

BEFORE THE  
STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

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In the Matter of  
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

Case 03-G-1671

MARCH 2004

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Gas	North American Energy, Inc.	1-800-246-2427
Gas	North Atlantic Utilities, Inc.	1-516-759-5400 ext 24
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Electricity	Pepco Energy Services, Inc	1-800-ENERGY-9 1-800-363-7499
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CHOICE

Customer Choice  
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**Cover Story**

**Given a Choice**

**Customer choice programs are alive and well in some parts of the country. Here's how some utilities encourage consumers to make the switch.**

**By Karen Ryan**

ALTHOUGH THERE hasn't been much change in the last couple of years in the number of states that permit natural gas retail sales competition in the residential market, there has been some activity on the utility level as new "customer choice" pilot programs are launched and existing ones are expanded beyond the test phase. A customer choice program gives gas consumers the option of buying the gas commodity from a non-utility entity and using the local utility to deliver the gas to their home or business.



Print this page



**Orange and Rockland Utilities' Roberta Scerbo, director of retail access and energy services, and Terry Dittrich, the**

"The growth in residential customer choice programs has slowed for several reasons, including saturation of the prime markets, waning gas marketer interest and volatility in the gas market," says Bruce McDowell, AGA director of policy analysis. AGA's most recent survey on residential customer choice shows that roughly 30 million households have the option of buying gas from a non-utility supplier. As of mid-2002, however, only 3.9 million, or 13 percent of eligible residential gas users, were participating in a choice program.

"It's no surprise that such a large percentage of eligible residential customers have not switched from their utility to a gas marketer for supply," says Ken Costello, senior institute economist at the National Regulatory Research Institute (NRRI), the technical- and educational-support arm of the National Association of Regulatory Utility Commissioners. "First, it appears that consumers require at least a savings of between 5 to 10 percent off their gas bill before they'll seriously consider switching.

utility's recently retired director of retail access and energy services, have put their energy into giving customers a choice.

Second, customers who use small amounts of gas are less inclined to switch than those who use large amounts and, therefore, are more sensitive to price differentials across gas suppliers. Finally, there is customer inertia."

#### Competition in Action

Despite the national trend, competition is alive and well in Orange and Rockland Utilities Inc.'s (O&R) New York territory, where the utility has seen 30 percent of its residential gas customers migrate to an energy marketer in a relatively short time. "We're adding about 1,000 'choice' customers a month," says Roberta Scerbo, O&R director of retail access and energy services.

Among the factors O&R cites for its success is its "7% Switch and Save" program, developed by the utility and gas marketers serving its territory as a mechanism for introducing customers to marketers. The introductory program was launched in August 2000 after O&R determined that its aggressive education campaign on residential customer choice, while successful in teaching customers about deregulation and competition, did not yield the desired results.

"An O&R survey showed that a majority of our customers understood they had the option of buying gas from a third party, but either didn't know how or didn't want to bother because they thought it was too complicated and time-consuming," says Terry Dittrich, the utility's recently retired director of retail access and energy services. "We also discovered enormous resistance to switching because customers didn't know anything about the marketing firms and were suspicious of them. They needed assurance that switching was okay and that O&R supported it."

Under the Switch-and-Save program, the cost of gas is 7 percent lower than what the customer would have paid O&R for supply. This discount is in effect for the first two billing periods after the customer initially switches to a marketer.



"Since we do the billing for the marketers, we calculate the gas cost based on our commodity price less 7 percent and pay the marketers that amount," explains Scerbo. "Customers who enroll through us when they first switch are eligible for the introductory discount and are randomly assigned to a participating marketer."

Owning the receivables is another factor O&R deems a key to success. O&R includes its own as well as the marketers' charges—that is, both the commodity and the distribution charges—on a customer's O&R utility bill and reimburses the gas marketer for 100 percent of the commodity, according to Dittrich.

"O&R's philosophy is that we're prepared to work as a partnership with our marketers in order to maximize the number of customers getting the gas commodity from a third party. It'll take time, but it is workable if you take the steps logically and don't rush it. We still need to deal with other issues such as the provider of last resort, which is going to be the toughest nut to crack," says Dittrich.

"Don't say choice cannot work. It does, and O&R is the model," says Bill Kinneary, president of Total Gas & Electric, an energy marketing firm serving O&R's New York territory as well as markets in three other states. "I don't know of any other program where the incumbent utility still serves customers and has done such an excellent job of promoting fair competition and a level playing field."

#### Florida Joins the Unbundled

Florida joined the cluster of states that permit

NAESB Developing Retail

residential customer choice when regulators there recently approved a unique transitional plan proposed by Central Florida Gas that moves all of the utility's residential customers to a single gas marketer.

Historically, 86 percent of the utility's throughput was to the industrial sector, according to Garry Porter, Central Florida Gas director of sales and marketing. But over the last decade, Central Florida Gas's sales-service load eroded as industrial and commercial customers chose to buy gas supplies from non-utility sources. At the same time, the growth in bedroom communities and the accompanying businesses, such as grocery stores and restaurants, accelerated.

As a result of the changing customer profile, the utility saw its annual sales-service throughput drop to the point that purchasing gas from suppliers at a competitive price was becoming increasingly difficult. "We could see that our cost of service would keep going up and that the cost per therm to residential customers would increase to the point that we'd lose our residential base to competing sources of energy. We had to change our strategy and focus on increasing load in the residential and commercial sectors," says Porter.

With regulatory permission, Central Florida Gas recently assigned to a single marketer all of its residential customers as well as the few remaining commercial customers who had not already switched to a marketer when that sector's gas service was unbundled more than 18 months ago. The single marketer was selected in a competitive bidding process. "We hope in a year or two to obtain approval to open up the residential market to two marketers. Then we'll begin to see the free-market system take over," says Porter.

The reasoning behind the single marketer idea? "There are so many things a utility has to unwind after 30 or 40 years of providing bundled service that we decided we needed some time to make those changes and fine-tune everything," Porter explains. "We also wanted to demonstrate to marketers that this is a viable residential market that will continue to grow and, at the same time, to ensure significant benefits to all of our customers as we move forward."

#### **What's New in Georgia**

The situation in Georgia—the first, and so far only, state to actually permit a utility to drop the gas merchant function completely—appears to be clearing up. Legislation creating Georgia's competitive gas retail market was enacted in 1997, and by October 1999 Atlanta Gas Light Co. (AGL), the state's largest gas distribution utility, was no longer providing gas sales service, including the provider-of-last-resort function.

#### **Gas Market Model Business Practices**

MODEL BUSINESS PRACTICES for the deregulated retail gas market are being developed by the North American Energy Standards Board's (NAESB) Retail Gas Quadrant. Among other things, the practices will cover credit risks between gas marketers and gas utilities, and customer processes such as billing and payment.

The creditworthiness and the billing and payment documents are expected to be completed by year's end, according to Mike Novak, assistant general manager at National Fuel Gas Distribution Corp. and chair of the NAESB Retail Gas Quadrant's executive committee.

"Unlike a standard that spells out how something should be done, the model business practices will provide a roadmap to the various ways that something could be done," explains Novak. "We are not making judgment calls on which practices are best; each state has its own process to make these calls. Instead, to avoid reinventing the wheel, we are developing a menu-oriented catalog based on existing practices—things that work today."

Because of the commonality of the types of transactions conducted in the deregulated gas and electricity retail markets, NAESB's Retail Gas Quadrant and Retail Electric Quadrant are working together so that, where appropriate, the two industries' model business practices are in sync, says Bill Oppenheim, PECO Energy manager of asset optimization and co-chair NAESB's Retail Gas Quadrant customer processes subcommittee. He also reports that when the subcommittee completes its work on the billing and payment document, it will take up customer enrollment and switching, and then customer inquiries and information. For details on NAESB's activities, visit [www.naesb.org](http://www.naesb.org). —K.R.

The jump into a totally deregulated gas retail market wasn't exactly hurdle-free. "We didn't know what would and would not work. We just had to get out there and do it," says Stan Wise, a Georgia Public Service Commission commissioner.

One of the first major problems revolved around the requirement that gas marketers incorporate AGL's gas delivery charges into the gas sales bill. The unexpected quick migration of huge numbers of AGL customers to marketing firms had left many marketers unprepared to handle the large volume of customer accounts.

"It was tough at first," says Bart Gobeil, AGL Resources manager of marketer services. "We had customers who didn't get a bill for six or seven months." As a result, the state legislature amended the original legislation to add billing parameters for marketers.

About a year into deregulation, a mandated shift in AGL's transportation rate design would further confuse and irritate consumers. Basically, the new rate design removed a subsidy that residential gas consumers had enjoyed for years and "did it in one fell swoop," says Wise. Historically, interruptible-service customers, such as industrial plants, were subsidizing the cost of delivering gas to firm-service customers, such as homeowners. Under the new rate design, residential consumers for the first time were seeing the real cost of transporting gas to them and "didn't understand why they were charged \$25 or \$30 a month to pay for the gas delivery system during the summer months when they were only consuming a few therms of gas," he says.

And then came the winter of 2000-01. Natural gas prices nationwide suddenly jumped to record highs. "Our customers went ballistic. Everyone wanted to find a scapegoat, so many people blamed deregulation of the Georgia gas market despite the fact that it was really the nature of market forces at work," says Nick Gold, AGL Resources director of community relations. Acknowledging the consumer unrest, Georgia's governor formed a blue ribbon task force to determine if the gas merchant function should revert back to the regulated utility. The panel rejected re-regulation.

"Regardless of the flaws in the original legislation, re-regulation would have had a huge impact and been extremely expensive, with the cost likely to be borne by consumers," says Wise. "If the state had resurrected regulation at the gas retail level and put the burden on AGL, it would have bankrupted the utility. If the burden had been put on the marketers, they probably would have sued. Re-regulating would have made California's energy crisis look like a walk in the park."

After the governor's panel rejected re-regulation, the state legislature amended the original deregulation statute. Signed into law last year, the new legislation addresses numerous issues including consumer rights and whether the utility or a marketer should be the provider of last resort that supplies gas to low-income and other consumers unable to get service from any of the marketers. Georgia's legislators decided that a gas marketer selected through a competitive bidding process should take on the provider-of-last-resort role, and it established a special fund to help the marketer cover the cost of serving this group of consumers.

**Marketer Reluctance**

Besides consumer reluctance to sign on with a gas marketer, there's also the problem of attracting marketers into a territory. "Some jurisdictions have placed price caps on gas utility rates, making it hard for marketers to undersell the utility and earn a profit," says NRRI's Costello. "It's a difficult business, and there are fewer players than before



**Terry Dittrich and Roberta Scerbo review the latest numbers in Orange and Rockland Utilities' "7% Switch and Save" customer choice program.**

entering the residential markets."

The problem of attracting marketers is all too familiar to SEMCO Energy Gas Co. The utility selected Battle Creek as the site of a residential customer choice pilot program, launched in 1997 and the first such program in Michigan, according to Roberta Floyd, a communications specialist at the utility. "We didn't have a huge number of Battle Creek customers leave our system for a marketer in part because the customers were getting a good price from us, and many customers really didn't understand the program despite our efforts to explain how it works."

SEMCO Energy Gas is making customer choice available to all of its 117,000 residential customers beginning next year. "But there aren't any interested marketers; they all pulled out last year," says Floyd. "The problem is basically the cost of gas and the uncertainty in the gas market. There just isn't enough of a profit margin for marketers in our territory."

#### **From the Marketers' Perspective**

Agreeing with Total Gas & Electric's Kinneary that customer choice can work if given a chance, Saul Horowitz, CEO of ECONergy Energy Co., which serves gas markets in four states and the District of Columbia, maintains: "It's often the fault of the utilities if unbundling doesn't work, and marketers pull out of the market. The market will always seize an opportunity and make it work. If opportunities don't exist, it's often because utilities still position themselves as the very comfortable fallback position for consumers."

He goes on to note that when utilities actively encourage migration to a marketer, the customer choice program usually works. "The utility's attitude toward retail competition trickles down to its employees and to the entire market. If the utility is positive on retail competition, it will work with marketers and the public can feel it. If, however, a utility is negative on deregulation, employees and customers feel that too, and the utility can make the marketer's life miserable."

But the real "kiss of death to the competitive market is regulatory caps on utility prices and rates," says Horowitz. Kinneary concurs and adds some other prerequisites that he believes are necessary for successful gas retail competition:

- The utility has a monthly market price that it recovers in full each month, so the customer's bill reflects what it really costs the utility every month to buy gas.
- The utility's delivery service rates are unbundled so that all of the gas costs are put in the purchased gas adjustment or its equivalent and none are shifted to the delivery service charge. "For example, in many areas the utility collects the bad debt associated with delivery service and the gas commodity in its rates. The marketers also collect bad debt on the commodity side. This means that choice-program customers are paying twice for commodity bad debt. Stripping inappropriate charges out of the delivery rate lowers the cost of delivery service to choice-program customers."
- The utility purchases the marketers' receivables so that the marketers' bad-debt expenses are zero or at the very least a proportional share of the customer payment is allocated to the marketer when the customer doesn't pay the bill in full. "Many utilities keep the entire partial payment instead of passing a portion on to the marketer. This is enough to destroy the economics of choice."
- There should be no fees when a customer wants to switch from the utility to a marketer. "These fees are a death knell to competition because the marketer ends up paying them in order to get the customer to switch."

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Prepared Testimony of:

RELIABILITY PANEL  
Christopher Corbett  
Utility Engineer 3  
Policy Section  
Office of Gas & Water  
Department of Public Service  
Three Empire State Plaza  
Albany, New York 12223-1350

Michael J. Scott  
Utility Supervisor  
Gas Rates Section  
Office of Gas & Water  
Department of Public Service  
Three Empire State Plaza  
Albany, New York 12223-1350

- 1 Q. Please state your full name and address.
- 2 A. Christopher J. Corbett, Three Empire State  
3 Plaza, Albany, New York 12223-1350.
- 4 Q. Mr. Corbett, are you presenting other testimony  
5 in this proceeding?
- 6 A. Yes, and my qualifications and work experience  
7 are described in my retail access testimony  
8 submitted in this proceeding.
- 9 Q. Mr. Scott, are you also presenting other  
10 testimony in this proceeding?
- 11 A. Yes, and my qualifications and work experience  
12 are described in my testimony regarding certain  
13 capital funding projects.
- 14 Q. What is the purpose of the Staff Reliability  
15 Panel?
- 16 A. The Panel will make recommendations intended to  
17 provide continued assurance of reliability and  
18 identify certain changes that should be made to  
19 the balancing and cash-out provisions governing  
20 Consolidated Edison Company of New York, Inc.'s  
21 (Consolidated Edison) relationship with gas  
22 marketers operating in its service territory.
- 23

1     **Reliability**

2     Q.   What are the existing reliability requirements  
3           for marketers?

4     A.   Under current Commission guidelines, marketers  
5           serving gas aggregation customers must have  
6           firm, primary point pipeline capacity to  
7           Consolidated Edison's city-gate for the winter  
8           period of November through March.  As an  
9           alternative, marketers may purchase bundled  
10          commodity and capacity from a supplier, provided  
11          that it includes firm, primary point capacity  
12          for the five winter months.  The marketers may  
13          also purchase capacity from Consolidated Edison.

14    Q.   Do you have any reliability concerns?

15    A.   Yes.  The advantage of the current arrangement  
16          to marketers is that when capacity is available  
17          in the market, marketers may be able to obtain  
18          it at a lower cost than Consolidated Edison, who  
19          is obligated to enter into contracts for a  
20          twelve month period.  However, it is also  
21          possible that marketers might obtain capacity  
22          and then either default on delivering gas to the  
23          company or exit the market and return their  
24          customers to the company but retain the capacity

1 for other purposes. This could leave the  
2 company with insufficient capacity to serve its  
3 customers unless additional capacity is  
4 available in the market.

5 Q. What do you recommend?

6 A. Staff recommends that Consolidated Edison be  
7 required to file revised tariff leaves that  
8 would require marketers who acquire their own  
9 pipeline capacity or bundled commodity and  
10 capacity to provide the company access to it so  
11 that it remains available for New York customers  
12 in the event of marketer default or departure.  
13 A similar provision was required for Orange &  
14 Rockland Utilities, Inc. (Orange & Rockland) in  
15 an Order dated October 23, 2003 in Case 02-G-  
16 1553. Orange & Rockland has since filed tariff  
17 provisions to implement this objective, and  
18 those proposed tariff changes are pending.  
19 Staff recommends that Consolidated Edison's  
20 tariff leaves contain terms and conditions that  
21 are equivalent to the leaves approved for Orange  
22 & Rockland.

23

24

1           **Balancing and Cash-out**

2    Q.   What are balancing and cash-out?

3    A.   Generally speaking, balancing refers to matching  
4           gas deliveries with customer requirements.

5           Balancing can occur at the city-gate or at the  
6           burner tip. City-gate balancing is used in  
7           situations where a utility tells a marketer how  
8           much gas to bring each day. In that situation,  
9           the marketer's obligation is to deliver the  
10          amount of gas identified by the utility,  
11          typically within a tight tolerance band of plus  
12          or minus 2%. Burner-tip, or on-system, balancing  
13          is used where the marketer determines how much  
14          gas it will bring each day. In that situation,  
15          the marketer's obligation is to deliver enough  
16          gas to meet its customers' actual gas use,  
17          typically within 10%. Cash-out refers to  
18          process by which a utility and each marketer  
19          financially settle the differences between the  
20          amount of gas the marketer delivered to the  
21          utility and the amount that its customers  
22          actually used. This is typically done on a  
23          daily or monthly basis for each pool of  
24          customers served by a marketer.

1 Q. Could you define other commonly-used terms that  
2 relate to balancing and cash-out provisions?

3 A. We will explain what is meant by (1) pool, (2)  
4 tolerance band, (3) imbalance, (4) cash-out  
5 tier, (5) price-index, (6) price-index  
6 multiplier (PIM), and (7) operational flow  
7 order.

8 (1) "Pool" means a group of marketers and/or  
9 direct customers with similar gas service  
10 characteristics (e.g., firm, daily metered; firm  
11 monthly metered; interruptible daily metered and  
12 interruptible monthly metered).

13 (2) "Tolerance band" refers to the allowed  
14 difference between the amount that a utility  
15 tells a marketer to bring for its customers  
16 subject to city-gate balancing, known as a gas  
17 nomination, and actual deliveries brought by the  
18 marketer to the city-gate; for customers subject  
19 to on-system balancing, the tolerance band is  
20 the difference between gas deliveries and actual  
21 gas use, before PIM are imposed.

22 (3) "Imbalance" means the difference between the  
23 amount of gas the marketer delivers to a utility  
24 and the amount of gas that the marketer's

1 customers use in a period.

2 (4) "Cash-out tiers" refers to different ranges  
3 of imbalance.

4 (5) A "price-index" is the price of gas, as  
5 published in a reputable journal such as Platts  
6 Gas Daily or Inside FERC.

7 (6) The "Price-Index Multiplier" refers to a  
8 factor that is applied to a price-index to  
9 calculate the cash-out owed by or to a marketer  
10 from a utility based on the marketer's actual  
11 deliveries to the utility and the amount of gas  
12 the marketers' customers actually used. As the  
13 imbalance grows, the PIM become more  
14 disadvantageous for the marketer, providing an  
15 incentive for the marketer to match gas  
16 deliveries to their customers' actual usage.

17 (7) An operational flow order is a directive to  
18 a marketer (or customer) to limit either gas  
19 injections or gas consumption to maintain proper  
20 operation of the system.

21 Q. Has Staff generally discussed balancing and  
22 cash-out provisions with interested parties?

23 A. Yes. These provisions have been topics  
24 addressed at monthly meetings of the Natural Gas

- 1 Reliability Advisory Group.
- 2 Q. What is the Natural Gas Reliability Advisory  
3 Group?
- 4 A. It is a cooperative effort of major stakeholders  
5 in New York that meets regularly to address and  
6 discuss reliability related issues including  
7 balancing and cash-outs. These issues typically  
8 relate to preserving and increasing the  
9 reliability of gas supplies to meet New York's  
10 needs. Participants include utilities,  
11 marketers, interstate pipeline companies,  
12 intervenor groups representing industry and  
13 government, as well as Department Staff, which  
14 chairs the Advisory Group.
- 15 Q. What was the outcome of the parties' discussions  
16 of balancing and cash-out provisions?
- 17 A. Staff reviewed the balancing and cash-out  
18 practices of all major gas utilities and  
19 identified areas of commonality and differences.  
20 Key areas were identified in which it would be  
21 desirable to move toward more consistent  
22 statewide practices to enhance marketer  
23 discipline and assure reliability. It is  
24 Staff's goal to have these preferred practices

- 1 implemented statewide, subject to operational  
2 limitations that may exist on each utility's  
3 system.
- 4 Q. How do Consolidated Edison's practices compare  
5 to the preferred practices identified by Staff?
- 6 A. While many of Consolidated Edison's practices  
7 are consistent with the preferred practices,  
8 some should be modified.
- 9 Q. Please describe some of the key features of  
10 Consolidated Edison's current balancing and  
11 cash-out programs.
- 12 A. Consolidated Edison's interruptible customers  
13 are all daily metered and subject to on-system  
14 balancing with a choice of daily or monthly  
15 balancing terms. The monthly balanced  
16 interruptible customers have a choice of a 10%,  
17 20% or 30% tolerance, with different charges  
18 applicable for each. All interruptible  
19 customers are cashed-out at the end of the month  
20 using price-index multiplier tiers. These tiers  
21 are: up to a 10% imbalance is cashed-out at 100%  
22 of the cost of gas; imbalances over 10% but less  
23 than 20% are cashed-out at 110% of the gas  
24 price; and, imbalances over 20% are cashed-out

1 at 120% of the cost of gas. Consolidated  
2 Edison's firm customers are all monthly metered  
3 and are subject to city-gate balancing. These  
4 customers are cashed-out monthly with  
5 deficiencies subject to price-index multiplier  
6 tiers.

7 Q. What modifications to the company's balancing  
8 and cash-out provisions do you recommend?

9 A. We recommend that Consolidated Edison revise its  
10 tariffs applicable to interruptible customers  
11 to:

12 1. Develop and implement the use of a system  
13 where PIM tiers of cash-out charges are imposed  
14 on each pool after "automatic" netting of  
15 imbalances, in each pipeline area, unless the  
16 company can demonstrate compelling reasons why  
17 such a system should not be implemented. That  
18 is, to the extent the pool as a whole is within  
19 the tolerance band (within 10%) no index-price  
20 multipliers should apply. However, if the pool  
21 is out of balance by more than 10%, only those  
22 marketers whose deliveries are outside of this  
23 tolerance band would be subject to price-index  
24 multipliers.

1        2. Base the index price for cash-outs on  
 2        midpoint or average prices from a reputable  
 3        journal such as Platts Gas Daily or Inside FERC,  
 4        with multipliers applied for increasing levels  
 5        of imbalance.

6        3. Revise the multiplier tiers for cashing-out  
 7        imbalances to: 10% and below, over 10% to 15%,  
 8        over 15% to 20%, and over 20%.

9        4. Revise the PIM premium or discount  
 10       applicable to under-deliveries and over-  
 11       deliveries, as follows:

12	<u>Tier</u>	<u>Under-deliveries</u>	<u>Over-deliveries</u>
13		<u>PIM</u>	<u>PIM</u>
14	<10%	100%	100%
15	>10-15%	110%	90%
16	>15-20%	115%	85%
17	>20%	140% Winter	60% Winter
18		130% Summer	70% Summer

19       5. Provide that separate Operational Flow Orders  
 20       be issued for both over and under-delivery  
 21       situations.

22       Q. Do you recommend any changes to the tariff  
 23       provisions applicable to firm customers?

24       A. Yes. The company's tariff provisions applicable

1 to firm customers should be revised to  
2 incorporate the second and fifth recommendations  
3 described above.

4 Q. Have Staff's preferred practices been adopted  
5 for other utilities?

6 A. Yes. The preferred practices have been adopted  
7 for Orange & Rockland (Case 02-G-1553), New York  
8 State Electric and Gas Corporation (Case 01-G-  
9 1668), National Fuel Gas Distribution  
10 Corporation (Case 00-G-1858), and are included  
11 in the Rochester Gas and Electric Corporation  
12 Joint Proposal filed on March 9, 2004 in Case  
13 03-G-0766.

14 Q. Does that conclude your testimony at this time?

15 A. Yes, it does.



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STATE OF NEW YORK  
EXECUTIVE DEPARTMENT  
STATE CONSUMER PROTECTION BOARD

George E. Pataki  
Governor

Teresa A. Santiago  
Chairperson and Executive Director

March 16, 2004

Via E-mail and US Mail

Hon. Jaclyn A. Brillling  
Secretary  
Public Service Commission  
Three Empire State Plaza  
Albany, NY 12223

Orig Files  
C 03-G-1671 et al  
Copies:  
Mr. K. Lang  
Mr. P. Catalano  
ALS Borkiller

Re: Case 03-G-1671 – Consolidated Edison Company of New York, Inc. – Gas Rates  
Case 03-S-1672 – Consolidated Edison Company of New York, Inc. – Steam Rates

Dear Secretary Brillling:

Please find enclosed herewith an original plus five (5) copies of the testimony of Mr. Tariq N. Niazi on behalf of the New York State Consumer Protection Board in the above-captioned proceedings, consisting of twenty-three (23) pages, one exhibit, as well as three schedules.

Very truly yours,

Seth R. Lamont  
Assistant Counsel

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Proceeding on Motion of the Commission as to the Rates,  
Charges, Rules and Regulations of Consolidated Edison  
Company of New York, Inc. for Gas Service.

Case  
03-G-1671

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.

Case  
03-S-1672

DIRECT TESTIMONY AND EXHIBIT OF

TARIQ N. NIAZI

Dated: March 16, 2004  
Albany, New York

TERESA A. SANTIAGO  
CHAIRPERSON and EXECUTIVE DIRECTOR  
NYS CONSUMER PROTECTION BOARD  
5 EMPIRE STATE PLAZA  
SUITE 2101  
ALBANY, NY 12223-1556  
<http://www.nysconsumer.gov>

## NIAZI

1 Q. Please state your name, title and business address.

2 A. Tariq N. Niazi, Chief Economist, New York State Consumer Protection Board  
3 ("CPB"), Suite 2101, Five Empire State Plaza, Albany, New York 12223.  
4

5 Q. Mr. Niazi, please summarize your background and experience.

6 A. I passed my candidacy examination, completed all required course work and passed  
7 all comprehensive examinations in the Doctoral Program in Managerial Economics at  
8 Rensselaer Polytechnic Institute. I have a Master's Degree in Economics from the  
9 State University of New York at Albany. I also received a Master's Degree in Public  
10 Administration from Punjab University in Pakistan and a Bachelor's Degree in  
11 Economics and Political Science at Forman Christian College in Pakistan.

12 I have been employed by the CPB since March 1981, first as an economic  
13 consultant and then as a rate analyst. Later, I was promoted to the position of  
14 Principal Economist. I was appointed to my present position in October 1990. I have  
15 worked on numerous issues in electric, gas, telephone and water proceedings. My  
16 responsibilities are in the areas of economic and financial analysis, rate design, policy  
17 analysis, cost of service, tariff analysis and cost of capital.

18 I serve as the CPB's representative at the New York Independent System  
19 Operator ("NYISO"). The CPB has been designated by the NYISO as the statewide  
20 consumer advocate and is a formal voting member of the NYISO's decision making  
21 committees. I also represent CPB on the Natural Gas Reliability Advisory Group as a  
22 consumer representative. I am also a member of the New York State Energy  
23 Research and Development Authority's System Benefit Advisory (SBC) Group.

NIAZI

1 Q. Have you previously testified before the New York State Public Service Commission?

2 A. Yes. I have testified in numerous proceedings before the Commission.

3

4 Q. What is the purpose of your testimony?

5 A. In its November 21, 2003 rate filing for natural gas operations, Consolidated Edison  
6 Company of New York, Inc., ("Con Edison" or the "Company") requested an  
7 increase in revenue requirement of approximately \$108 million or 9.8%, for the rate  
8 year, the twelve months ending September 30, 2005. The Company also requested  
9 a revenue requirement increase of \$65 million, or 14.6% for its steam operations.  
10 Con Edison requested a return on equity of 12.00% for both natural gas and steam  
11 businesses.

12 In this testimony, I demonstrate that the return on equity requested by the  
13 Company is vastly overstated and that Con Edison's cost of equity is currently  
14 9.14%. I also respond to several assertions made by the Company in support of its  
15 excessive return estimate and identify several errors in its presentation. When  
16 those errors are corrected, the Company's equity return is very similar to my  
17 estimate.

18 I also address three other proposals by the Company that affect its revenue  
19 requirement; (1) the recovery in rates of certain costs related to the attack on the  
20 World Trade Center, (2) a revenue requirement allowance for nine additional  
21 employees associated with requirements under the Sarbanes-Oxley Act of 2002,  
22 and (3) Con Edison's request that it return to the PSC's Policy Statement regarding

23

1 pensions and postretirement benefits other than pensions (OPEBs). I demonstrate  
2 why each of these proposals should be rejected at this time.

3  
4 Q. Have you prepared an exhibit?

5 A. Yes. I am sponsoring Exhibit \_\_\_\_ (CPB), consisting of three schedules.

6  
7 **I. RATE OF RETURN ON EQUITY**

8 Q. What return on common equity is Con Edison requesting?

9 A. Con Edison is requesting a return on common equity of 12.0%. Its recommendation  
10 is based on estimates from four different methods: 1) a range of 10.0% to 10.75%  
11 based on the discounted cash flow method ("DCF"); 2) a range of 10.75% to 11.50%  
12 based on the capital asset pricing model ("CAPM"); 3) a range of 10.8% to 10.9%  
13 based on the Risk Premium method and 4) a range of 14.0% to 14.5% based on the  
14 Comparable Earnings method. As I discuss in my testimony, the equity returns based  
15 on the DCF and the CAPM methods are vastly overestimated and should be rejected,  
16 while equity returns based on the Risk Premium and Comparable Earnings method  
17 should be discarded as these methods have been repeatedly rejected by the  
18 Commission.

19  
20 Q. What is your recommended rate of return or capitalization rate for Con Edison?

21 A. I recommend a total equity return of 9.14%. My equity cost estimate is based on  
22 applying the DCF method and CAPM to a proxy group of electric and combination  
23 electric and gas companies rated "A/A" and higher by Moody's and Standard &

NIAZI

1 Poor's. This rating criteria is somewhat relaxed from the "A/A" rated proxy group for  
2 combination electric and gas companies, reflected in the Recommended Decision in  
3 the Generic Finance Case (91-M-0509). As explained below, that relatively minor  
4 modification is appropriate and necessary to arrive at a reasonable size for the proxy  
5 group to obtain reliable results.

6 The DCF approach applied to the proxy group results in a median equity cost  
7 estimate of 9.40%. The CAPM approach applied to the same proxy group produces  
8 an equity cost of 8.38% for the traditional CAPM and 8.84% for the zero-beta CAPM.  
9 The average of the two CAPM methods results in an equity return of 8.61%. The  
10 CAPM analysis is based on a 10.2% market return, a .67 proxy group beta, a risk free  
11 rate of 4.69% and a risk premium of 5.51%. Applying weightings of 2/3 to the DCF  
12 result and 1/3 to the CAPM results, in accordance with the Commission's decision in  
13 several cases,<sup>1</sup> indicates an equity return of 9.14% for Con Edison.

14  
15 Q. How did you select the proxy group companies for your analysis?

16 A. I initially selected the proxy group companies using electric and combination electric  
17 and gas companies that are rated "A/A" by Moody's and Standard & Poor's. Eleven  
18 companies satisfied these criteria. I discarded two companies, Duke Energy, and  
19 FPL Group, Inc. since they have significant unregulated operations. This left a proxy  
20 group of 9 companies that is smaller than the appropriate sized sample set for pure  
21 gas companies established in the Generic Finance Case. To enlarge the proxy  
22 group, I relaxed the initial criteria and added companies rated higher than "A/A" by

---

<sup>1</sup> See, most recently, Cases 02-E-0198 and 02-G-0199, Rochester Gas and Electric Corporation, Order Adopting Recommended Decision with Modifications, March 7, 2003, p. 72.

1 either Moody's and/or Standard & Poor's. Currently there are two companies,  
2 Ameren Corporation and WPS Resources that have a split rating of "Aa/A" from  
3 Moody's and Standard & Poor's, and MGE Energy, Inc. that is rated "Aa/AA" by  
4 Moody's and Standard & Poor's respectively. I added Ameren Corporation and MGE  
5 Energy to my proxy group. WPS Resources was left out since it has significant  
6 unregulated operations. After including these two companies, the proxy group that I  
7 have used for my analysis is comprised of 11 companies as shown in Exhibit\_\_  
8 (CPB), Schedule 1.

9  
10 **Discounted Cash Flow Model**

11 Q. What is your DCF equity return estimate for Con Edison?

12 A. I applied a two-stage DCF growth model to the proxy group of electric and  
13 combination companies. This is the same model that was developed in the Generic  
14 Finance Proceeding and was adopted by the ALJs in their Recommended Decision.  
15 As shown in Exhibit\_\_ (CPB), Schedule 1, page 4 of 4, this resulted in a median  
16 equity return of 9.40%.

17  
18 Q. Could you please briefly describe the DCF method that you applied?

19 A. Yes. The DCF method is a market based approach that determines the return on  
20 equity from the investor's perspective. The familiar DCF formula is:

21  
22 
$$P_0 = \frac{D_1}{k-g}$$
  
23  
24  
25  
26

## NIAZI

1 This fundamental equation states that a rational investor equates the current  
2 market price ( $P_0$ ) of a stock to the expected future returns from that stock. Future  
3 returns from the stock are the expected stream of dividends discounted at the market  
4 required return ( $k$ ) net of the effect of growth ( $g$ ).  $D_1$  is the first year dividend.

5 Since the capitalization rate is not directly observable, the basic idea of the  
6 DCF approach is to estimate the cost of equity from the observed share price and an  
7 estimate of investor expected future dividends. This is based on the intuitive concept  
8 that dividends plus capital appreciation reflect the investor's total expected return.

9 The DCF formula can be rewritten by solving the above equation for the cost of  
10 equity ( $k$ ).

$$11 \quad k = D_1/P_0 + g$$

12 In terms of the rewritten DCF formula, the cost of equity ( $k$ ) is equal to the sum  
13 of expected dividend yield ( $D_1/P_0$ ) and the expected growth rate of future dividends  
14 ( $g$ ).

15  
16 Q. What is the first component of the DCF formulation [ $k = D_1/P_0 + g$ ]?

17 A. The first component of the DCF formulation is the expected dividend yield ( $D_1/P_0$ ). It  
18 is the quotient of the expected future dividends and the current stock price. A stock's  
19 dividend yield, in comparison with the dividend yield of other stocks, indicates whether  
20 it is an income or a growth asset. For example, bonds generally have high yields and  
21 low growth, and are hence considered income assets. Conversely, common stocks of  
22

## NIAZI

1 growing firms have low yields and high growth, and are generally considered growth  
2 assets.

3  
4 Q. What is the growth term ( $g$ ) in the standard DCF formula?

5 A. The growth term in the DCF formula represents the growth in the value of the firm's  
6 common stock as reflected through dividend and stock price increases. The DCF  
7 approach assumes that the firm is operating in a "steady state." If the steady state  
8 holds, the growth rates in earnings per share, dividends per share and book value per  
9 share are the same, and is a product of the retention ratio and the expected return on  
10 equity.

11 In reality, it is not possible to achieve a "true" steady state. Thus, book value  
12 per share, dividends per share and earnings per share generally grow at different  
13 rates that may all differ from the growth rate indicated by the retention ratio and  
14 expected return on equity.

15  
16 Q. How did you estimate the two-stage proxy group DCF equity returns for Con Edison?

17 A. I estimated the two-stage proxy group DCF equity return, relying on the model used in  
18 Case 91-M-0509 (the Generic Finance Proceeding) by the Electric and Gas Industry  
19 Group. The six-month average prices for the companies in the proxy group are the  
20 average of the monthly high and low closing price of each stock. I used the period  
21 September 1, 2003 to February 29, 2004. The other data, including dividends per  
22 share, earnings per share, book value per share and the shares of common stock, are  
23 all taken from the December 5, 2003 and the January 2, 2004 issues of the Value



## NIAZI

1 returns than investors in a stable stock for assuming additional risk. The CAPM  
2 quantifies the additional return investors require for accepting higher risk.

3  
4 Q. Please describe Exhibit\_\_(CPB), Schedule 2.

5 A. Exhibit\_\_(CPB), Schedule 2 consists of two pages. Page 1 shows the traditional  
6 CAPM formula used to derive the required return for the proxy group, while page 2  
7 shows the zero-beta CAPM application. The required return is the sum of the risk-  
8 free rate and the market risk-premium adjusted using the proxy group average beta.  
9 To determine the risk-free rate, I used a six-month average ending February 29, 2004  
10 of Long-Term and 10-year Treasury Bond Yields as reported by the Federal Reserve  
11 Board. (Federal Reserve Statistical Release, March 8, 2004) That average is 4.69%.  
12 The proxy group beta of 0.67 used to adjust the market risk-premium is the average of  
13 the individual company betas as reported by Value Line. These are the same electric  
14 and combination electric and gas proxy group companies (11) used for the DCF  
15 analysis. I have used a market return of 10.2%, based on the March, 2004 issue of  
16 Merrill Lynch Quantitative Profiles - Monthly Insights for Equity Management. The  
17 10.2% estimate is an investor required return for a portfolio of 1,218 firms. The  
18 required return for the S&P 500 as reported by Merrill Lynch in the March, 2004 issue  
19 of Quantitative Profiles is 10.1%.

20 The risk premium was derived by subtracting the risk-free rate from the market  
21 return. Subtracting the average of the Long-Term and the 10-year Treasury bond yield  
22 of 4.69% from the market return of 10.2% results in a risk premium of 5.51%.

23

## NIAZI

1           Incorporating all variables in the respective formulas, indicates a required  
2           return of 8.38% for the traditional CAPM approach and 8.84% for the zero-beta CAPM  
3           approach, as shown in Exhibit\_\_(CPB), Schedule 2, page 1 and 2 respectively. The  
4           average of the two CAPM approaches results in an equity estimate of 8.61% (8.38%  
5           + 8.84%)/2).

### 7           **Overall Recommendation**

8           Q.     What is your recommended equity return for Consolidated Edison?

9           A.     I recommend an equity return of 9.14%. I used the 2/3 – 1/3 weighting used by the  
10           Commission and also recommended by the Judges in the Generic Finance case.  
11           (Case 91-M-0509) My DCF estimate is 9.40% and my CAPM estimate is 8.61%.  
12           With the DCF estimate given 2/3 weight and the CAPM estimate given 1/3 weight, the  
13           resulting return is 9.14%.

14  
15          Q.     Have you made an adjustment to your equity return recommendation for a multi-year  
16           rate plan?

17          A.     No. The Company's rate request covers a single year. Although, Mr. Rosenberg  
18           indicates that the Company plans to propose a three-year rate plan, to the best of my  
19           knowledge, no such plan has been filed. If the Company files a multi-year rate  
20           proposal or parties enter into negotiations, the CPB will be willing to discuss different  
21           options.

NIAZI

1 Q. The Company has proposed to increase the investor required return by 16 basis  
2 points to account for issuance costs. Do you agree with this adjustment?

3 A. No. The Commission has recognized this adjustment only when issuance costs are  
4 expected during the rate year. Mr. Rosenberg refers to a common stock offering  
5 going back to May 2003 and generally refers to the issuance of new shares by Con  
6 Edison over the next several years. However, there is no specific information  
7 regarding common stock offerings by the Company during the rate year. In Cases 02-  
8 E-0198 and 02-G-0199, Rochester Gas and Electric Corporation for Electric and Gas  
9 Service, the Administrative Law Judge (ALJ) rejected an allowance for issuance costs  
10 because RG&E was not expected to issue equity during the rate year. The  
11 Commission in agreeing with the ALJ said the following:

12 We agree with the Judge's recommendation to exclude a  
13 separate adjustment for selling and issuance costs, because our policy  
14 has been to allow recovery of such expenses when they are incurred  
15 and there has been no assertion by the Company in this case of an  
16 external equity allowance. (Order Adopting Recommended Decision  
17 With Modifications, Cases 02-E-0198, 02-G-0199, Rochester Gas and  
18 Electric Corporation for Electric and Gas Service, issued March 7,  
19 2003, at 71.)  
20

21 Q. In Cases 03-E-0765, 03-G-0766, Rochester Gas and Electric Corporation, DPS Staff  
22 proposed an adjustment to the proxy group return to account for unregulated assets  
23 contributing to the consolidated return. Do you agree with such an adjustment?

24 A. Yes. Conceptually I agree with DPS Staff that in setting a regulated cost of equity, the  
25 proxy group return must be adjusted if the companies making up the proxy group  
26 have on average significant unregulated assets. I have not performed such a  
27

**NIAZI**

1 calculation, however, if Staff or some other party were to propose such an adjustment,  
2 I would likely, after proper review, recommend that the Commission approve it.  
3

4 Q. Have you applied any other adjustments to your estimate of equity return?

5 A. No. Although I have included two companies in my proxy group that are rated higher  
6 than "A/A" by Moody's and Standard & Poor's respectively, one of which has a split  
7 rating of "Aa/A", the overwhelming majority of the proxy group is rated "A/A", which is  
8 the same rating as that of Consolidated Edison. Therefore, no adjustment is required  
9 for this factor.  
10

11 Q. Have you estimated the revenue impact of your 9.14% equity return recommendation  
12 as compared to the Company's 12.0% allowance?

13 A. Yes. My recommendation would save Con Edison gas customers approximately \$48  
14 million, without impairing the Company's ability to provide safe and adequate gas  
15 service.  
16

17 Q. Does your recommendation apply to Con Edison's steam operations as well?

18 A. Yes. I have calculated Con Edison's overall cost of equity for its regulated operations,  
19 including steam. My recommendation would save Con Edison steam customers  
20 approximately \$18.0 million, without impairing the Company's ability to provide safe  
21 and adequate steam service.  
22

1 **Analysis of Con Edison's Equity Return Proposal**

2 Q. Please briefly describe how the Company estimated its proposed cost of equity of  
3 12.0%.

4 A. Company Witness Robert G. Rosenberg recommends an equity return of 12.0%  
5 based on the use of four different methods. The four methods he used were DCF,  
6 CAPM, Risk Premium and Comparable Earnings. He applied all four methods to a  
7 proxy group of companies with both Aa/AA and A/A bond ratings. His proxy group  
8 includes thirteen utilities. First, for the DCF approach, he used a two-stage model. As  
9 shown in Exhibit\_\_\_(RGR-1), Schedule 3, Mr. Rosenberg estimated three different  
10 DCF equity returns using different combinations of growth rates. Mr. Rosenberg's  
11 DCF calculations result in equity returns ranging from 9.5% to 10.8%. Second, he  
12 used the CAPM approach that produced equity returns of 9.6% and 10.2% based on  
13 the Ibbotson risk premium for the traditional and zero-beta CAPM, respectively, and  
14 equity returns of 11.3% and 12.2% based on the S&P 500 risk premium for the  
15 traditional and zero-beta CAPM, respectively. Mr. Rosenberg adds a 60 basis points  
16 size premium to his results, bringing his CAPM estimates to 10.2% and 11.9% for the  
17 Traditional CAPM and 10.8% and 12.8% for the zero-beta CAPM respectively. Third,  
18 Mr. Rosenberg used two Risk Premium analyses, resulting in estimates of 10.81%  
19 and 10.86% equity returns. Finally, Mr. Rosenberg's use of the Comparable Earnings  
20 approach produced an equity return in the range of 14.0% to 14.5%. Based on all the  
21 different methods used by Mr. Rosenberg, his equity returns ranged from a low of  
22 9.5% to a high of 14.5%.

23

**NIAZI**

1 Q. Do you agree with the Company's approach in estimating its equity return?

2 A. No. I will respond to the approach used by Mr. Rosenberg and show why his  
3 estimates should not be relied upon. His DCF analysis is not consistent with the  
4 Recommended Decision in the Generic Finance Case and results in estimates that  
5 are overstated. His CAPM estimate is also overstated since it is based on the use of  
6 completely unrealistic market returns. Finally, the two other methods he uses, Risk  
7 Premium and Comparable Earnings, were rejected by the ALJs in the Generic  
8 Finance Case and have been repeatedly rejected by the Commission.

9  
10 Q. Is Mr. Rosenberg's DCF analysis consistent with that adopted in the Recommended  
11 Decision in the Generic Finance Case?

12 A. No. While Mr. Rosenberg used the two-stage DCF approach applied to a proxy  
13 group, as adopted in the Recommended Decision in the Generic Finance Case, he  
14 did not use Value Line data as was clearly specified in that proceeding. Instead, he  
15 used an average of the Value Line projected 5-year growth rates and First Call 5-year  
16 projected growth rates for the near term, and three separate projected growth rates  
17 for the long-term. The three estimates for long-term projected growth that Mr.  
18 Rosenberg uses are the growth in the Gross Domestic Product ("GDP"), projected  
19 sustainable growth and industry growth. Interestingly, his estimate using retention  
20 growth that is based on projections by Value Line results in an equity return of 9.5%  
21 which is only 10 basis points higher than my DCF estimate of 9.4%. The use of the  
22 other two long-term projections of growth results in estimates that are 130 and 80  
23 basis points higher than his estimate using retention growth based on Value Line

1 projections. I recommend that his use of the growth in GDP and industry growth as  
2 estimates for long-term projected growth be rejected. These are broad measures of  
3 growth while Value Line projections are analyst's forecasts of companies in the proxy  
4 group. Overall, all of Mr. Rosenberg's DCF estimates, except that using retention  
5 growth based on Value Line projections, are overstated.

6  
7 Q. Please comment on Mr. Rosenberg's CAPM analysis.

8 A. Mr. Rosenberg estimates two sets of equity returns based on the traditional and zero-  
9 beta CAPM approaches. First, he uses a risk premium of 7.0% based on the spread  
10 between common stock returns and returns on long-term government bonds from  
11 data reported in Ibbotson Associates publication of Risk Premia Over Time Report:  
12 2003, to estimate CAPM equity returns of 9.6% based on the traditional and 10.2% on  
13 the zero-beta approaches respectively. Since risk premium is the difference between  
14 market return and the risk free rate, Mr. Rosenberg's assumed market return is 12.0%  
15 based on the risk free rate of 5.0% he used in his CAPM analysis. This market return  
16 is 180 basis points above the 10.2% market return reported by Merrill Lynch for 1,218  
17 firms as reported in its March, 2004 issue of Quantitative Profiles – Monthly Insight for  
18 Equity Management.

19 Second, Mr. Rosenberg calculates a market return of 14.75% for the S&P 500  
20 and then subtracts the 5.0% risk-free rate that he has used in his CAPM analysis to  
21 arrive at a risk premium of 9.75%. The market return for the S&P 500 as reported in  
22 the March, 2004 issue of Quantitative Profiles – Monthly Insight for Equity  
23 Management, is 10.1%. In other words, Mr. Rosenberg's estimate of the S&P 500

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1 market return is 465 basis points higher the estimate provided by Merrill Lynch.  
2 Accordingly, the market returns indicate that the inputs to the CAPM formula result in  
3 an excessive return. Therefore, the inputs must be flawed based on the end result.

4 Mr. Rosenberg estimates equity returns based on CAPM ranging from 9.6% to  
5 12.2%. He uses a 60 basis points size premium to account for mid and small market  
6 capitalization to further increase his CAPM estimates to 10.2% and 12.8%. This  
7 Commission has never adopted such an adjustment, nor, to the best of my knowledge  
8 was this factor discussed or adopted in the Generic Finance Case where many  
9 different approaches were considered.

10  
11 Q. What would Mr. Rosenberg's CAPM estimate of the equity return be if he used the  
12 correct market return of 10.2%, as reported by Merrill Lynch, in his CAPM analysis?

13 A. Mr. Rosenberg's CAPM estimate would be 8.38% and 8.84% for the traditional and  
14 zero-beta approaches, respectively, or an average CAPM return of 8.61%. The risk  
15 premium would be 5.20%, instead of 7.0% and 9.75% used by Mr. Rosenberg. The  
16 8.61% CAPM equity return would be the same as my CAPM estimate, although we  
17 use different risk free rates and beta. Mr. Rosenberg uses a risk free rate of 5.0%  
18 while I use 4.69%. Similarly, Mr. Rosenberg has used a beta of 0.65, while my beta  
19 estimate is 0.67.

20  
21 Q. Please comment on the Risk Premium and the Comparable Earnings approaches  
22 used by Mr. Rosenberg.

23 A. The Commission has repeatedly rejected the use of the Risk Premium and the

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1 Comparable Earnings approaches as used by Mr. Rosenberg. In Cases 94-G-0885  
2 and 93-G-0765, the Commission referenced the Recommended Decision and  
3 rejected the risk premium approach:

4 ... the Judge rejected two additional methods: the company's risk  
5 premium approach (whose results he deemed too volatile), and  
6 comparable earnings (presented by staff because it was included in the  
7 generic finance case consensus proposal).  
8  
9

10 Opinion No. 95-16, National Fuel Gas Distribution Corporation, issued  
11 September 15, 1995, page 44.  
12

13 The Comparable Earnings approach was also rejected by Judges Ansaldo and  
14 Deixler in the Generic Finance Case. The Recommended Decision said the following:

15 A comparable earnings approach is not appropriate for development of  
16 the cost of equity and should not be included in the method adopted for  
17 that purpose by the Commission.  
18

19 Recommended Decision, Case 91-M-0509, issued July 19, 1994, page  
20 48.  
21

22 Q. What would be Con Edison's equity return estimate, based on the 2/3-1/3 weighting  
23 for the DCF and the CAPM approaches, with appropriate corrections for all the flaws  
24 you have noted above?

25 A. Combining Mr. Rosenberg's DCF estimate that uses retention growth based on Value  
26 Line projections for long-term growth and his corrected CAPM estimate based on the  
27 10.2% Merrill Lynch market return that I discuss above, would result in an equity  
28 return of 9.20%. Mr. Rosenberg estimated a two-stage DCF proxy group return  
29 based on retention growth of 9.5%. As discussed above, his CAPM estimate based  
30 on the Merrill Lynch market return of 10.2% would be 8.38% and 8.84% respectively  
31 for the traditional and zero-beta approaches, or an average CAPM return of 8.61%.

1 Assigning 2/3 weight to the DCF estimates, and 1/3 to the CAPM return consistent  
2 with the methodology approved in the Generic Finance Case, results in an equity  
3 return of 9.20% that is very close to my estimate of 9.14%. Thus, when adjusted for  
4 errors, Mr. Rosenberg's return agrees with my analysis.

5  
6 **II. WORLD TRADE CENTER COSTS**

7 **Q.** Please summarize Con Edison's position on the recovery of costs related to the  
8 restoration of facilities damaged as a result of the attack on the World Trade Center.

9 **A.** The Company has deferred those costs in three categories: (1) restoration and  
10 emergency response; (2) rebuilding of facilities; and (3) interference, or costs  
11 associated with the relocation of Company facilities (testimony of Con Edison Witness  
12 Mr. Edward J. Rasmussen, p. 20). Con Edison has applied for recovery of these  
13 costs from the \$750 million federal appropriation for damaged properties and  
14 businesses associated with the attack on the World Trade Center. The Company is  
15 self-insured for transmission and distribution facilities related to interference  
16 (Exhibit\_\_\_(CPB), Schedule 3, response to Information Request 318, DPS Staff to  
17 Con Edison).

18 Mr. Rasmussen opines that the Company is unlikely to recover all of its  
19 deferred costs relating to the World Trade Center disaster from federal funding and  
20 insurance (Rasmussen testimony, p. 21). As a result, Con Edison proposes to  
21 recover interference costs and certain security costs associated with the attack on the  
22 World Trade Center in rates in this proceeding. For its natural gas operations, the  
23 Company seeks recovery of \$18.9 million of interference costs (testimony of Con

**NIAZI**

1 Edison witness Robert S. Boyle, p. 7), which includes approximately \$2.0 million of  
2 security costs associated with the World Trade Center event (Exhibit\_\_\_\_(CPB),  
3 Schedule 3, response to Information Request 319(a), DPS Staff to Con Edison). The  
4 Company cites the threat levels set by the Department of Homeland Security as the  
5 impetus for these increased security expenditures (Exhibit\_\_\_\_(CPB, Schedule 3)  
6 response to Information Request 320, DPS Staff to Con Edison). For its steam  
7 operations, the Company seeks recovery of \$9.9 million of interference costs  
8 associated with the attack on the World Trade Center (Boyle testimony, p. 14).

9  
10 Q. What is the CPB's position on Con Edison's proposal?

11 A. Those costs should not be recovered in rates at this time. As stated by Con Edison  
12 witness Mr. Boyle, "At this juncture, it is unclear whether all or any of the Company's  
13 interference expenses in Lower Manhattan will be reimbursed." (Boyle testimony, p.  
14 7) Given this uncertainty, it would be premature for ratepayers to fund those costs at  
15 this time. Instead, those costs should continue to be deferred. Deferral would help  
16 ensure that Con Edison has an incentive to recover those costs through federal funds.

17 Inasmuch as the Company is currently "making every effort to seek reimbursement  
18 for all its WTC-related costs from the federal government" and is "uncertain" at this  
19 time whether any or all of those costs will be recovered, it is the CPB's position that  
20 the Commission should take a wait and see approach, favoring deferral over recovery  
21 in this proceeding (Exhibit\_\_\_\_(CPB), Schedule 3, response to Information Request  
22 318, DPS Staff to Con Edison).

1 **III. COMPLIANCE WITH THE SARBANES-OXLEY ACT OF 2002**

2 Q. Please summarize the Company's position regarding its compliance costs with  
3 respect to the Sarbanes-Oxley Act of 2002?

4 A. Con Edison contends that the Sarbanes-Oxley Act of 2002 (Act) and the related rules  
5 adopted by the Securities and Exchange Commission (SEC) impose numerous  
6 requirements on the Company. It claims that to meet those requirements, it needs to  
7 hire nine additional management employees, including three accountants, three  
8 auditors and three employees in the financial reporting area. It intends to hire those  
9 additional employees and is seeking recovery of the costs associated with those  
10 employees in this rate case (testimony of Con Edison Witness Mr. Robert Muccilo, p.  
11 5). The fully loaded cost of those nine employees is \$1,067,000, of which 16.2%  
12 (\$172,854) is attributable to gas operations and 5.1% (\$54,417) is attributable to  
13 steam operations (response to Information Requests 168 and 174, DPS Staff to Con  
14 Edison).

15  
16 Q. What is the CPB's position on this proposal?

17 A. The CPB opposes the Company's proposal. Sarbanes-Oxley was signed into law on  
18 July 30, 2002 and became effective at that time. Since that date, the Company has  
19 apparently complied with the Act's requirements, without the need for nine additional  
20 employees. Indeed, the Company incurred only \$178,000 of incremental costs  
21 associated with the Act in the more than 18 months since it became effective  
22 (Exhibit \_\_\_(CPB), Schedule 3, response to Information Request 159, DPS Staff to  
23 Con Edison). Only \$28,836 of these costs (16.2%) are attributable to the Company's

1 gas operations and \$9,078 of these costs (5.1%) are attributable to its steam  
2 operations. Moreover, the central requirement of the Act as it relates to Con Edison,  
3 is that executives of the Company must certify the accuracy of its financial reports.  
4 This should not impose additional requirements on Con Edison employees of the  
5 magnitude the Company claims. Further, while the Sarbanes-Oxley Act of 2002 is  
6 quite comprehensive and its goals laudable, it appears that the majority of the  
7 compliance costs are front loaded. Any new systems, methodologies, procedures,  
8 protocols and reporting requirements required by the Act should be implemented by  
9 this time, more than 18 months after the Act became effective. Therefore, it makes  
10 little sense for the Company to hire nine additional employees at this time to comply  
11 with that Act. Interestingly, the Company has not performed any cost benefit analysis  
12 of the need to hire the nine additional employees (Exhibit\_\_\_(CPB), Schedule 3,  
13 response to Information Request 166, DPS Staff to the Company).

14 For all these reasons, the CPB opposes the Company's proposal to include the  
15 costs of nine additional management employees as a result of the Sarbanes-Oxley  
16 Act of 2002 and the related rules adopted by the SEC, in its revenue requirement in  
17 this proceeding.

18  
19 **IV. PENSIONS AND OPEBS**

20 **Q.** Please provide a brief explanation of the PSC's Pension Policy Statement.

21 **A** Following a notice and comment period, the Pension Policy Statement was adopted  
22 by the Commission in Case 91-M-0890 – In the Matter of the Development of a  
23 Statement of Policy Concerning the Accounting and Ratemaking Treatment for

1           Pensions and Postretirement Benefits Other than Pensions, Statement of Policy And  
2           Order Concerning The Accounting And Ratemaking Treatment For Pensions And  
3           Postretirement Benefits Other Than Pensions, September 7, 1993. Generally, that  
4           Policy Statement deals with the accounting and rate treatment of pension and  
5           postretirement benefits other than pensions (OPEBs). Specifically, the Pension Policy  
6           Statement covers the accounting and ratemaking treatment to be applied to three  
7           Statements of Financial Accounting Standards (SFAS) set forth by the Financial  
8           Accounting Standards Board, including: SFAS No. 87, which deals pensions; SFAS  
9           No. 88, which addresses settlements and curtailments of defined benefits pension  
10          plans and for termination benefits; and SFAS No. 106, which deals with  
11          postretirement benefits other than pensions (Id., p. 2). One of the primary objectives  
12          of the Policy Statement is to moderate rate impacts on customers of utility service.  
13          (e.g., Id., p. 4).

14  
15       Q.     Please summarize the Company's proposal in this proceeding regarding the PSC's  
16           Pension Policy Statement.

17       A.     By way of background, Con Edison went off the Pension Policy Statement as a part of  
18           a negotiated agreement in Case 96-G-0548, approved by the Commission in 1997.  
19           The testimony of Company witness Rasmussen reveals that the Company wishes to  
20           return to the Pension Policy Statement with some modification (Rasmussen  
21           testimony, pp. 15-20). In particular, the Company "is requesting permission to utilize  
22           deferral accounting again for differences between the actuarially calculated Pension  
23           and Other Postretirement Benefit costs incurred with amounts provided in rates"

## NIAZI

1 (revised Response to Information Request 84, DPS Staff to the Company). Mr.  
2 Rasmussen notes that the primary reason for this proposal is that the volatility of  
3 financial markets has increased substantially in recent years (Rasmussen testimony,  
4 pp. 15 - 16).

5  
6 Q. What is the CPB's position on Con Edison's proposal to return to the Pension Policy  
7 Statement at this time?

8 A. The CPB does not support that proposal in the absence of substantial concessions to  
9 ratepayers.

10 From April 1997, when the Company went off the Pension Policy Statement,  
11 until November 2003, the most recent month for which data are available, Con Edison  
12 earned an additional \$53.516 million for its gas business as a result of departing from  
13 the Policy Statement (Exhibit\_\_\_\_(CPB), Schedule 3, response to Information Request  
14 87, DPS Staff to Con Edison). Over that same period, the Company earned an  
15 additional \$23.573 million for its steam operations as a result of departing from the  
16 Policy Statement (Exhibit\_\_\_\_(CPB), Schedule 3, response to Information Request 88,  
17 DPS Staff to Con Edison).

18 It would be unfair to permit the Company to be off the Pension Policy  
19 Statement when it believes that its assets will perform well, and on the Pension Policy  
20 Statement during periods of relative financial uncertainty. If the Company is permitted  
21 to pick and choose when it will be subject to the Pension Policy Statement, ratepayers  
22 will likely be harmed in the long run.

23

1 Q. Does this conclude your testimony?

2 A. Yes.

**Exhibit**

Consolidated Edison Company of New York

Two-Stage DCF Growth Model

(PROXY GROUP OF A-RATED COMBINATION ELECTRIC & GAS UTILITIES)

COMPANY NAME	BETA	6 MONTH	DPS				'05-07	03/04
		PRICE (A)	2003 (B)	2004 (C)	2005 (C')	2006 (C'')	(=2007) (D)	(D')
Alliant Energy	0.75	24.12	1.00	1.00	1.06	1.13	1.20	1.00
Ameren Corp	0.70	44.89	2.54	2.54	2.54	2.57	2.62	2.54
CH Energy Group	0.75	45.29	2.16	2.16	2.17	2.19	2.20	2.16
Consolidated Edison	0.60	41.56	2.24	2.26	2.28	2.30	2.32	2.25
MGE Energy Inc.	0.55	31.68	1.35	1.36	1.37	1.37	1.38	1.36
NSTAR	0.70	47.87	2.17	2.21	2.25	2.29	2.33	2.19
OGE Energy Corp	0.65	23.44	1.33	1.33	1.33	1.33	1.33	1.33
SCANA Corporation	0.65	34.34	1.38	1.44	1.50	1.56	1.62	1.41
Southern Co.	0.60	29.57	1.39	1.42	1.47	1.52	1.58	1.41
Vectren Ccorp.	0.75	24.00	1.11	1.15	1.19	1.23	1.27	1.13
Wisconsin Energy	0.65	32.18	0.80	0.80	0.86	0.93	1.00	0.80

PROXY GROUP

SUMMARY STATISTICS

# of Companies	11	11	11	11	11	11	11	11
SUM								
AVERAGE	0.67	34.45	1.59	1.61	1.64	1.67	1.71	1.60
STANDARD DEVIATION	0.06	8.69	0.56	0.56	0.54	0.53	0.53	0.56
MINIMUM	0.55	23.44	0.80	0.80	0.86	0.93	1.00	0.80
MAXIMUM	0.75	47.87	2.54	2.54	2.54	2.57	2.62	2.54

SOURCE: Value Line Investment Survey

December 5, 2003

January 2, 2004

COMPANY NAME	04/05	05/06	06/07	EPS			BVPS	
	(D'')	(D''')	(D''''')	2003 (E)	2004 (F)	06-08 (G)	2003 (H)	2004 (I)
Alliant Energy	1.03	1.10	1.16	1.60	1.65	1.90	19.95	20.60
Ameren Corp	2.54	2.55	2.59	2.95	3.00	3.30	26.45	27.10
CH Energy Group	2.17	2.18	2.19	2.65	2.70	3.00	30.75	31.30
Consolidated Edison	2.27	2.29	2.31	2.85	3.00	3.20	28.80	29.70
MGE Energy Inc.	1.36	1.37	1.38	1.80	2.00	2.25	15.20	15.65
NSTAR	2.23	2.27	2.31	3.40	3.50	4.00	25.75	27.05
OGE Energy Corp	1.33	1.33	1.33	1.65	1.75	2.00	13.40	13.85
SCANA Corporation	1.47	1.53	1.59	2.45	2.60	3.00	21.00	22.15
Southern Co.	1.45	1.50	1.55	1.90	1.95	2.30	12.95	13.70
Vectren Ccorp.	1.17	1.21	1.25	1.60	1.70	2.00	14.10	14.60
Wisconsin Energy	0.83	0.90	0.96	2.25	2.30	2.75	20.15	21.80

PROXY GROUP

SUMMARY STATISTICS

# of Companies	11	11	11	11	11	11	11	11
SUM								
AVERAGE	1.62	1.66	1.69	2.28	2.38	2.70	20.77	21.59
STANDARD DEVIATION	0.55	0.54	0.53	0.59	0.60	0.64	6.13	6.24
MINIMUM	0.83	0.90	0.96	1.60	1.65	1.90	12.95	13.70
MAXIMUM	2.54	2.55	2.59	3.40	3.50	4.00	30.75	31.30

COMPANY NAME	06-08 (J)	SHARES		06-08 (M)	DPS	2007	2007	B*R (Q)
		2003 (K)	2004 (L)		GROWTH 03-07 (N)	RET RATIO (O)	AVE ROE (P)	
Alliant Energy	22.70	111.00	112.00	112.00	4.66%	36.84%	8.51%	3.13%
Ameren Corp	29.50	163.00	164.80	170.20	0.78%	20.61%	11.34%	2.34%
CH Energy Group	32.75	15.75	15.75	15.00	0.46%	26.67%	9.23%	2.46%
Consolidated Edison	32.60	225.40	226.60	231.40	0.88%	27.50%	9.97%	2.74%
MGE Energy Inc.	18.00	18.20	18.00	20.35	0.55%	38.67%	12.79%	4.95%
NSTAR	32.00	53.03	53.03	53.03	1.79%	41.75%	12.85%	5.36%
OGE Energy Corp	15.50	87.00	87.00	87.00	0.00%	33.50%	13.15%	4.40%
SCANA Corporation	26.00	111.00	111.00	111.00	4.09%	46.00%	11.85%	5.45%
Southern Co.	16.35	735.00	745.00	775.00	3.25%	31.30%	14.48%	4.53%
Vectren Ccorp.	16.45	75.70	76.00	76.80	3.42%	36.50%	12.40%	4.53%
Wisconsin Energy	27.50	118.00	119.50	124.00	5.74%	63.64%	10.39%	6.61%

PROXY GROUP

SUMMARY STATISTICS

# of Companies	11	11	11	11	11	11	11	11
SUM								
AVERAGE	24.49	155.73	157.15	161.43	2.33%	36.63%	11.54%	4.23%
STANDARD DEVIATION	6.63	192.13	194.88	203.07	1.89%	10.98%	1.75%	1.32%
MINIMUM	15.50	15.75	15.75	15.00	0.00%	20.61%	8.51%	2.34%
MAXIMUM	32.75	735.00	745.00	775.00	5.74%	63.64%	14.48%	6.61%

COMPANY NAME	GROWTH			SUSTAINABLE			
	IN SHARES (R)	CURRENT MBR (S)	S FACTOR (T)	V FACTOR (U)	SV FACTOR (V)	GROWTH RATE (W)	LONG FORM ROE (X)
Alliant Energy	0.22%	120.90%	0.27%	17.29%	0.05%	3.18%	7.55%
Ameren Corp	1.09%	169.72%	1.84%	41.08%	0.76%	3.10%	8.40%
CH Energy Group	-1.21%	147.28%	-1.79%	32.10%	-0.57%	1.89%	6.48%
Consolidated Edison	0.66%	144.31%	0.95%	30.70%	0.29%	3.03%	8.14%
MGE Energy Inc.	2.83%	208.42%	5.90%	52.02%	3.07%	8.02%	11.51%
NSTAR	0.00%	185.90%	0.00%	46.21%	0.00%	5.36%	9.52%
OGE Energy Corp	0.00%	174.93%	0.00%	42.83%	0.00%	4.40%	9.45%
SCANA Corporation	0.00%	163.52%	0.00%	38.85%	0.00%	5.45%	9.40%
Southern Co.	1.33%	228.34%	3.05%	56.21%	1.71%	6.24%	10.65%
Vectren Ccorp.	0.36%	170.21%	0.62%	41.25%	0.25%	4.78%	9.32%
Wisconsin Energy	1.25%	159.70%	1.99%	37.38%	0.74%	7.35%	9.75%

PROXY GROUP

SUMMARY STATISTICS

# of Companies	11	11	11	11	11	11	11
SUM							
AVERAGE	0.59%	170.29%	1.17%	39.63%	0.57%	4.80%	9.11%
STANDARD DEVIATION	0.99%	28.43%	1.93%	10.12%	0.97%	1.83%	1.34%
MINIMUM	-1.21%	120.90%	-1.79%	17.29%	-0.57%	1.89%	6.48%
MAXIMUM	2.83%	228.34%	5.90%	56.21%	3.07%	8.02%	11.51%

Median 9.40%

**CONSOLIDATED EDISON COMPANY OF NEW YORK**

TRADITIONAL CAPM

Formula:  $R_c = R_f + b (R_m - R_f)$

Where:

$R_c$  = Required Return for the Company.

$R_f$  = Risk Free Return = 4.69%, six-month average ending February 2004 of Long-Term and 10-Year Treasury Bond Yields, Federal Reserve Statistical Release, (March 8, 2004).

$R_m$  = Market Return = 10.2%, Quantitative Profiles-Monthly Insights for Equity Management, Merrill Lynch, (March 2004).

$b$  = Beta = .67, Proxy Group Average Beta for A-Rated Combination Electric & Gas Utilities (The Value Line Investment Survey, Ratings and Reports, (December 5, 2003; January 2, 2004).

Required Return:

$$8.38\% = 4.69 + .67(10.2 - 4.69)$$

**CONSOLIDATED EDISON COMPANY OF NEW YORK**

ZERO-BETA CAPM

Formula:  $R_c = R_f + 3/4(b) (R_p) + 1/4(R_p)$

Where:

$R_c$  = Required Return for the Company.

$R_f$  = Risk Free Return = 4.69%, six-month average ending February 2004 of Long-Term and 10-Year Treasury Bond Yields, Federal Reserve Statistical Release, (March 8, 2004).

$R_m$  = Market Return = 10.2%, Quantitative Profiles-Monthly Insights for Equity Management, Merrill Lynch, (March 2004).

$b$  = Beta = .67, Proxy Group Average Beta for A-Rated Combination Electric & Gas utilities. (The Value Line Investment Survey, Ratings and Reports, (December 5, 2003, January 2, 2004).

$R_p$  = Risk Premium = 5.51, Market Return minus Risk free rate.

Required Return:

$$8.84\% = 4.69 + .75(.67) (5.51) + .25(5.51)$$

Consolidated Edison Company of New York, Inc.  
Case 03-G-1671  
Case 03-S-1672

Of Company Witnesses Boyle and Muccilo  
Dated January 23, 2004

Question #318:

- a. Will Con Edison be seeking reimbursement for the WTC-related interference costs from the Federal Government or pursuant to its insurance policies?
- b. If the response to (a) is no, why not?
- c. If the response to (a) is yes, then why is the company seeking recovery from ratepayers now?
- d. How does Con Edison propose to account for any forms of reimbursement the company may receive for these costs?

Response:

- a. Yes. Wherever possible, the Company is seeking reimbursement for all of its WTC related costs, including funds for interference work, from the Federal government. The Company is self – insured for the transmission and distribution (street) facilities involved in interference and therefore not recoverable from insurance carriers.
- b. Not applicable.
- c. While the Company is making every effort to seek reimbursement for all of its WTC-related costs from the Federal government, the Company does not know at this time, pending completion of the Company's federal application audit, if it can anticipate recovery for the costs expended and deferred in these accounts and is uncertain whether any or all of the interference costs will be reimbursed. As for security costs, please also see the response to #319(b).
- d. In the event the Company does receive reimbursement for costs being borne by customers, the Company will defer the reimbursement for customer disposition.

Consolidated Edison Company of New York, Inc.  
Case 03-G-1671  
Case 03-S-1672

Of Company Witnesses Boyle and Muccilo  
Dated January 23, 2004

Question #319:

- a. What are the security costs listed in Mr. Muccilo's work papers, and how are they related to interference costs?
- b. What is the company's basis for seeking recovery of security costs as part of the WTC-related interference costs?

Response:

- a. Although Mr. Muccilo's testimony discusses WTC interference costs, the costs shown in the workpapers include other WTC related costs. The testimony will be corrected to refer to these other categories of costs at the time of the hearing. The security costs listed in Mr. Muccilo's work papers are costs related to the WTC event but are not WTC related interference costs. Mr. Muccilo is requesting recovery of interference costs deferred in the WTC account plus some \$2 million of security costs at gas facilities deferred in the WTC account. The security costs primarily reflect costs incurred for the patrols of unmanned gas facilities. These patrols vary with the current terrorist alert system in this country. At level Yellow, patrols are done at nine facilities, twice per day, seven days per week. At level Orange, patrols occurred similar to Yellow, plus seven additional facilities twice per day and seven additional facilities once per day.
- b. The HUD federal reimbursement Action Plan limits recovery of such Category 1 security costs to those incurred through October 31, 2003 for locations below Canal Street. However, the Company has submitted for reimbursement the \$2.329 million to HUD/Empire State Development.\

PSC Staff's 7<sup>th</sup> Set Of Interrogatories  
Steam Case 03-G-1671  
Gas Case 03-S-1672  
Witness: Robert Muccilo

Question No. 159

- a. When did the requirements of the Sarbanes-Oxley Act become applicable to Con Edison?
- b. Please reference the specific provision(s) of the Sarbanes-Oxley Act that require Con Edison to hire additional employees between the test period and the end of the rate year.
- c. Please explain why the specific provisions noted in the response to (b) result in incremental activities and costs to Con Edison.
- d. Please identify any incremental costs incurred to date by Con Edison to comply with the requirements of the Act.
- e. Please identify any incremental costs incurred to date by CEI to comply with the requirements of the Act.
- f. Please indicate how all incremental costs identified in the responses to (d) and (e) were accounted for.
- g. Please identify all Sarbanes-Oxley compliance costs allocated to gas operations.
- h. Please identify all Sarbanes-Oxley compliance costs allocated to steam operations.

Response

- a. The Sarbanes-Oxley Act was signed into law on July 30, 2002 and was effective as of that time.
- b-c. The Sarbanes-Oxley Act and the related rules adopted by the SEC have numerous requirements. After reviewing these requirements, the Company determined how many personnel it believed were necessary to comply with both existing and new requirements. These requirements include additional documentation and testing of internal controls over financial reporting as well as requirements relating to the Act from other agencies.
- d-e. \$200,000 of incremental costs to date related to Audit Fees, \$178,000 is allocable to Con Edison). These dollars are for costs incurred in 2003 and will be significantly higher in 2004 and beyond because Price Waterhouse Coopers will be required to test the controls that are being documented.
- f. Amounts applicable to Con Edison were accounted for as Administrative and General Expenses. Amounts applicable to other than Con Edison were accounted for by each individual subsidiary or CEI on its own books of account.
- g. In addition to the labor and labor related costs, rate year expenses applicable to gas include \$74,000 for Sarbanes-Oxley Audit Fees.
- h. In addition to the labor and labor related costs, rate year expenses applicable to steam include \$31,000 for Sarbanes-Oxley Audit Fees.

PSC Staff's 7<sup>th</sup> Set Of Interrogatories  
Steam Case 03-G-1671  
Gas Case 03-S-1672  
Witness: Robert Muccilo

Question No. 166

- a. Did the company consider using contractor services to perform the activities to be performed by the nine new management personnel?
- b. If the answer to (a) is no, why not?
- c. If the answer to (a) is yes, why did this option rejected?
- d. Please provide any cost/benefit analyses that were relied on in the decision to hire the nine additional employees.

Response

- a. No.
- b. The Company generally performs all accounting and internal auditing services with Company employees, which it believes are better suited to perform these functions.
- c. Not applicable.
- d. There was no cost benefit analysis performed.

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.  
GAS RATE CASE 03-G-1671  
STEAM RATE CASE 03-S-1672

State of New York Department of Public Service: Interrogatory No. 87

Responding Witness: Edward J. Rasmussen

Question:

- a. Please provide CECONY's stand-alone earned return on equity (ROE) for its gas business by month since it departed from the Policy Statement.
- b. Please provide an estimate of what CECONY's stand-alone earned ROE for its gas business would have been by month for the same period, had it remained on the Policy Statement.
- c. Please calculate the dollar amount of additional earnings for CECONY's gas business that were generated by departing from the Policy Statement.
- d. Please specify the amount of these extra earnings that were shared with ratepayers.
- e. Please provide the calculations and workpapers supporting the response to (d).

Response

- a. The table below shows CECONY's stand-alone earned ROE for its gas business by month since it departed from the Policy Statement.

**Con Edison Company of New York, Inc.**  
**Earned Return on Equity - Gas Operations**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
January		13.97%	11.89%	13.69%	14.18%	13.26%	11.46%
February		14.49%	11.82%	13.61%	14.77%	12.91%	11.17%
March		14.89%	11.77%	14.00%	15.06%	13.27%	11.10%
April	10.97%	14.63%	11.98%	14.29%	15.61%	12.21%	11.12%
May	10.87%	14.69%	12.00%	14.91%	15.10%	10.91%	11.55%
June	11.08%	14.33%	12.41%	15.05%	14.64%	11.66%	11.08%
July	11.31%	13.75%	12.35%	15.79%	14.15%	11.70%	10.84%
August	11.41%	13.82%	12.36%	15.53%	13.91%	12.23%	10.56%
September	11.59%	12.52%	12.70%	13.36%	13.93%	12.50%	9.81%
October	11.60%	12.40%	12.70%	14.00%	13.72%	12.08%	10.56%
November	12.80%	12.28%	12.66%	14.03%	12.75%	11.79%	10.31%
December	13.34%	11.83%	13.46%	16.23%	13.18%	11.70%	

- b. The table below shows an estimate of what CECONY's stand-alone earned ROE for its gas business would have been by month for the same period, had it remained on the Policy Statement.

**Con Edison Company of New York, Inc.**  
**Estimated Return on Equity On Policy Statement - Gas Operations**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
January		13.61%	11.06%	12.20%	11.62%	12.47%	11.62%
February		13.82%	10.95%	11.94%	11.57%	12.31%	11.51%
March		13.97%	10.86%	12.15%	11.50%	12.48%	11.51%
April	12.77%	13.79%	11.04%	12.25%	11.63%	11.96%	11.56%
May	12.68%	13.77%	11.03%	12.67%	11.70%	11.50%	11.79%
June	12.87%	13.55%	11.40%	12.61%	11.19%	11.68%	11.66%
July	12.89%	13.36%	11.29%	13.08%	10.67%	11.69%	11.61%
August	12.70%	13.36%	11.25%	12.73%	10.39%	11.96%	11.55%
September	13.28%	12.00%	11.54%	11.74%	10.32%	12.05%	11.03%
October	13.31%	11.79%	11.50%	11.61%	10.11%	11.92%	11.18%
November	13.46%	11.58%	11.41%	11.53%	10.49%	11.82%	11.02%
December	13.72%	11.04%	12.15%	11.88%	10.88%	11.67%	

- c. The table below shows an estimate of the dollar amount of additional earnings for CECONY's gas business that were generated by departing from the Policy Statement. It should be noted that the amounts shown by month represent rolling twelve months cumulative totals and are not additive.

**Con Edison Company of New York, Inc.**  
**Estimated Earnings Resulting from**  
**Not Being On Policy Statement - Gas Operations**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
January	\$-	\$(1,839)	\$6,687	\$11,259	\$17,560	\$54	\$(1,110)
February	-	(1,092)	6,993	12,466	18,003	43	(1,721)
March	-	(344)	7,299	13,673	18,446	31	(2,332)
April	(1,193)	403	7,604	14,880	18,888	19	(2,943)
May	(1,368)	1,150	7,910	16,087	19,331	8	(3,555)
June	(1,542)	1,897	8,216	17,295	19,774	(3)	(4,166)
July	(1,715)	2,645	8,522	18,502	20,216	(15)	(4,777)
August	(1,890)	3,392	8,828	19,709	20,658	(27)	(5,388)
September	(2,064)	4,139	9,134	20,916	21,101	(38)	(5,999)
October	(2,238)	4,887	9,440	22,123	21,544	(49)	(6,610)
November	(2,412)	5,634	9,745	23,330	21,986	(61)	(7,222)
December	(2,586)	6,381	10,052	24,537	22,429	(73)	-

- d. The table below shows a calculation of the theoretical amount of these extra earnings that would be shared with ratepayers. Actual overearnings calculation are to done on a cumulative basis over the term of the current rate agreement, periodic spikes in earnings during one fiscal period do not represent the actual amounts to be deferred for the customers benefit. The numbers on the table represent variations from overearnings accruals recorded by the Company.

**Con Edison Company of New York, Inc.**  
**Estimated Overearnings Earnings Resulting From**  
**Not Being On Policy Statement - Gas Operations**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
January	\$-	\$(4,681)	\$-	\$-	\$6,356	\$(3,949)	\$(1,830)
February	-	(6,331)	-	-	7,069	(2,625)	(160)
March	-	(7,529)	-	-	7,979	(4,019)	(80)
April	-	(6,150)	-	-	6,193	-	(968)
May	-	(6,055)	-	-	(2,865)	5,112	(4,383)
June	-	(4,302)	-	-	7,862	2,570	(2,619)
July	-	(475)	-	(562)	7,910	2,281	(1,733)
August	-	(278)	-	-	7,942	(267)	(748)
September	(2,135)	-	-	9,493	7,777	(1,542)	-
October	(2,335)	-	-	8,084	7,940	(3,883)	-
November	(3,496)	-	-	9,033	5,253	(3,011)	-
December	(5,523)	-	-	(4,456)	5,282	(2,683)	-

- e. The attached excel file contains the calculations used in the responses for items a – d above.



"Gas Earnings  
Calculations S-87.xls"

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.  
GAS RATE CASE 03-G-1671  
STEAM RATE CASE 03-S-1672

State of New York Department of Public Service: Interrogatory No. 88

Responding Witness: Edward J. Rasmussen

Question:

- a. Please provide CECONY's stand-alone earned ROE for its steam business by month since it departed from the Policy Statement.
- b. Please provide an estimate of what CECONY's stand-alone earned ROE for its steam business would have been by month for the same period, had it remained on the Policy Statement.
- c. Please calculate the dollar amount of additional earnings for CECONY's steam business that were generated by departing from the Policy Statement.
- d. Please specify the amount of these extra earnings that were shared with ratepayers.
- e. Please provide the calculations and workpapers supporting the response to (d).

Response

- f. The table below shows CECONY's stand-alone earned ROE for its steam business by month since it departed from the Policy Statement.

**Con Edison Company of New York, Inc.**  
Earned Return on Equity - Steam Operations

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
January		7.34%	1.44%	1.30%	6.00%	0.86%	8.07%
February		7.26%	1.51%	2.51%	4.65%	0.21%	8.64%
March		7.83%	1.69%	1.42%	6.79%	-1.88%	10.32%
April	7.81%	7.04%	2.55%	0.59%	6.39%	-1.75%	10.88%
May	8.52%	6.77%	2.14%	0.57%	6.08%	-0.83%	8.28%
June	7.65%	6.81%	2.30%	0.44%	6.06%	-1.18%	7.05%
July	7.55%	6.04%	1.54%	0.83%	5.79%	1.42%	5.11%
August	7.57%	5.94%	1.18%	-0.20%	6.79%	1.42%	4.94%
September	7.85%	4.85%	1.37%	-1.54%	8.18%	0.65%	5.83%
October	8.85%	4.42%	1.11%	-1.93%	8.90%	1.10%	4.46%
November	9.94%	3.52%	0.91%	-1.33%	8.97%	1.20%	4.38%
December	8.50%	1.64%	1.32%	2.65%	3.45%	6.87%	

- g. The table below shows an estimate of what CECONY's stand-alone earned ROE for its steam business would have been by month for the same period, had it remained on the Policy Statement.

**Con Edison Company of New York, Inc.**

## Estimated Return on Equity On Policy Statement - Steam Operations

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
January		7.21%	1.08%	0.31%	3.01%	-0.30%	7.17%
February		7.11%	1.12%	1.29%	1.61%	-1.00%	10.28%
March		7.66%	1.26%	-0.08%	3.68%	-3.06%	11.60%
April	7.53%	6.85%	2.09%	-1.15%	3.22%	-2.91%	12.05%
May	8.24%	6.56%	1.65%	-1.44%	2.85%	-1.98%	10.80%
June	7.36%	6.58%	1.77%	-1.84%	2.78%	-2.31%	9.92%
July	7.26%	5.80%	0.98%	-1.71%	2.45%	0.31%	8.03%
August	7.27%	5.68%	0.57%	-2.98%	3.40%	0.33%	7.95%
September	7.31%	4.57%	0.73%	-4.58%	4.73%	-0.41%	8.93%
October	8.31%	4.12%	0.44%	-5.22%	5.42%	0.06%	7.39%
November	9.40%	3.20%	0.20%	-4.84%	5.45%	0.17%	7.05%
December	7.96%	1.31%	0.57%	-1.10%	-0.12%	5.86%	

- h. The table below shows the dollar amount of additional earnings for CECONY's steam business that were generated by departing from the Policy Statement. It should be noted that the amounts shown by month represent rolling twelve months cumulative totals and are not additive.

**Con Edison Company of New York, Inc.**Estimated Earnings Resulting from  
Not Being On Policy Statement - Steam Operations

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
January	-	344	954	2,475	6,908	2,734	2,244
February	-	392	1,041	3,035	7,038	2,710	2,019
March	-	439	1,129	3,594	7,167	2,686	1,793
April	1,260	487	1,216	4,155	7,296	2,662	1,568
May	1,273	534	1,303	4,715	7,425	2,638	1,344
June	1,286	582	1,390	5,275	7,554	2,614	1,119
July	1,300	630	1,478	5,835	7,684	2,589	893
August	1,313	677	1,565	6,395	7,813	2,565	668
September	1,326	725	1,652	6,956	7,942	2,541	443
October	1,339	772	1,739	7,516	8,071	2,517	218
November	1,352	820	1,827	8,076	8,200	2,493	(7)
December	1,365	867	1,914	8,636	8,330	2,469	-

- i. The table below shows a calculation of the theoretical amount of these extra earnings that would be shared with ratepayers. The actual overearnings calculation will be done on a cumulative basis over the term of the current rate agreement, periodic spikes in earnings during one fiscal period do not represent the actual amounts to be deferred for the customers benefit. The numbers on the table represent variations from overearnings accruals recorded by the Company.

**Con Edison Company of New York, Inc.**  
**Estimated Overearnings Earnings Resulting From**  
**Not Being On Policy Statement - Gas Operations**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
January	\$-	\$-	\$-	\$-	\$-	\$-	\$-
February	-	-	-	-	-	-	-
March	-	-	-	-	-	-	(2,785)
April	-	-	-	-	-	-	(3,980)
May	-	-	-	-	-	-	(764)
June	-	-	-	-	-	-	-
July	-	-	-	-	-	-	-
August	-	-	-	-	-	-	-
September	-	-	-	-	-	-	-
October	-	-	-	-	-	-	-
November	-	-	-	-	-	-	-
December	-	-	-	-	-	-	-

- j. The attached excel file contains the calculations used in the responses for items a – d above.



"Steam Earnings  
Calculation S-88.xls"

Question No. 320:

- a. Were the security measures incurred as the result of a government mandate?
- b. If the response to (a) is yes, please identify the each mandate and the costs associated therewith.

Response:

a-b: The security costs described in the response to question 319 are for security patrols at Con Edison's critical gas facilities initially implemented following the September 11, 2001 attack on the World Trade Center and continuing under the "Elevated Condition (Yellow) and the "High Condition (Orange)" levels of the terrorist threat level conditions specified in the Homeland Security Advisory System ("HSAS"), as required by the Office of Pipeline Safety, US Department of Transportation.

On September 5, 2002, the Research and Special Programs Administration's Office of Pipeline Safety, US Department of Transportation (RSPA/OPS) issued the *Pipeline Security Information Circular* ("*Circular*") and *Pipeline Security Contingency Planning Guidance* ("*Guidance Document*"). The *Circular* identifies actions that transmission and distribution pipeline operators should implement to protect the security of critical pipeline facilities. The *Guidance Document* contains guidelines for protective measures, including security patrols, under the HSAS threat conditions. The *Circular* required that intrastate pipeline operators submit to the State pipeline safety regulatory agency a written statement confirming that they are implementing the measures stated in the *Circular* and the *Guidance Document*. Con Edison submitted its written statement to the Department of Public Service by letter dated March 5, 2003.

As mentioned in response to question 319, the vast majority of the WTC gas security money was spent on patrolling unmanned gas facilities. At level Yellow, patrols are done at nine facilities, twice per day, seven days per week. At level Orange, patrols occurred the same as Yellow, plus seven additional facilities twice per day and seven additional facilities once per day.

*Testimony*

BEFORE THE  
STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

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In the Matter of

Case 03-G-1671

Case 03-S-1672

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

Gas and Steam Rates

March 2004

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Prepared Testimony of

JOHN J. DOWLING, P.E.

Associate

Luthin Associates

15 Walling Place

Avon-By-The-Sea, New Jersey 07717

Q. Please state your name and business address.

1

2 A. My name is John J. Dowling, and my business address is 15 Walling  
3 place, Avon-By-The-Sea, New Jersey 07717.

4

5 Q. What is your educational background and experience?

6 A. I received a Bachelor of Engineering degree in Mechanical Engineering  
7 from Polytechnic University, then known as the Polytechnic Institute of  
8 Brooklyn, in 1970. Upon graduation, I accepted employment with the New

Testimony of John J. Dowling, P.E.

1 York State Department of Public Service. My responsibilities have included  
2 all engineering analyses for major rate cases, as well as review of operating  
3 practices and construction programs

4

5 Q. Have you previously testified before the New York State Public Service  
6 Commission?

7 A. Yes. I have presented testimony in a variety of proceedings before this  
8 Commission.

9

10 Q. What is the purpose this your testimony?

11 A. My purpose is to discuss the various aspects of the proposed gas and steam  
12 rate designs, and I will address the recovery of Lost and unaccounted for Gas.

13

14 **Steam Sales**

15 Q. Do you agree that steam sales are in an irreversible decline?

16 A. No. The fundamental benefits of steam service are too great to conclude  
17 that this service is inevitably in decline. Those benefits include increased  
18 fuel diversity and fuel switching opportunities available at central  
19 generators, reduced fuel storage mechanical equipment installations at the  
20 customers' sites and, particularly in the case of steam absorption chillers,  
21 reduced demand on the electric distribution and generation systems. All

Testimony of John J. Dowling, P.E.

1       these factors suggest that the Commission should maintain its strong  
2       support for continuation of steam service at competitive prices.

3

4       Q. What should the Company do to support steam sales?

5       A. First, the Company should provide for discounted rates for large  
6       incremental loads, particularly summer loads. These discounted rates could  
7       be limited to buildings equal to or greater than 150,000 gross square feet of  
8       space. The minimum rate allowable for such incremental load should be at  
9       least equal to the incremental fuel cost plus incremental line losses. Further,  
10      because capital costs are significantly greater for steam chillers than for  
11      electric compressor chillers, the Company should develop a program to  
12      finance the installation of steam chillers both in new installations and in  
13      replacement projects.

14

15      Q. Is not this last proposal an interference in the market for building  
16      equipment, and by implication an interference in the energy markets?

17      A. Not at all. In many unregulated markets, durable goods suppliers finance  
18      the purchase of equipment. There are numerous examples of this in the home  
19      appliance and consumer electronics market, as well as the automobile  
20      industry, which was the first to adopt that business model on a large scale.

Testimony of John I. Dowling, P.E.

1 Further, efficient competitive development of all the energy markets,  
2 including the electricity and steam markets, will minimize the need for public  
3 agencies to build new electric generation to insure adequate reliability.

4

5 Q. Why are the financial opportunities available to developers and operators  
6 not sufficient to allow development of the steam system?

7 A. The financial decisions of developers and lenders are often based on  
8 relatively short term considerations. The benefits of energy efficiency to the  
9 developer must often be amortized over an extended period. Moreover, some  
10 of those benefits, such as reduced pressure on the electricity system, are not  
11 available directly to the individual developer or operator at all. In this  
12 situation, it is good public policy, as well as good business practice, to make  
13 available another source of funds directed toward the development of an  
14 important component of the utility infrastructure, in this case the steam  
15 system.

16

17 **Steam Rate Design**

18 Q. Describe the company's proposal to apply an Access Charge to its steam  
19 rates.

20 A. The proposed Access charge is based on the customer's historic steam use,  
21 or rather the customer's contribution to total net revenue requirement in the

Testimony of John J. Dowling, P.E.

1 past. As it would be determined by past usage, both the individual's and the  
2 total system usage, customers can not only unable to affect this part of the bill,  
3 they cannot determine what effect this change may have on them. Most larger  
4 customers cannot even determine whether this will be the ultimate rate form,  
5 or whether they will be converted to Contract Demand rates in the third year  
6 of the proposal.

7

8 Q. Is the Access Charge a "surrogate for a demand charge," as stated by the  
9 Steam Rate Panel?

10 A. No. This charge is simply a Customer Charge by another name.

11

12 Q. Do you support the propose Contract Demand Charge?

13 A. No. The Contract Demand Charge is different from a traditional Demand  
14 Charge only to the extent that the demand value will never decrease,  
15 regardless of any change in the customer's use. While the Commission has  
16 approved Contract Demand Charge for electric Standby Rates, the  
17 considerations relative to that service hardly apply to other utility services. In  
18 Standby Rates, the underlying service is to provide reliable backup to loads  
19 that may never require it. In fact, these facilities may be designed to operate  
20 without resorting to the full standby demand at all. Nevertheless, the  
21 Company still accepts the obligation to maintain facilities to meet that

Testimony of John J. Dowling, P.E.

1 Contract Demand. In this case, the use of Contract Demand would be an  
2 unnecessary burden on any customer whose steam use was permanently or  
3 temporarily reduced, a would be the case of a building which was  
4 experiencing reduced occupancy, or perhaps closed for an extended period of  
5 renovation. It is not necessary for such customers to guarantee the monthly  
6 cash flow of a major utility, particularly one as financial stable as Con Edison.

7

8 Q. In the event that the Contract Demand Charge and the Access Charge is  
9 rejected, the company has proposed to add a Weather Normalization Clause  
10 (WNC) to its steam rates. Do you support this?

11 A. No. Again, this is an unnecessary guarantee of cash flow to Con Edison,  
12 funded by unwilling customers. The variability of steam sales due to weather  
13 is hardly a threat to the Company's financial position.

14

15 **Interruptible Gas Minimum Charge**

16

17 Q. Do you support the Company's proposal to add a new minimum charge to  
18 Interruptible Gas Service?

19 A. No. This is unnecessary change to the terms and conditions of service.  
20 Requiring minimum volumes fundamentally alters the economic decisions  
21 such customers are faced with in a negative way. Particularly at a time when

Testimony of John J. Dowling, P.E.

1 fuel diversity and over-reliance on natural gas are serious issues of public  
2 policy, and it is short-sighted to require greater consumption of natural gas.  
3 Company does not provide greater value in exchange for this new  
4 requirement.

5

6 Q. Are you not concerned about the Company's claim that small interruptible  
7 customers are harmed by the fuel switching proclivities of the largest  
8 customers?

9 A. Those customers are not necessarily harmed by such fuel switching, but  
10 they are harmed if the company substitutes more costly supply for those  
11 customers. The correct solution for that problem is to withdraw Con Edison's  
12 authority to make mid-month rate revisions to any supply that is actually  
13 flowing at the beginning of the month, while still allowing oil users to return  
14 to gas supply at an appropriate, possibly higher, price.

15

16 Q. Does this new requirement simply bring the terms of this service in line  
17 with other dual fuel services, such as the SC12 Rate 2?

18 A. No. SC12 Rate 2 is an entirely different service, with substantially  
19 different terms and conditions, including limited interruption, the possibility  
20 of reimbursement for the cost of alternate fuel if interruptions exceed thirty  
21 days, and no authority for the Company to increase the price mid-month.

Testimony of John J. Dowling, P.E.

1 **Gas Revenue Sharing**

2 Q. Have you examined the Company's proposal for sharing net revenues  
3 related to non-firm sales?

4 A. Yes. The Company has proposed to retain 80% of the non-firm net  
5 revenues in excess of \$15 million annually. The current tariff requires the  
6 Company to flow through to customers \$100 of the first \$35 million, 80% of  
7 the next \$35 million, and 90% of the excess over \$70 million. At the  
8 company's expected level of non-firm revenue, the total customer benefit  
9 would be reduced from \$39 million to \$33.8 million. The Company's  
10 incremental share of incremental revenue would increase from 10% or 20% to  
11 25%.

12

13 Q. Do you support this change?

14 A. No. This proposal both reduces the customers' incremental share of these  
15 revenues, and the total amount applied to reduce bills. As illustrated by the  
16 Company's proposal to increase the amortization of interruptible plant, the  
17 firm customer is the ultimate guarantor of the unrecovered costs of non-firm  
18 services. As such 100% of non-firm revenue should be equitably applied to  
19 reduce firm rates. However, in the interest of providing incentives for Con

Testimony of John J. Dowling, P.E.

1 Edison to fulfill its mission to provide energy services to the non-firm market,  
2 I propose that it be allowed to retain the 10% of net non-firm revenue in  
3 excess of \$35 million.

4

5 **Other Changes to Non-Firm Sales**

6 Q. Do you have any other proposals to mitigate the regrettable effects of the  
7 proposed rate increases?

8 A. Yes. Many of the Company's fuel-switching customers prefer price  
9 certainty over a strategy based strictly on minimizing costs. For these  
10 customers, Con Edison should offer an optional non-firm service, at a  
11 negotiated price, which would differ from current services in that, to the  
12 extent Con Edison requires interruption; the Company would reimburse the  
13 customer the cost of his or her alternate fuel, at the customers' inventory  
14 price. For customers, this provides the benefit of some supply and price  
15 certainty, while allowing Con Edison to target interruptions to the cheapest  
16 source of replacement fuel.

17

18 **Lost and Unaccounted for Gas**

19 Q. What is the Company's proposal for recovery of the cost of Lost and  
20 Unaccounted for Gas?

Testimony of John J. Dowling, P.E.

1 A. The Company has proposed a bifurcated cost recovery to replace the  
2 incentive recovery now in place. This approach would apply a fixed Lost and  
3 Unaccounted for Gas Factor (LAUF) to transportation gas throughput, and an  
4 implied factor developed by changing the basis for the computation of the  
5 Average Cost of Gas (ACOG). This implied factor would effectively be  
6 updated monthly. The new computation of the ACOG would use gas  
7 purchases for resale as its divisor, rather than the current divisor of gas  
8 purchases. By using sales volumes as the divisor, there is no need to add a  
9 LAUF, because the "lost" volumes are not in the divisor.

10

11 Q. What is wrong with that approach?

12 A. There are two problems. First, because of timing differences between the  
13 reading dates of the purchase meters and the sales meters, there can be large  
14 monthly variations in the difference between sales and purchase volumes,  
15 leading to volatility. Second, because purchases can be measured only by  
16 subtracting volumes injected for transportation service, and because a fixed  
17 LAUF applies to the volumes, any mismatch between actual lost and  
18 unaccounted for gas volumes for transportation and the fixed factor will  
19 automatically be recovered from sales customers. This is inequitable on its  
20 ace. Third, the automatic full recovery of losses diminishes the incentive for  
21 the Company to control this expense. The current incentive has been

Testimony of John J. Dowling, P.E.

1 effective, and while retaining it may no longer be necessary, guaranteed full  
2 recovery of this cost is unwarranted.

3

4 Q. Does this conclude your pre-filed testimony?

5 A. Yes.

6

7

8

**COUCH  
WHITE**

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*Testimony*

March 16, 2004

**VIA HAND DELIVERY**

Hon. Jaclyn Brilling  
Secretary  
State of New York Public  
Service Commission  
Three Empire State Plaza  
Albany, New York 12223-1350

*Orig Files  
C 03-G-1671 et al  
Copies:  
Mr K. Lang  
Mr. P. Catalano  
ALJ Bouteiller*

Re: Case 03-G-1671 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Gas Service

Case 03-S-1672 - 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

Dear Secretary Brilling:

Enclosed are an original and five (5) copies of the pre-filed Direct Testimony of Dr. Alan Rosenberg and Direct Testimony of Mr. Paul Chernick filed on behalf of the City of New York in the above-captioned proceedings. Please have the extra copies of the testimony time-stamped and returned to our messenger.

Please call me if you have any questions.

Very truly yours,

COUCH WHITE, LLP

*Robert M Loughney*  
Robert M. Loughney

RML/slg  
Enclosures

cc: ALJ William Bouteiller (via Hand Delivery; w/enc.)  
Active Parties List (via e-mail and U.S. Mail; w/enc.)

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**ORIGINAL**

Before the  
**New York Public Service Commission**

Case Nos. 03-G-1671 | 03-S-1672

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**CONSOLIDATED EDISON COMPANY  
OF NEW YORK**

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Direct Testimony of  
**Dr. Alan Rosenberg**

On Behalf of  
**The City of New York**

March 2004  
Project 8165



**BRUBAKER & ASSOCIATES, INC.**  
ST. LOUIS, MO 63141-2000

Before the  
New York Public Service Commission

CONSOLIDATED EDISON COMPANY OF NEW YORK

Case Nos. 03-G-1671 | 03-S-1672

Direct Testimony of Dr. Alan Rosenberg

1 Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A My name is Dr. Alan Rosenberg. My business address is 1215 Fern Ridge Parkway,  
3 Suite 208; St. Louis, MO 63141-2000.

4 Q WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?

5 A I am a consultant in the field of public utility regulation with Brubaker & Associates,  
6 Inc. (BAI), energy, economic and regulatory consultants. My Qualifications are  
7 attached as Appendix A.

8 Q ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY IN THIS  
9 PROCEEDING?

10 A I am testifying on behalf of the City of New York.

11 Q HAVE YOU PREVIOUSLY TESTIFIED IN RATE PROCEEDINGS BEFORE THIS  
12 COMMISSION?

13 A I have testified before the New York PSC on numerous occasions over the past 20  
14 years, including proceedings involving Con Edison.

1 Q WHAT IS THE SUBJECT MATTER OF YOUR TESTIMONY?

2 A I have been asked to review Con Edison's proposal on revenue sharing in the gas  
3 case, as well as selected issues on both gas and steam rate design particularly as  
4 the latter may affect the Company's lethargic steam sales. My silence on any issue  
5 not explicitly addressed in this testimony should not necessarily be construed as  
6 agreement with the Company's view.

7 **Non-Firm Gas Revenue Sharing**

8 Q HOW IS REVENUE FROM NON-FIRM CUSTOMERS TREATED FOR RATE  
9 MAKING PURPOSES?

10 A Currently, all fixed costs are allocated to firm customers. Consequently, in theory, all  
11 revenues from non-firm customers should be passed back to these firm customers.  
12 Typically, this is done with some type of continuing rider or rate adjustment  
13 mechanism.

14 Because all fixed costs are assumed to be recovered from firm customers, for  
15 the utility to retain any portion of these non-firm revenues would imply that the utility is  
16 earning more than its authorized return on equity. (I am tacitly assuming, of course,  
17 that the rate year assumptions turn out as forecasted and approved by the  
18 Commission. However, that is always an implicit assumption in ratemaking.)

19 Q IS THERE ANYTHING NECESSARILY WRONG WITH SIMPLY RETURNING  
20 THESE NON-FIRM REVENUES TO THE FIRM CUSTOMERS?

21 A No. However, treating non-firm revenues in this fashion, i.e. passing 100% of the  
22 revenues back to the firm customers, is sometimes said to leave the utility without an  
23 incentive to maximize these non-firm revenues. The counter argument is that a utility

1 has an obligation to provide service at the lowest reasonable cost. To the extent that  
2 maximizing throughput on the system minimizes the unit cost, it could also be said  
3 that the utility always has this motivation or else it would risk being found imprudent.

4 **Q HOW CAN THE UTILITY BE FINANCIALLY MOTIVATED, IN A POSITIVE**  
5 **FASHION, TO MAXIMIZE THE NON-FIRM REVENUES?**

6 A There are two methods for financially motivating the utility to maximize non-firm  
7 revenues. The first is to impute a certain amount of non-firm revenues as an offset to  
8 costs when designing the firm rates. This gives the utility the maximum incentive to  
9 achieve at least the imputed level of non-firm revenues. The second is to institute a  
10 form of sharing the non-firm revenues, beyond the imputed amount, between the firm  
11 customers and the utility. Because all these non-firm revenues rightfully belong to the  
12 firm customers, the sharing formula must be weighted predominantly to the  
13 customers.

14 **Q WHAT IS THE CURRENT RATEMAKING ARRANGEMENT FOR NON-FIRM**  
15 **REVENUE SHARING?**

16 A As I understand the Gas Rate Panel, currently no imputation is made. However, all  
17 (100%) of non-firm revenues, up to \$35 million, is returned back to the firm  
18 customers. Between \$35 million and \$70 million, the sharing is 80% to customers  
19 and 20% retained by the Company. All revenues in excess of \$70 million are shared  
20 90%/10%.

1 Q HOW HAS THE COMPANY FARED UNDER THE REVENUE SHARING  
2 ARRANGEMENT IN PREVIOUS YEARS?

3 A According to the response to the City's Interrogatory #36, Con Edison has improved  
4 its return on equity anywhere from 24 to 59 basis points as a result of its retention of  
5 a share of non-firm gas revenues.

6 Q IS THE COMPANY PROPOSING TO CHANGE THIS FORMULA?

7 A Yes. Apparently, it is not satisfied with the current arrangement.

8 Q HOW IS IT PROPOSING TO CHANGE THE FORMULA?

9 A The Company is proposing to impute \$15 million of non-firm revenues as an offset to  
10 the costs allocated to the firm customers. Then it is proposing to retain 25% of all  
11 non-firm revenues in excess of \$15 million.

12 The following table illustrates the change to the formula that Con Edison is  
13 proposing.

<u>Non-Firm Revenue Level</u>	<u>Share Retained by Con Edison</u>	
	<u>Current</u>	<u>Proposed</u>
Zero to \$15 Million	0%	0% (Imputed)
\$15 to \$35 Million	0%	25%
\$35 to \$70 Million	20%	25%
Over \$70 Million	10%	25%

1 Q HOW DOES THE PANEL SUPPORT THE \$15 MILLION LEVEL OF IMPUTATION?

2 A They do not. Although the Panel cites to Mr. Muccilo's testimony (Gas Rate Panel,  
3 p. 40), neither the Panel nor Mr. Muccilo provide any justification for the  
4 reasonableness of a \$15 million imputation as opposed to, for example, a \$40 or  
5 \$50 million imputation.

6 Q WHAT IS THE OSTENSIBLE REASON GIVEN BY THE PANEL FOR CHANGING  
7 THE FORMULA FROM THE CURRENT METHODOLOGY?

8 A According to the Rate Panel, the Company is proposing this change to "mitigate the  
9 effect of the proposed increase". (Gas Rate Panel, p. 40.)

10 Q DO YOU AGREE WITH THE PANEL?

11 A In view of the very large increase being sought by the Company, I agree that the  
12 Commission ought to do what is possible to mitigate the increase. However, what the  
13 Company is proposing does **not** mitigate the increase, it **exacerbates** it.

14 Q PLEASE EXPLAIN HOW THE PANEL'S PROPOSAL EXACERBATES THE  
15 INCREASE.

16 A Con Edison itself estimates non-firm revenues for the Rate Year in the range of \$40  
17 million. Assuming non-firm revenues of that level, under the current formula, \$39  
18 million would be returned to firm customers. Under the Panel's proposed change to  
19 the formula, only \$33.8 million would be provided to these customers. **In other**  
20 **words, the Company proposal would result in a further increase to the**  
21 **Company's revenues of \$5.2 million compared to the current formula.** I do not  
22 consider this to be mitigation.

1 Q WHAT WOULD BE THE RESULT OF THE COMPANY'S PROPOSAL IF CON  
2 EDISON ACHIEVED JUST THE AVERAGE OF THE NON-FIRM REVENUES THAT  
3 IT HAS ACHIEVED THE PAST SEVERAL YEARS?

4 A According to the response to Data Request G-135, I calculate that the average non-  
5 firm revenues achieved for Rate Years 1997 through 2003, was approximately \$60  
6 million. **If that level was attained in the Rate Year, the consequences of Con**  
7 **Edison's proposal would be that it would retain \$17.5 million in additional**  
8 **revenues, an increase of \$12.5 million compared to the current formula.**  
9 Remember, all this money is in addition to its authorized rate of return.

10 Q HOW WOULD YOU PROPOSE TO CHANGE THE SHARING FORMULA SO THAT  
11 IT ACHIEVES ITS PURPOSE OF MITIGATING THE INCREASE?

12 A I recommend imputing the Company forecast of \$40 million in non-firm revenues as  
13 an offset to the revenue requirement. This poses minimal risk to Con Edison  
14 because:

- 15 • \$40 million is Con Edison's own forecast.
- 16 • Since 1996, the smallest amount of non-firm revenue that has been achieved  
17 is \$54 million. (Reference responses to Requests G-135 and G-136)
- 18 • The Company is striving to maximize the revenue derived from non-firm  
19 transactions.

20 For revenues between \$40 million and \$70 million, I recommend a sharing of  
21 85%/15%. For revenues over \$70 million (as did happen in Rate Year 2000), I would  
22 accept the Company proposal for a 75%/25% sharing (instead of the 90%/10% that  
23 exists now).

1           The following table compares my recommendation on revenue sharing with  
2           the situation, as it currently exists.

<u>Non-Firm Revenue Level</u>	<u>Share Retained by Con Edison</u>	
	<u>Current</u>	<u>Recommended</u>
Zero to \$35 Million	0%	0% (Imputed)
\$35 to \$40 Million	20%	0% (Imputed)
\$40 to \$70 Million	20%	15%
Over \$70 Million	10%	25%

3   **Q    HOW WOULD YOUR PROPOSAL MITIGATE THE CURRENT INCREASE?**

4   A    If the forecasted non-firm revenue target is achieved (\$40 million), my  
5        recommendation would imply a mitigation of \$1 million, or less than 1% of the  
6        requested increase, compared to the current sharing methodology. Of course, if non-  
7        firm revenues were just the average of what they had been for the years 1997  
8        through 2003 (\$60 million), the mitigation would be \$2 million. Consequently, my  
9        recommendation is quite modest.

10   **Q    IS IT POSSIBLE FOR YOUR FORMULA TO RESULT IN A LARGER RETENTION**  
11        **OF NON-FIRM REVENUES BY CON EDISON THAN WOULD RESULT UNDER**  
12        **THE CURRENT FORMULA?**

13   A    Yes. I estimate that for non-firm revenues in excess of \$87 million, Con Edison would  
14        retain more in non-firm revenues under my recommendation than under the current

1 formula. Thus, my proposal provides strong motivation for Con Edison to maximize  
2 these non-firm revenues.

3 **Gas Rate Design**

4 **Q IS THE COMPANY PROPOSING TO MAKE ANY CHANGES TO INTERRUPTIBLE**  
5 **RATES?**

6 A Yes, the Company states that there is one change being proposed. The Company is  
7 proposing to impose a minimum charge on S.C. 9 (Rate B) and S.C. 12 (rate 1)  
8 interruptible customers (and off-peak users) whose estimated annual usage exceeds  
9 1.0 million therms (Gas Rate Panel, p. 36). The monthly minimum charge would be  
10 computed by applying the monthly delivery rates to 50% of the customer's average  
11 daily usage (estimated annual usage divided by 365 days), and multiplying that  
12 amount by the number of days in the monthly billing period.

13 **Q WHAT IS THE COMPANY'S RATIONALE FOR THIS PROPOSAL?**

14 A The Company gives two alleged reasons for this change. First, the Company claims  
15 that the change is needed to protect the interests of smaller interruptible customers.  
16 The Company claims that larger interruptible customers switch back and forth  
17 between gas and alternate fuel, thereby driving the gas costs up for other customers.  
18 Second, the Company alleges that this change is justified by the change in the rules,  
19 which now state that interruptible customers in New York City have priority over sales  
20 of excess gas to off-system markets.

1 Q DO YOU AGREE WITH THE COMPANY PROPOSAL?

2 A No. Charging what amounts to a "take or pay" access charge for interruptible service  
3 is totally averse to the notion of interruptible service, which may or may not be there.  
4 Interruptible service is an opportunity service and should not be subject to any  
5 minimums other than a cost-based customer charge. Moreover, the cut-off point of  
6 1.0 million therms annually is totally arbitrary, and could result in disparate and  
7 unreasonable results. For example, two customers with similar actual usage paying  
8 different rates based simply on an estimate of usage in the upcoming year. Finally,  
9 there is absolutely no justification given for the 50% level as opposed to, for instance,  
10 a 10% or 20% minimum.

11 Q PLEASE PROVIDE AN EXAMPLE OF HOW THE CUT-OFF POINT COULD LEAD  
12 TO DISPARATE RESULTS.

13 A Suppose that a customer with historical usage of 2 million therms only uses 800,000  
14 therms in a future year. Under the Company proposal, this customer would pay more  
15 than another customer who also used 800,000 therms but was not subject to the  
16 minimum bill provision.

17 Q WHAT OUTCOME COULD RESULT FROM THIS "MINIMUM BILL" PROPOSAL?

18 A Customers who are unsure of their usage could decide to cease (or be deterred from  
19 ever starting) gas service altogether since there is no comparable "minimum bill"  
20 associated with the use of alternative fuel. This could reduce the amount of  
21 interruptible or off-peak revenues available to firm customers and Con Edison. I do  
22 not see how such an outcome could benefit anyone, including Con Edison.

1 Q IS THE MINIMUM CHARGE NEEDED TO PROTECT THE INTERESTS OF  
2 SMALLER INTERRUPTIBLE CUSTOMERS?

3 A No. First and foremost, I did not notice any provision in the Company's testimony  
4 explaining how they were going to return any of the revenues received as a result of  
5 the minimum (which the Company estimates at \$145,000) to these customers that are  
6 in alleged need of "protection". Allowing the Company to retain these revenues only  
7 protects the Company.

8 Secondly, the entire premise that certain customers need protection is  
9 hypothetical and devoid of any factual support. The Company has provided no  
10 evidence, in either pre-filed testimony or during discovery, that larger customers  
11 switch from gas to alternative supplies and back to gas with any more alacrity than do  
12 smaller customers. In fact, it acknowledged that it had not analyzed any historic data  
13 to support this assertion. (Response to Staff Interrogatory G-147). Furthermore, the  
14 Company has provided no data that shows that switching fuels causes gas costs to  
15 increase in comparison to what those costs would have been otherwise. (Moreover, if  
16 that were true, the Company should be proposing to charge firm users a lower  
17 commodity cost of gas than interruptible customers because presumably those  
18 customers do not switch between gas and alternative fuel. The Company is making  
19 no such proposal.)

20 Finally, the Company projects that the minimum bill provision will affect only  
21 six of 1,253 interruptible customers and result in total annual revenues of \$145,000.  
22 As noted above, the Company has not adequately justified singling out these six  
23 customers for such a discriminatory rate, nor has it considered the potential  
24 consequences (i.e., loss of revenues) associated with such an unusual requirement  
25 for interruptible service.

1 Q DO YOU AGREE WITH THE COMPANY THAT THEIR MINIMUM BILL PROPOSAL  
2 IS CONSISTENT WITH THE COMMISSION'S RECENTLY ESTABLISHED  
3 CRITERIA FOR INTERRUPTIBLE SERVICE?

4 A No. The Company claims that the new criteria afford interruptible customers a "higher  
5 quality of service" because the new criteria ostensibly "does not permit interruptions  
6 for economic reasons" (Gas Rate Panel, p. 38). There are several problems,  
7 however, with that argument.

8 Initially, the Gas Rate Panel contradicts itself. Although it states that the new  
9 criteria does not permit interruptions for economic reasons, it asserts that  
10 interruptions are permitted as a means "to avert unnecessary cost burdens on firm  
11 customers". Surely, that is an economic reason.

12 In any event, there is no assurance that the new criteria will result in a "higher  
13 quality of service" than what the interruptible customers currently receive. The notice  
14 of interruption is just as short under the new criteria as before. There is no new limit  
15 on either the frequency or duration of the interruptions. Consequently, there is no  
16 evidence that interruptible customers will enjoy a "higher quality of service". For all  
17 we know, there might be more interruptions in 2004 and 2005 than there were in  
18 2002 and 2003.

19 Finally, even if we assume, for the sake of discussion, that the quality of  
20 service would be "higher", there is no cost of service evidence provided by Con  
21 Edison that the increase caused by the minimum bill would be commensurate with  
22 the alleged "higher quality of service".

1 **Steam Rate Design**

2 **Q WHAT ISSUES WILL YOU ADDRESS WITH REGARDS TO STEAM RATE**  
3 **DESIGN?**

4 A I have been asked by the City to review four issues: Con Edison's line extension  
5 policy; the Company proposal to eliminate S.C. 6, the steam transportation rate; the  
6 current S.C. 5 negotiated contract rate for load retention or new load; the continuation  
7 of the steam air conditioning rate discount; and the Company proposal to eliminate  
8 the steam variance incentive/penalty program. In general, the filing demonstrates  
9 that Con Edison's steam sales are generally flat, after adjustment for weather and  
10 that the Company and its customers would benefit from increased sales of steam.  
11 Thus, any rate design changes must include an analysis of the impact on steam  
12 sales.

13 **Q WHAT IS THE CURRENT LINE EXTENSION POLICY?**

14 A The current line extension policy states that should a main extension or reinforcement  
15 be needed to provide service, the customer must pay a prepayment to the extent that  
16 one year worth of base revenue is insufficient to cover the cost of the extension or  
17 reinforcement (Jacob, p. 10). One-tenth of the prepayment then is refunded to the  
18 customer, without interest, each year, over a ten-year period.

19 **Q HOW IS CON EDISON PROPOSING TO CHANGE THIS POLICY?**

20 A The Company is proposing to change the one-year period to a two-year period.

1 Q WHAT IS YOUR VIEW OF THE PROPOSED CHANGE?

2 A I believe that a line extension policy ought to balance two goals. The first is to  
3 expand the system and so make the service more available to potential customers.  
4 This is essential for a utility with a monopoly service and ultimately should benefit all  
5 users because of economies of scale. The second objective is to try to minimize  
6 stranded investment if a customer leaves the system. The Company's proposal  
7 represents but a small step in the right direction.

8 Q HOW WOULD YOU AMEND THE EXTENSION POLICY TO BEST BALANCE  
9 THOSE TWO OBJECTIVES?

10 A First, I recommend increasing the standard main extension allowance from 100 feet  
11 to no less than 1,000 feet. 1,000 feet is only about one east-west city block and is a  
12 more reasonable distance for the allowance. This liberalization of the extension is  
13 especially important in view of the fact that the steam grid of mains is generally less  
14 dense than that of the gas or electric system. Any customer contribution requirement  
15 would only be calculated on the basis of costs in excess of that 1,000-foot allowance.  
16 As noted earlier, Con Edison needs to take steps to increase its revenues and add  
17 new load. Extending the standard extension allowance should help to spur growth by  
18 eliminating or reducing prepayment fees.

19 Second, rather than require a prepayment, I would instead recommend a  
20 back-loaded fee in aid of construction that would equal any positive difference  
21 between the cost of the extension and the non-fuel base revenues received over ten  
22 years. This fee also should be apportioned proportionately between all customers  
23 who take service on the new extension/reinforcement. (Of course, should a customer  
24 not be creditworthy, or if there is reason to believe that a particular end-use is

1 transitory, exceptions could be allowed.) Again, this change should help to spur  
2 growth on the system by eliminating potentially burdensome up-front payments.

3 Finally, in the event the Commission rejects my recommendation for a back-  
4 loaded fee in aid of construction, the two-year assessment of revenues proposed by  
5 Con Edison should be the minimum number of years utilized for the assessment.  
6 Depending on the type of customer and potential expanded or new load involved, it  
7 may be that a longer revenue assessment period should be utilized. For example,  
8 expanded or new City or hospital or university facilities represent little risk of flight, or  
9 stranded investment, to Con Edison and, therefore, a longer revenue assessment  
10 period may be justified. Con Edison should be required to perform a customer-  
11 specific revenue assessment, subject to Commission review.

12 **Q WHAT IS THE COMPANY PROPOSING TO DO WITH S.C. 6, THE STEAM**  
13 **TRANSPORTATION TARIFF?**

14 **A** The Company is proposing to eliminate this tariff because there are no subscribers to  
15 this tariff (Jacob, p. 10).

16 **Q DO YOU AGREE WITH THAT PROPOSAL?**

17 **A** No. The Company only reluctantly agreed to institute S.C. 6 in the last rate case,  
18 only a few years ago. I would recommend that the Commission direct Con Edison to  
19 investigate why customers have not utilized that tariff. Certainly there was interest in  
20 the tariff in the last case. Perhaps the rates are too high, the scheduling conditions  
21 are too onerous or the Company has not made its customers sufficiently aware of the  
22 availability of the tariff. In any event, as noted earlier, the Company should be taking

1 every reasonable step to increase throughput, and eliminating the S.C. 6 tariff is not  
2 consistent with that goal.

3 **Q THE COMPANY STATES THAT THE COST OF PROVIDING THIS SERVICE IS**  
4 **"HIGHLY DEPENDENT UPON SITE SPECIFIC CIRCUMSTANCES AND "MAY**  
5 **NOT BE COST-BASED." IS THIS A REASON TO JETTISON THE TARIFF?**

6 A No. In the first place, the Company has provided no evidence to support this  
7 assertion. In fact, I do not even know how they would gather such evidence since  
8 there are no customers on the rate. Second, on the gas system, the Company's  
9 position is that the cost of transporting gas is the same for a customer buying gas  
10 from a third party as for a similarly situated customer who buys gas from the  
11 Company. The situation should be no different with steam. In short, there is no  
12 basis for concluding that rates under S.C. 6 are not cost-based.

13 **Q DO YOU HAVE ANY RECOMMENDED CHANGES TO S.C. 5, THE SPECIAL**  
14 **CONTRACT RATE?**

15 A Yes. Based on the evidence I have seen, the rate may not be accomplishing its  
16 objective. For example, in the year ended June, 2003, S.C. 5 sales were less than  
17 one-half of one percent of total sales, and the average revenue was almost \$15.00  
18 per one thousand pounds, not a particularly attractive rate. These results would  
19 suggest that the S.C. 5 tariff is underutilized, which is disappointing. Con Edison  
20 should be utilizing the S.C. 5 tariff to compete with other fuels and maximize steam  
21 revenues.

**Q PLEASE CONTINUE.**

A I have reviewed the S.C. 5 tariff and it appears to provide the Company with reasonable amount of discretion to enter into contracts to attract or retain steam customers. Therefore, the underutilization of the tariff must be attributable to either the Company's implementation of the tariff or its lack of promotion of the tariff, or both. Given that the Company and its customers will benefit from increased throughput, the Commission should review the lackluster utilization of the S.C. 5 tariff.

1 **Q DO YOU HAVE ANY SUGGESTIONS FOR INCREASING THE EFFICACY OF**  
2 **S.C. 5?**

3 A Yes. First, I would suggest adding the term "short run" before the word marginal cost.  
4 If there is excess capacity on the steam system, as there appears to be, there is no  
5 reason to overstate marginal costs. The marginal cost should only be the actual  
6 incremental cost that would be incurred to meet the additional usage on S.C. 5.

7 Second, I would put a provision in the S.C. 5 tariff that states that under no  
8 circumstances can the S.C. 5 contract rate be greater than the normally applicable  
9 standard tariff in the customer's circumstances. This would encourage new load to  
10 enter into an S.C. 5 Contract with more assurance that it would not be penalized by  
11 paying more than tariff. This would help S.C. 5 achieve its stated objective, i.e. to  
12 attract new load.

13 Third, I would urge that the Company be directed to disclose its calculation of  
14 the marginal cost with all prospective applicants for S.C. 5. I believe this would  
15 encourage more new customers to consider steam as their source of energy.

16 **Q DO YOU HAVE ANY OTHER VIEWS ON CON EDISON'S DISCOUNT PROGRAM?**

1 A Yes. Special Provision E of Annual Power Service and Apartment House Service  
2 provides for a \$2.00 per Mlb discount for new air conditioning loads in excess of a  
3 certain amount. The language of the tariff appears to allow Con Edison to lower or  
4 eliminate that discount, or even let the steam air conditioning discount program lapse.  
5 Air conditioning load is clearly contra seasonal and is a way to improve the load factor  
6 and hence efficiency of the steam system. It would also reduce the stress on the  
7 electric system in the summer. It is a win-win situation. I urge the Commission to  
8 direct Con Edison to preserve the \$2.00 per Mlb discount.

9 **Q HAVE YOU REVIEWED THE COMPANY'S PROPOSED CHANGES TO THE LINE**  
10 **LOSS INCENTIVE/PENALTY MECHANISM?**

11 A Yes. Currently, steam base rates assume a loss factor of 10.9%, and that amount is  
12 imputed in rates. For losses between 10.9% and 13.5% of annual sendout, the  
13 variance above 10.9% is recovered through the steam fuel adjustment clause. To the  
14 extent that losses exceed 13.5%, the Company is penalized. To the extent that  
15 losses are less than 10.9%, the Company is allowed to retain the full savings.

16 **Q WHAT IS THE COMPANY PROPOSAL IN THIS REGARD?**

17 A The Company presents theoretical and empirical evidence that a good portion (about  
18 93% on average) of the losses are fixed in nature, and beyond the Company's  
19 control. It estimates this fixed amount at approximately 4,600 MMLb per year. Based  
20 on this evidence, the Company proposes to eliminate the incentive/penalty  
21 mechanism.

22 **Q DO YOU AGREE WITH THIS PROPOSAL?**

1 A No.

2 Q WHAT ARE YOUR RECOMMENDATIONS WITH REGARD TO THE STEAM LOSS  
3 ISSUE?

4 A I recommend removing the entire steam imputation from current base rates (and from  
5 the Company's embedded cost of service study). I make this recommendation on two  
6 grounds. First, the Company evidence shows that if steam volumes significantly  
7 increase from historical levels, it is conceivable that the loss factor percentage could  
8 drop below 10.9% (as explained by Company witness Dr. Litkhoui). If Con Edison  
9 does not file another steam case for a number of years, the Company could  
10 conceivably over collect losses under the current mechanism. Secondly, Con  
11 Edison's cost of service study allocates these losses on the basis of volume or  
12 throughput, which is totally at odds with Dr. Litkhoui's evidence.

13 Q HOW WOULD YOU PROPOSE TO RECOVER STEAM LOSSES?

14 A For steam losses up to the financial equivalent of 4,600 MMlb per year (i.e., that  
15 amount times the average heat rate times the average cost of fuel), that amount  
16 should be recovered 100% through a special loss recovery rider established for that  
17 purpose. For losses greater than 4,600 MMlb I would employ a sliding scale as  
18 follows:

	<u>Losses as a Percent of Sendout</u>	<u>Portion of Steam Losses Greater than 4,600 MMlbs That is Recoverable</u>
19	Less than 10.9%	110%
20	Between 10.9% and 13.5%	100%
21	Greater than 13.5%	90%
22		
23		
24		

1 Con Edison could reduce the losses as a percent of throughput, and thus realize a  
2 greater benefit by, for example, increasing throughput. Thus, my approach would  
3 complement my other recommendations that are directed toward increasing  
4 throughput.

5 Moreover, the loss recovery mechanism should differ by class to recognize  
6 the fixed nature of the losses. After reviewing Dr. Litkhov's evidence, I believe that  
7 recovering 50% of the losses on a customer basis and 50% on a volumetric basis  
8 would be more consistent with cost of service principles and more than fair to the  
9 smaller customers.

10 **Q ARE THERE ANY OTHER RAMIFICATIONS OF THE FIXED NATURE OF THE**  
11 **STEAM LOSSES?**

12 **A** I believe the fixed nature of the losses ought to be recognized in calculating the  
13 marginal cost for purposes of the S.C. 5 contracts.

14 **Q DOES THIS CONCLUDE YOUR TESTIMONY?**

15 **A** Yes.

Qualifications of Alan Rosenberg

1 Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A Alan Rosenberg. My business mailing address is P. O. Box 412000, 1215 Fern  
3 Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.

4 Q WHAT IS YOUR OCCUPATION?

5 A I am a consultant in the field of public utility regulation and am a principal in the firm of  
6 Brubaker & Associates, Inc. (BAI), energy, economic and regulatory consultants.

7 Q PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

8 A I was awarded a Bachelor of Science Degree from the City College of New York in  
9 1964 and a Doctorate of Philosophy in Mathematics from Brown University in 1969.  
10 Subsequently, I held an Assistant Professorship of Mathematics at Wesleyan  
11 University in Connecticut. In the summer of 1975, I was a Visiting Fellow at Yale  
12 University. From July, 1975 through January, 1981, I was Assistant Controller and  
13 Project Manager for a division of National Steel Products Company. My  
14 responsibilities there included supervision of management accounting, cost  
15 accounting and data processing functions. I was also responsible for internal control,  
16 general ledger systems, working capital levels, budget preparation, cash flow  
17 forecasts and capital expenditure analysis.

18 I have published in major academic journals and am a member of the  
19 International Association for Energy Economics. I was an invited speaker at the  
20 NARUC Introductory Regulatory Training Program and a panelist at a conference on  
21 LDC and Pipeline Ratemaking sponsored by the Institute of Gas Technology. I have  
22 presented a paper on stranded costs at the 21st Annual International Conference of

1 the International Association for Energy Economics. I have had a paper on  
2 transmission congestion pricing published in The Electricity Journal. I am also a  
3 Certified Energy Procurement Professional by the Association of Energy Engineers.

4 In January, 1982, I joined the firm of Drazen-Brubaker & Associates, Inc., the  
5 predecessor of Brubaker & Associates. Since that time, I have presented expert  
6 testimony on the subjects of industry restructuring, open access transmission,  
7 marginal and embedded class cost of service studies, prudence and used and useful  
8 issues, electric and gas rate design, revenue requirements, natural gas transportation  
9 issues, demand-side management, and forecasting.

10 I have previously testified before the Federal Energy Regulatory Commission  
11 as well as the public service commissions of Arizona, Connecticut, Delaware, Florida,  
12 Idaho, Illinois, Iowa, Massachusetts, Michigan, Montana, New Jersey, New Mexico,  
13 New York, Ohio, Pennsylvania, Rhode Island, Vermont, Virginia, Wyoming and the  
14 Provinces of Alberta, British Columbia, Nova Scotia, and Saskatchewan in Canada.

15 In addition to our main office in St. Louis, the firm also has branch offices in  
16 Denver, Colorado; Chicago, Illinois; Corpus Christi, Texas; and Plano, Texas.

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