

# Public Utility Law Project of New York, Inc.

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June 6, 2013

Hon. Jeffrey Cohen, Acting Secretary  
NYS Public Service Commission  
Three Empire State Plaza  
Albany, New York 12223-1350

Re: Case 12-M-0192, *Joint Petition of Fortis Inc. et al. and CH Energy Group, Inc. et al. for Approval of the Acquisition of CH Energy Group, Inc. by Fortis Inc. and Related Transactions.*

Dear Acting Secretary Cohen:

The Public Utility Law Project of New York, Inc. (“PULP”) submits this response to the May 30, 2013 letter addressed by Petitioners Central Hudson Gas & Electric Co. (“Central Hudson”) and Fortis, Inc. (“Fortis”) to Commissioners. In their letter, Petitioners assert that subsequent to the Administrative Law Judges’ May 3, 2013 Recommended Decision (“RD”), which recommends that the Commission not approve the acquisition of Central Hudson by Fortis,<sup>1</sup> they engaged in further contemplation and are now “proposing final enhancements to the terms of the transaction beyond the terms included in the Joint Proposal.” The major item in the “final enhancements” is continuation of the Joint Proposal rate plan for one year. The “enhancements” also include concessions to labor, modification of Central Hudson’s board composition to include two directors from the service territory, continued capital investment commitment, and a vague promise of continuation of local community support for ten years.

PULP previously filed initial and reply comments opposing the Joint Proposal. While fully supporting the ultimate conclusion of the Judges in their RD that the acquisition of Central Hudson by Fortis not be approved, PULP also filed a brief on exceptions taking issue with

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<sup>1</sup> The RD is available at <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={E49CB194-BF79-4F60-9E47-C15B84362D17}>.

certain subsidiary findings of the Judges,<sup>2</sup> and filed a reply brief opposing exceptions taken by other parties. PULP will not reiterate its prior arguments made in opposition to the acquisition, and will address here only the new proposal petitioners submitted to the Commissioners by letter after conclusion of the comment and RD exceptions processes.

***Extension of the rate plan to June 30, 2015 is not a benefit to the public or ratepayers.***

The principal economic “enhancement” to provisions of the Joint Proposal is extension of the current three-year rate plan, which expires June 30, 2013, through June 30, 2015 – a so-called rate “freeze”.<sup>3</sup> A closer look reveals this “enhancement” is mainly in Fortis’ interest, and continuation of the rate plan as proposed in the letter not in the public interest or the interest of customers.

The current three-year rate plan, begun July 1, 2010, presumptively was designed to set reasonable rates which allow a fair opportunity for the utility to earn a 10% return on investors’ equity (“ROE”). Further, if earnings exceed 10% ROE, there is a “dead band” in which the utility keeps all earnings, and earnings would only begin to be shared with customers at 10.5%. The Joint Proposal would extend the rate plan through June 30, 2014 and modify the sharing mechanism by eliminating the “dead band” so sharing could begin when earnings are higher than

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<sup>2</sup> PULP’s Brief on Exceptions erroneously referenced an online policy statement of “Fortis Investments” antagonistic to “Golden Share” provisions like the one Central Hudson would implement if the Joint Proposal were approved. Petitioners’ Brief Opposing Exceptions declares, however, that there is no connection at all between the Petitioner Fortis, Inc. or any of its subsidiaries, (which include a “Fortis Investments, LLP”), and the similarly named but unrelated company quoted by PULP. PULP regrets the error, but adheres to its position that the untested “Golden Share” scheme may be voidable or may not work adequately to “ring fence” the utility from adverse holding company financial actions or events such as voluntary or involuntary bankruptcy proceedings.

<sup>3</sup> Under the Joint Proposal, the rate plan would be extended through June 30, 2014. Since the company did not timely file to change rates and it would take about a year to do that, approval of the one-year extension in the Joint Proposal does little more than deter the Commission from instituting a new case to review and lower Central Hudson’s rates.

10.0%.<sup>4</sup> The latest “final enhancements” proposed in Petitioners’ letter to Commissioners would extend the current plan, as it would be modified by the Joint Proposal, for another year.

Under this latest iteration and new rate plan proposal, however, Central Hudson’s earnings may significantly exceed the level recently found to be reasonable by the Commission. Since 2010, when Central Hudson’s rates were last fixed, the Commission has progressively reduced the allowed ROE in major electric and gas rate cases. Most recently, on March 15, 2013, the Commission approved a rate case settlement in which National Grid d/b/a/ Niagara Mohawk, also an upstate combination gas and electric company, agreed to an ROE of 9.3% with no “dead band” before 50/50 sharing of incremental earnings with customers.<sup>5</sup>

PULP’s analysis, based on Central Hudson’s filings with the Securities and Exchange Commission (SEC), finds that Central Hudson’s earnings have generally been well above 9.3% over the course of the current Central Hudson rate plan. These SEC filings, which can be used to calculate ROEs on a trailing four quarter basis that generally agree with DPS regulatory calculations to within +/- 30 basis points, show that during the implementation period of the Company's current rate plan to date (the eleven quarters from July 1, 2010 through March 31, 2013), Central Hudson’s four quarter trailing ROE has exceeded 10% six times. Four of these times the Company achieved an ROE at-or-above the 10.5% threshold for sharing. Even during the quarter ended March 31, 2013, which was adversely (and disproportionately) impacted by

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<sup>4</sup> “Central Hudson’s current rate plan specifies that when the utility’s earned return on equity exceeds 10.5%, ratepayers receive 50% of the excess up to an earned return of 11.0%; 80% of the excess between 11.0% and 11.5%; and 90% of the excess over 11.5%. Under the terms of the Joint Proposal, the 50% and 90% sharing thresholds would be lowered, and the 80% sharing level would be eliminated. Ratepayers would be credited with 50% of earnings between 10.0% and 10.5%, and 90% in excess of 10.5%.” RD at 25.

<sup>5</sup> The Commission stated, “[t]he agreed-upon cost of capital, including an ROE of 9.3 percent, provides the Company with an achievable revenue requirement to attract capital to maintain and grow its business interests while maintaining customer rates at reasonable levels.” Order Approving Joint Proposal, Case 12-E-0201, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation d/b/a National Grid for Electric Service*.

increased costs of tree-trimming, weather related service restoration costs, and costs related to a cyber incident in February, 2013, the trailing four quarter return on average equity only dropped to 9.2% (just below the NIMO allowed rate of return, and still comfortably above DPS staff's recently proposed 8.7% ROE in the pending Con Edison rate case).<sup>6</sup> Absent just the reversal of storm related deferrals, ROE for the quarter ended March 31, 2013 would have been 9.7%. A summary of PULP's analysis of Central Hudson's SEC filings is attached to this letter.

The Joint Proposal modifies the Company's earnings sharing mechanism to eliminate the deadband above the allowed 10% rate of return. This leaves in place an allowed rate of return that is far out of step with recent Commission determinations of a reasonable ROE. A ten per cent ROE is much too high in light of the economic realities and hardships faced today by Central Hudson's ratepayers, more than 12,000 of whom face service interruption annually for bill collection purposes. The balance in the proposal is skewed against consumers, versus the utility's opportunities for excessive profits above a reasonable level. The latest proposed extension of the plan for yet another year beyond what was originally contained in the Joint Proposal is an "enhancement" only for Fortis. All it appears to "enhance" is the prospects of Fortis earning more than what the Commission would find to be a reasonable return if it were to determine the issue after hearings.

It is true that the Joint Proposal would modify the earnings sharing mechanism, and the further extension of the rate plan to 2015 would again change the company's rate plan in a way that would not otherwise occur, but *this is not a benefit*. Rather, lowering the sharing

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<sup>6</sup> See Testimony of DPS Staff Witness Craig E. Henry filed May 31, 2013 recommending 8.7% ROE based on Commission-approved methodology, in Cases 13-E-0030, et al., Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison, etc., *available at* <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={F4E40DC7-6E5B-4733-986F-EAC976DCA985}>.

threshold from 10.5% to 10% is the lessening of a detriment. To be a benefit, the Company's future rates and ROE would need to be determined and evaluated in light of current economic circumstances and in a proper manner with evidentiary support. This is manifestly not the proposal of the petitioners; rather they seek to maintain and extend the status quo, albeit with minor modifications, and keep ratepayers under the same rate regime that existed four years ago – a regime that the PSC is now consistently discarding in recent decisions. The changing circumstances render irrelevant the Petitioners' assertion, echoed by Multiple Intervenors, that a "freeze" of the Joint Proposal rates for yet another year would be a good deal because Central Hudson's rates have gone up an average of \$23 million a year over the last seven years. It is clear that trends are changing. Due to lower interest costs, cost cutting, high earnings, or other factors, leading major investor owned utilities have clung to their current rates at the end of rate plans rather than seek new rates at the first opportunity, which could trigger full rate review and evidentiary hearings as to reasonableness of current rates and ROEs.<sup>7</sup>

The test is not whether the latest "final enhancements" to the rate plan would improve upon the defective Joint Proposal, but whether they are better than what might otherwise occur if there were no acquisition and merger case. "Petitioners must show that the benefit is a consequence of the transaction and would not otherwise occur." RD at 58. If there were no merger case, and with the track record of high earnings, it is possible that even though Central Hudson did not timely file to change rates at the end of the rate plan this month, the Commission could move to set temporary rates, reduce the ROE and sharing levels to 9.3% or less, and make other real improvements that would be totally independent of the acquisition.

It is well established Commission precedent that temporary rates and a rate reduction are

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<sup>7</sup> In the past year, Con Edison, National Fuel, Central Hudson, and Iberdrola have not filed for new rates to take effect immediately after expiration of their rate plans.

appropriate actions when a utility's "recent earnings level indicates that its electric rates may be unjust, unreasonable, and higher than needed to provide safe and adequate service, particularly in light of the recent allowed ROE and sharing provisions established for other utilities."<sup>8</sup>

Immediate Commission action to rectify excessive rates is justified when, as in this case, a rate plan that could generate unreasonable profits for a utility is about to expire and "there are no provisions to address potential excess earnings conditions beyond that date."<sup>9</sup> Recently, the Commission issued an order to show cause why temporary rates should not be set for National Fuel Gas Distribution Company, pending a full review whether they should be lowered, with refunds retroactive to the temporary rates are set.<sup>10</sup>

National Fuel, like Central Hudson in its latest gambit with the Commission, had sought to negotiate a continuation its current rates without hearings and a full rate review, and wanted to earn slightly less than a 10 percent ROE. This was soundly rejected by the Commission, which issued a show cause order why temporary rates should not promptly be set pending full review, with potential refunds to customers of excessive earnings from the date temporary rates are set.

Conceivably, in addition to revising the Central Hudson ROE through temporary and

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<sup>8</sup> "Orange and Rockland's recent earnings level indicates that its electric rates may be unjust, unreasonable, and higher than needed to provide safe and adequate service, particularly in light of the recent allowed ROE and sharing provisions established for other utilities." Case 06-E-1433, Orange and Rockland Utilities – Temporary Rates, Order Making Temporary Rates Subject To Refund, at 3-4 (issued March 1, 2007).

<sup>9</sup> Case 00-G-1495, National Fuel- Rates, Order To Show Cause, at 1 (issued August 31, 2000) ("The rate plan expires on September 30, 2000 and there are no provisions to address potential excess earnings conditions beyond that date").

<sup>10</sup> *Order Instituting Proceeding and to Show Cause*, Case 13-G-0136, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of the National Fuel Gas Distribution Corporation for Gas Service (Issued and Effective April 19, 2013).

new rates, the Commission could also take steps to truly enhance the rate plan.<sup>11</sup> Such real enhancements for the benefit of the public and ratepayers could be considered and adopted wholly independent of the proposed Fortis takeover and the most recent “enhancements” postulated by Central Hudson and Fortis.

As discussed, the ROE level is out of step with recent Commission determinations and there is no reason to be giving Central Hudson a sweeter deal on ROE than the other utilities. In addition, the Petitioners are inviting the Commission to make the error of setting future rates without adequate evidentiary support. There were no evidentiary hearings on the Joint Proposal, and so there is no testimony in the record to support the continuation of a 10% ROE for any period, much less for an extension through June 2015. As a result, the proposed rate plan is arbitrary. In an analogous situation, the North Carolina Supreme Court on April 12, 2013 issued an opinion nullifying a Duke Power rate settlement approved by that state's Public Service Commission (PSC). Duke Power in its initial rate case filing had asked for an 11.5% ROE. A witness for the PSC's Public Staff had testified that the ROE should be 9.25%. A non-unanimous settlement agreement was eventually reached, including the utility and the PSC's Public Staff, for an agreed-upon ROE of 10.5%. The estimated difference between the recommended ROE of 9.25% and the agreed-upon ROE of 10.5% in the settlement was

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<sup>11</sup> For example, the Commission could enhance the plan further with provisions to

- decrease service interruptions for bill collection purposes from over 12,000 in 2012 to less than the 5,000 level of 2005 and redirect the resources now being used to shut service off to other purposes that will help keep service on, such as maintenance
- enroll all eligible customer in the low income rate program,
- reform the skewed storm damage provisions of the current rate plan, which do not measure effectiveness of tree trimming, pole and line replacement programs, which do not measure outages more than 24 hours in duration, which assure the company the same revenue whether meters are spinning or not, which allow the company to skimp on outage prevention, and which shift all risk of storm damage to customers through cost recovery deferrals.

approximately \$100,000,000. In its opinion, the North Carolina Supreme Court reversed the PSC order approving the rates, and remanded the case to the PSC for further proceedings. *State of North Carolina ex Rel. Utilities Commission; Duke Energy Carolinas, etc. v. Attorney General Roy Cooper, etc.*, (Sup. Ct. N. Carolina No. 268A12 April 12, 2013).<sup>12</sup> The Court faulted the PSC approval of the settlement because it lacked any independent determination of ROE:

Without sufficient findings of fact as to these issues, we cannot say that the Commission ‘ma[de] its own independent conclusion . . . that the propos[ed] [ROE] [wa]s just and reasonable to all parties in light of all the evidence presented.\* \* \* \* Instead, it appears that the Commission adopted wholesale, without analysis or deduction, the 10.5% stipulated ROE, as opposed to considering it as one piece of evidence to be weighed in making an otherwise independent determination.\* \* \* \* Accordingly, the Commission’s order must be reversed and this case remanded to the Commission so that it can make an independent determination regarding the proper ROE based upon appropriate findings of fact that balance all the available evidence.

*Id.* In addition, the Court chastened the North Carolina Commission in its focus on investor interests in setting the ROE. Citing the North Carolina statutes, the Court made clear that there must be consideration not only of investor interests, but also the impact of changing economic conditions on customers:

Given the legislature’s goal of balancing customer and investor interests, the customer-focused purpose of Chapter 62, and this Court’s recognition that the Commission must consider all evidence presented by interested parties, which necessarily includes customers, it is apparent that customer interests cannot be measured only indirectly or treated as mere afterthoughts and that Chapter 62’s ROE provisions cannot be read in isolation as only protecting public utilities and their shareholders. Instead, it is clear that the Commission must take customer interests into account when making an ROE determination. Therefore, we hold that in

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<sup>12</sup> Available at <http://appellate.nccourts.org/opinions/?c=1&pdf=MjAxMy8yNjhBMTItMS5wZGY=>

retail electric service rate cases the Commission must make findings of fact regarding the impact of changing economic conditions on customers when determining the proper ROE for a public utility.

*Id.* While New York's Public Service Law has no comparable express provision mandating the Commission to take into account the impact of a proposed rate deal on consumers, the Commission should do so.

***The Commitment To Continue Central Hudson's Capital Expenditures To Reach Central Hudson's Net Plant Targets Is Not A Benefit That Is A Consequence Of The Transaction***

Petitioners assert in their letter that one benefit of their acquisition of Central Hudson would be their commitment to achieve Central Hudson's previously developed net plant targets through over \$200 million of capital expenditures before the end of the proposed rate plan extension. This is an empty promise – Fortis has no plan to inject equity or other material resources into Central Hudson so that the Company can achieve its net plant targets. In fact, the source of funds any funds for capital expenditures would remain the same as if the transaction never occurred: Central Hudson could meet them itself through its own internal resources as a regulated utility; its earnings, existing capital base and its own credit-worthiness/rating. The capital structure of Central Hudson would not be changed by the acquisition, and no resources from its would be acquirer would likely be forthcoming if needed in the future. The reason for this is quite simple: all of the “resources” raised by Fortis for this transaction will go to buy out the interests of existing Central Hudson shareholders. \$600 million of equity financing for the Fortis holding company was raised, along with approximately \$350 million of preferred equity and debt. The acquisition increases Fortis' financial leverage, requiring the existing and now overly generous rate plan to remain in place as the vehicle for high dividend payments from

Central Hudson to the holding company parent that might in turn ameliorate Fortis' additional burden of financial leverage.

The only conceivable "benefit" to petitioners commitment to continue Central Hudson's capital expenditures to achieve its net plant targets might be its promise to be a good steward to Central Hudson's continued goal to meet net plant targets. Even this seems questionable, however, given that upon announcement of the proposed acquisition in February, 2012, S&P put Fortis' ratings on short term negative watch, citing their expectation of increased debt at the holding company level to finance the acquisition and that post-acquisition, "deconsolidated credit metrics may be below our established thresholds."<sup>13</sup> A parent put on negative credit watch upon announcing their acquisition of you is hardly a resource to count on for extra resources if needed in the event of unforeseen circumstances.

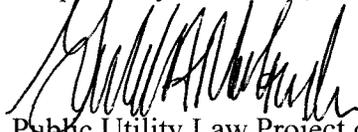
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<sup>13</sup> Reuters, *S&P puts Fortis ratings on watch negative*, Feb. 22, 2012, available at <http://www.reuters.com/article/2012/02/22/idUSWNA073320120222>.

***Conclusion***

Accordingly, for the reasons stated above, the putative “enhancements” proposed by Petitioners in their recent letter to Commissioners are not sufficient to change the conclusion of the Judges in their Recommended Decision that the acquisition of Central Hudson by Fortis should not be approved.

Respectfully submitted,



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Attachment: Central Hudson Trailing Four Quarter Return on Equity (ROE) as of Quarters  
Ending July 1 2010 thru March 31 2013

Cc: ALJs and active parties (via email).

# Public Utility Law Project of New York, Inc.

## Central Hudson Trailing Four Quarter Return on Equity (ROE) as of Quarters Ending July 1 2010 thru March 31 2013

2013	Quarter Ended:	
	03/31/13	
Earnings Available for Common Stock	13,513	
Same, Trailing Four Quarters as of Quarter End	43,226	
Beginning Equity	461,786	
Ending Equity	478,312	
Average Equity	470,049	
ROE	9.2% *	

\* 9.7% if deferral of storm costs of \$3.7M (\$2.3M net of tax) had been allowed.

2012	Quarter Ended:			
	12/31/12	09/30/12	06/30/12	03/31/12
Earnings Available for Common Stock	11,304	12,256	6,153	16,491
Same, Trailing Four Quarters as of Quarter End	46,204	48,018	47,185	48,161
Beginning Equity	445,295	442,177	441,754	445,625
Ending Equity	469,661	458,357	455,101	461,786
Average Equity	457,478	450,267	448,428	453,706
ROE	10.1%	10.7%	10.5%	10.6%

2011	Quarter Ended:			
	12/31/11	09/30/11	06/30/11	03/31/11
Earnings Available for Common Stock	13,118	11,423	7,129	12,397
Same, Trailing Four Quarters as of Quarter End	44,067	40,449	38,524	41,142
Beginning Equity	444,228	439,727	456,229	446,483
Ending Equity	445,295	442,177	441,754	445,625
Average Equity	444,762	440,952	448,992	446,054
ROE	9.9%	9.2%	8.6%	9.2%

2010	Quarter Ended:	
	12/31/10	09/30/10
Earnings Available for Common Stock	9,500	9,498
Same, Trailing Four Quarters as of Quarter End	45,148	45,499
Beginning Equity	430,080	420,229
Ending Equity	444,228	439,727
Average Equity	437,154	429,978
ROE	10.3%	10.6%