it appears that TransGas may believe, incorrectly, that the ultimate decision will be a joint one among the company, the parties, and the Commission. The decision is Con Edison's; the role of the Commission is to evaluate the prudence of that decision, and the parties' involvement is limited to providing information to Con Edison and the Commission to assist them in making their respective evaluations and decisions.

TransGas' allegation that Con Edison is violating provisions of the Steam Plan Order⁴ with respect to its business dealings with TransGas is not germane to consideration of Con Edison's steam rates and not properly included in this proceeding. If TransGas truly believes Con Edison has violated a Commission Order, it may file a complaint with and seek appropriate redress from the Commission.

TransGas also wrongly interprets the Joint Proposal as leading to a repowering of Con Edison's Hudson Avenue Station. Such an interpretation is unsupported by the language of the Joint Proposal. While the repowering of Hudson Avenue is an option, it is not the only option. More importantly, no final decision has been made and no option has been excluded. Proof of this contention is demonstrated by the language in Section I.2, to wit: "The Resource Plan will examine and discuss various resource options (e.g., maintain and/or rebuild existing boilers, construct a new boiler(s), construct cogeneration, or seek competitively procured capacity). The Plan will identify the option(s) selected by Con Edison and fully support and justify that selection. [emphasis added]" Contrary to TransGas' assertions and assumptions, the purpose of Section I is to ensure that Con Edison has as much information as possible before it makes any decision, its purpose is not to pre-select a specific course of action.

Finally, TransGas proposes that the Commission revise the Joint Proposal in a way that grants TransGas an undue preference, in violation of Public Service Law §79(3). While the proposed provision may arguably be read more broadly, it clearly seeks to have the Commission order Con Edison to negotiate the terms of a steam contract specifically with TransGas, compare those contract terms with its other options, and, if it does not decide to enter into a contract with TransGas, justify as part of the Steam Resource Plan why it will not do so. TransGas is not entitled to such preferential treatment, and it is not appropriate for the Commission to require Con Edison to negotiate with specific named entities. To the contrary, doing so could subject the Commission to a claim that it is showing bias towards one competitor and creating an unfair advantage for that entity. More importantly, Con Edison's eventual burden in this matter is not to justify why it did not select certain options; it is to demonstrate that it made a reasonable and prudent decision regarding the option it selected.

⁴ Cases 96-S-1065 and 96-S-1121, Consolidated Edison Company of New York, Inc. – Steam Rates, Order Concerning Phase II Steam Plan Report (issued December 2, 1999).

Staff respectfully submits that the foregoing explanation, in combination with the Joint Proposal and the statements and reply statements submitted by other signatories, provides the Commission with a rational basis for revising the approach for the steam production study and approving or adopting the recommendations in the Joint Proposal. For the same reasons, TransGas' arguments do not support revising or rejecting the Joint Proposal, and its proposed modification should be denied.

COUNTY OF WESTCHESTER'S OBJECTIONS

East River Repowering Project Allocation

Westchester objects to the allocation to electric customers of costs related to the East River Repowering Project (ERRP). It maintains that the allocation used by Con Edison with regard to ERRP is not the same incremental methodology that Con Edison has applied historically to its other steam-electric generating stations. In support of its claims, Westchester provides an analysis purportedly demonstrating that, for the 12-month period ending in April 2006, electric customers have paid more than the corresponding market value of the electrical output generated from ERRP. This analysis, it contends, demonstrates that the ERRP allocation harms electric customers and is not in conformity with Commission policy.

There are several flaws in Westchester's analysis, and overall, its arguments do not require revising or rejecting the Joint Proposal. Westchester's opposition relies on the untenable premise that Commission policy regarding subsidization of Con Edison's steam system should focus solely on a near-term cost-benefit analysis. Rather, the Commission's policy regarding the elimination of subsidies to the steam system has been, and continues to be, tempered by the long-term benefits that offset any shortfall in electric revenues relative to costs, as well as the potential impacts to and burdens on steam and electric customers, respectively. Additionally, Westchester's analysis is premised on a limited amount of data (albeit the only available data for ERRP). The data examines only a single year and reflects a period during which the country experienced unprecedented damage to the natural gas infrastructure due to a severe hurricane season, resulting in an unanticipated spike in natural gas prices.

The near-term cost-benefit analysis used by Westchester represents just one aspect of what the Commission considered when it approved the allocation method for ERRP that is currently in effect. In fact, the Commission considered and rejected this same analysis in the

2004 Steam Rate Order. The Commission acknowledged that prevailing market prices for electricity were not high enough to cover the ERRP-related costs allocated to the electric department.⁵ However, the Commission did not find this fact to be determinative or sufficiently compelling to alter the allocation of ERRP's costs between steam and electric customers. Instead, the Commission looked to the totality of the circumstances and decided that several long-term benefits of ERRP outweighed the near-term cost-benefit analysis advanced by Westchester in that proceeding. Westchester's opposition to the Joint Proposal should be rejected here, as it was in 2004, because Westchester failed to demonstrate that the long-term benefits cited by the Commission are no longer valid. Indeed, Westchester completely ignores all long-term benefits in its analysis.

In the 2004 Steam Rate Order, the Commission provided a second rationale supporting the allocation methodology currently in use, and continued in the Joint Proposal, which Westchester also ignored in its analysis. The Commission explained why the continued operation of Con Edison's steam system is important and that the steam system's most significant benefit to Con Edison's electric customers is the avoidance of approximately 375 MW of electric load that would otherwise be added to the electric system. The addition of such a large load undoubtedly would result in increased energy prices, as well as increased transmission costs and distribution costs. The Commission specifically noted that "the continued operation of the steam system means that Consolidated Edison will not construct (or incur the costs for) electric transmission and distribution system reinforcements that would be needed to serve the energy loads of the customers who would switch."⁶ The Commission found that the electric system receives a significant benefit because ERRP "will serve load pockets on Manhattan's East Side and elsewhere in the borough."⁷ It also found that all customers benefit because ERRP offers an environmentally cleaner source of electricity than the Waterside plant that it replaced.⁸ Moreover, the Commission continued, ERRP is one of the more efficient generating plants in

⁵ 2004 Steam Rate Order, p. 27.

⁶ 2004 Steam Rate Order, p. 28.

⁷ 2004 Steam Rate Order, p. 27.

⁸ 2004 Steam Rate Order, p. 22.

New York City, which contributes to a lowering of the market price of energy during the summer for all of Con Edison's electric customers.⁹

Westchester is correct that the percentage of fuel costs recovered from electric customers for ERRP is greater than for its other steam-electric plants. However, it is incorrect that this variance is the result of the application of a different methodology. Westchester's claims lack merit because of the substantial differences in the type of generating equipment at ERRP compared to the other plants. Con Edison's former electric generating stations, and its other steam-electric generating stations, which form the basis of Westchester's comparison, produced electricity and steam using old technology. For the most part, those plants contain large boilers in which fuel is burned to heat water to first create steam; the steam is then passed through turbines to then create electricity and/or transmitted into the steam system. In contrast, ERRP uses modern technology—gas turbines and heat recovery steam generators. At ERRP, the burning of natural gas in the turbines creates electricity first, and then the exhaust heat is used by the steam generators to produce steam. Thus, from an electric generation perspective, the gas turbines at ERRP would use the same amount of natural gas regardless of whether steam is produced. The methodology by which fuel is allocated at ERRP corresponds to the manner in which electricity is produced, and therefore, similar to the methodology used to allocate fuel between electric and steam operations at the other plants.

In addition to the benefits cited by the Commission in the 2004 Steam Rate Order, Westchester's opposition should not result in the revision or rejection of the Joint Proposal because its data is based on a year of unprecedented high fuel prices directly influenced by anomalous weather patterns that crippled much of the natural gas infrastructure in the Gulf of Mexico. Westchester's near-term cost-benefit analysis is based largely on the cost of natural gas and the market clearing prices for energy and capacity. The data for these inputs can be volatile and the 12-month period used by Westchester is a prime example. The damage caused by the hurricanes last Fall led to significant spikes in the cost of natural gas. In response to the resulting extraordinary natural gas prices, many electric generators switched to oil to produce electricity. These circumstances created an unusual situation where electric prices were not correlated closely with natural gas prices. Because of its permitting requirements, ERRP was not able to make a similar switch in fuel source.

⁹ 2004 Steam Rate Order, p.22.

The effect of this anomaly on Westchester's analysis can be seen in its presentation. Westchester's analysis finds that fuel costs for ERRP exceeded energy revenues by over \$37 million. Over \$32 million of that difference, however, is directly attributed to the period of November 2005 through January 2006, a time when natural gas prices and electric prices were abnormally divergent and natural gas production in the Gulf Coast region had not recovered from Hurricanes Katrina and Rita. Therefore, the 12-month period analyzed by Westchester is not necessarily a reasonable indication of future costs at ERRP, and does not justify a substantial reworking of the cost allocation method approved in the 2004 Steam Rate Order.

Proceeds From the Sale of Waterside

Westchester also objects to Section B.1 of the Joint Proposal, which recommends the revenue requirement for the steam system. Westchester bases its opposition on the allocation between the electric and steam departments of the net gain from the sale of Con Edison's former Waterside plant. This objection is misplaced and improper since the issue of the allocation of the proceeds from the sale of the First Avenue Properties is being addressed in Case 01-E-0377 and is not a part of this proceeding.¹⁰ The Joint Proposal solely acknowledges that the Commission has not yet decided the proper allocation of the net gains, and uses the company's proposed allocations as a placeholder until the Commission decides the issue in Case 01-E-0377. Westchester has the ability to argue for its preferred allocation in that proceeding and should not be permitted to collaterally do so in this proceeding.¹¹ Inasmuch as Westchester raises no other objections to the proposed steam revenue requirement, its opposition does not warrant revision or rejection of the parties' recommendations.

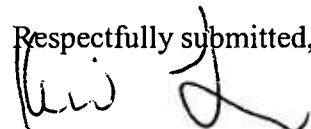
¹⁰ Case 01-E-0377, Petition of Consolidated Edison Company of New York, Inc. and FSM East River Associates, LLC for Approval of the Sale of Property, Order Approving Transfer Subject to Conditions (issued May 20, 2004), pp. 79-80.

¹¹ Staff further notes that Westchester is improperly focusing only on the Waterside parcel. The sale involved four properties and produced net proceeds of over \$100 million. Electric customers will receive over 50% of these proceeds, substantially more than indicated by Westchester's pleading.

CONCLUSION

For the reasons set forth above, the positions of the parties opposing the Joint Proposal do not warrant revision or rejection of the Joint Proposal. Staff respectfully requests that their arguments and proposed revisions be denied and that the Joint Proposal be approved or adopted as presented.

Respectfully submitted,



Kevin M. Lang
Managing Attorney



Dakin B. Lecakes
Assistant Counsel

Dated: June 30, 2006
Albany, New York