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

Re: 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 County of Westchester's Post
Hearing "Brief in Opposition to the Joint Proposal as it Relates to the Allocation of Costs
Between the Steam System and the Electric System".

Please do not hesitate to contact me at (914) 995-3143 if you have any questions.

Very truly yours,

Stewart M. Glass

Stewart M. Glass
Senior Assistant County Attorney

SMG:me
Encl.

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Proceeding on Motion of the Commission as)
To the Rates, Charges, Rule and Regulations of) Case 03-S-1672
Consolidated Edison Company of New York, Inc.)
For Steam Service

**BRIEF IN OPPOSITION TO JOINT PROPOSAL
AS IT RELATES TO THE ALLOCATION
OF COSTS
BETWEEN THE STEAM SYSTEM & THE ELECTRIC SYSTEM**

**STATE OF NEW YORK
PUBLIC SERVICE COMMISSION**

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Case 03-S-1672

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SUMMARY

The County of Westchester submits this brief in opposition to the Joint Proposal ("JP"). The underlying facts relied upon the parties in support of the JP are incorrect and/or skewed to lead to one conclusion, that a subsidy of the steam system by the electric system is justified. Nothing can be further from the truth.

Con Edison in its Statement in Support of the JP argues that all of the fuel consumed in the gas turbines should be allocated to electric production since the gas turbines would have to be operated to produce electricity even if no steam were produced. That argument underlies the whole case in support of the JP. However, that argument overlooks two important points: (1) if there was no need for a steam facility at this location Con Edison would not have built the East River Repowering Plant ("ERRP") and (2) Con Edison designed ERRP to burn an inordinate amount of fuel, not to supply electricity but to produce extra heat for steam.

Since ERRP was constructed as a steam plant, there is no basis for the argument that all costs except those that are exclusively steam should be allocated to the electric system.

Westchester objects to the JP for the following additional reasons:

1. If there are any efficiencies or savings from the joint production of steam and electricity at ERRP they are not of the level that is being claimed and allocated to steam.
2. Contrary to a statement in the JP the proposed cost allocations set forth in Appendix F of the JP are not based on principals of cost causation because the allocation of costs ignores the fact that production of steam was the controlling factor in siting and designing ERRP.
3. Costs for recovery of capital, taxes, operation and maintenance and fuel at ERRP would be allocated largely to electric production with only some, but not all, of the costs related exclusively to production of steam being allocated to steam. This allocation ignores the fact that

ERRP was undertaken primarily to provide steam, was designed with electric generating equipment which requires an inordinately large amount of fuel to produce each kilowatt hour of electricity and assigns significantly more capital costs to electric generation than is reasonable for a plant of this size, even one located in New York City.

4. The market benefits ascribed by New York City witness Chernick to the increment of capacity and energy to be produced at ERRP are illusory. Such benefits, to the extent they might be realized, would also be realized from a plant that could have been constructed at much lower costs than is being assigned to electric generation pursuant to Appendix F.

5. Whether East River constitutes a load pocket or not is irrelevant to the allocation of ERRP costs and does not justify charging electric customers the amounts the JP would assign to them.

6. The payment by the electric system of the fixed operation and maintenance charges and property taxes on 59th Street and 74th Street stations is not justified. Absent the use of these stations for the production of steam Con Edison could have sold those properties.

**IT IS IRREFUTABLE THAT THE EAST RIVER REPOWERING PLANT ("ERRP")
WAS CONSTRUCTED PRIMARILY AS A STEAM PLANT**

The primary purpose of ERRP is the provision of steam.¹ That ERRP is primarily a steam station is shown conclusively by several statements in Con Edison's application for repowering its East River plant.² The very first page of the Application states:

By this Application, Con Edison is proposing to repower its East River Generating Station primarily to replace the steam supply from the Waterside Station.

¹ Article X Pre-Application, Article X Application, TR 122 ll. 3-7

² Case 99-F-1314, Application of Consolidated Edison Company of New York, Inc. for a Certificate of Environmental Compatibility and Public Need to Repower its East River Generating station located in the Borough of Manhattan, New York City

At 2-2 the Application states:

Although the electric generation lost through the Waterside Station's retirement could be replaced by any new ...generation within the in-City market, there is no excess steam generating capacity available to replace its steam sendout. The Waterside Station now provides nearly 20 percent of the steam system's generating capacity and about 30 percent of the total steam sendout. Replacement of the Waterside Station with a state-of-the-art cogeneration facility is, therefore essential to the reliability and economics of the steam system."

The plant was located at the ERRP site because of its proximity to the steam system. (Tr. 127 ll. 3-5) When considering other sites, no site was rejected because of concerns about serving the electric load in New York City (Tr. 127, ll. 13-18). There were other ways of providing electric capacity to the City. (Tr. 401, ll.1-5) An electric generating plant does not have to be close to its load (Tr. 128 ll. 128-129). A facility being built to provide generation in general could be located in various areas. (Tr. 132, ll. 12-21) Con Edison is not in the business of building electric only generating facilities. (Tr. 131 ll. 23-32).

Staff witness Van Cook admitted the facility was located at ERRP because of the needs of the steam system and not because of the needs of the electric system. (Tr. 229 l. 17 to Tr 230 l. 6). Staff further acknowledged that the primary goal of ERRP was to lower steam costs. (Tr. 234, ll. 7-15). Accordingly, there is no real issue that the construction, location and design of ERRP was based on the needs of the steam system.

THE INCREMENTAL THEORY RELIED UPON TO JUSTIFY THE SUBSIDY OF THE STEAM SYSTEM IS INAPPLICABLE TO THE FACTS AS THEY EXIST TODAY.

The "incremental" cost method is based on the assumption that the "incremental cost of producing steam for send-out is assigned to the steam department" The basis for this approach was that the "savings related to the efficiency associated with joint electric and steam production have been allocated to the steam department." (Opinion 00-15, p. 7 footnote 10). The

assumption was that the joint production of steam and electricity produced cost savings, that there were economies of scale by having these two commodities produced together. Assigning cost in this way was not supposed to increase the cost of supplying electricity.

This principal would be violated by the JP. ERRP was designed to minimize the cost to the steam system irrespective of the cost to the electric system as is clearly demonstrated by the design of the plant and the high heat rate of this facility. Accordingly, the JP would unjustifiably transfer costs from the steam system to the electric system.

Prior to 1975, steam generation at steam-electric stations was treated as "incremental" to electric generation for ratemaking purposes due to the fact that electric generation capacity at the steam-electric plants represented a significant part of the total electric system capability and that cogeneration systems were originally installed to permit steam sendout as a by-product of electric generation. That is no longer the case, the generation of steam is clearly the primary output and with deregulation this electric generation is only a tiny portion of the electric generation capability in the City.

The Commission acknowledged as early as November 25, 1975 that the Steam system has changed "from a byproduct ... to a commodity which must be priced independently." (Con Edison – Steam Rates, 14 NY PSC 1026, 1029) and restated in Case 26794 (Order dated November 25, 1975, p.2236) In the [1975] steam case, the Commission instituted a mechanism that proportionately shared the savings because "[i]n light of the change in steam from a byproduct to the primary output of the combined steam and electric stations, and the higher cost of future steam production, we find a more equal sharing of fuel and processing charges between the two products is required" (Case 26794, Consolidated Edison Company of New York, Inc., 15 NY PSC 2220) (Opinion 78-27, p.6)

Con Edison itself, previously acknowledged that steam is not a by-product but an independent commodity that must be priced independently.

The Steam Department's rapid growth in net plant does not arise because of growth in load. Instead, it represents the natural result of **steam's change from a by-product of electric generation to a commodity which must be produced and priced independently.** (*emphasis added*) (Case No. 26794, Petition of Con Edison, March 13, 1975, p.5)

"...The company's suggested method is the same one that was used to allocate the costs of the Tennessee Valley Authority among power, flood control and navigation: namely, in proportion to the cost of supplying each of those services separately ..." (Case 26794, p. 2237-2238) The issue then to be determined is how do you allocate these costs. We advocate the use of an inputed heat rate of approximately 7200 Btus.

The Commission specifically chose not to focus on the cost of the unit producing the power but rather the value of the power. As Con Edison has sold off or retired all of its electric generating capacity, the Company's own cost of fuel can no longer be used as a proxy. There is, however, an alternative to what the value of the electricity generated by ERRP is and that is the competitive wholesale electric market overseen by the New York Independent System Operator. The price of electric power is set by many competitors bidding into the market so as to determine what the true cost of the next increment of power will be in any given hour. This is the only true measure of the cost of the electricity from ERRP and the price that electric customers should pay. As noted above, if this were done, the vast majority of the subsidy would be eliminated.

When the Commission went back to the incremental approach it stated it was the safer approach to follow **in the short-run.** (*emphasis added*) (Opinion 78-27, p. 8) Sufficient time has elapsed and the subsidy must end now that we are in a competitive electric market. (Steam System Plan, April 15, 1998, p. 21 GTB Exh.14)

A SUBSIDY, WHETHER CALLED A SUBSIDY OR A TRANSFERRED COST IS A SUBSIDY NONETHELESS.

It does not matter whether it is called a subsidy, transferred costs or “rents” the result is the same, electric customers are paying for costs to provide steam.

“A ‘subsidy’ is defined as the costs paid by electric customers for the steam-electric plants to the extent such costs are in excess of the market price of electricity. Absent the ‘subsidy’, any such above-market costs would have to be paid by steam customers.” (Case 99-S-1621, Shansky filed testimony p. 2) (Tr. 397, ll. 13-17) Mr. Shansky tried to disavow that definition but he testified in this case that “The primary objective of the plan (i.e. construction of ERRP) is to enable Con Edison to provide reliable steam service at reasonable cost.³ Moreover, during cross examination in this case Mr. Shansky acknowledged that the primary purpose of ERRP is the provision of Steam. (Tr. 122, ll. 3-7) Con Edison intends to carry ERRP on the books of its steam business unit, making it abundantly clear that the primary purpose of ERRP is to produce steam.

Con Edison long ago acknowledged that the steam system is subsidized by the electric system. As stated by Con Edison:

[t]he cold and unassailable fact is that the Steam Department has managed to survive because – and only because – it is a department of a regulated combination company whose electric and gas customers (principally its electric customers) and stockholders have supported, for some years, and continue to support, its losing operations.” (Case 26794, Memorandum in Support of the Petition of Consolidated Edison Company of New York, Inc. for Temporary Steam Rate Increase, May 29, 1975, p.8)

The Commission recognized the drain this caused on the other departments.

[i]t is the customers of the other departments (gas and electric) that are being forced to subsidize steam operations. Our obligation to assure that rates charged those customers are as low as is practicable requires that we

³Shansky prefiled testimony p 2, 3

ease the impact of interdepartmental subsidies at the earliest possible time.”
(Opinion 75-16, p. 7).

This obligation is particularly applicable in today’s environment of electric deregulation.

IF THE STEAM SYSTEM AND THE ELECTRIC SYSTEM WERE OWNED BY SEPARATE ENTITIES THE TRANSFER OF COSTS WOULD NOT BE IN ISSUE

The requirement that the operating expenses of the Steam Department should be borne, in part, by other than the Company’s steam customers is repugnant to the principle of Municipal Gas Co v. Pub. Serv. Comm’n, 225 NY 89 (1919)

The legislature did not intend that a burden should be lifted from consumers of one commodity in order that it might be cast upon consumers of the other.

In fact, if the steam system were owned by other than Con Edison we would not be before the Commission on this issue.

A SUBSIDY MUST NOT BE IMPOSED IN A VACUUM

It is acknowledged that the Commission has taken into account in prior proceedings the relative impact of an increase in steam rates versus an increase in electric rates. Of course, due to the larger size of the electric system it has been easy for the Commission to justify that costs properly allocable to steam be shifted to electric customers. However, if considering such a shift, it must not be done in a vacuum. The Commission must take into consideration the other costs that are being placed on the electric system. Presently, the Commission is considering a proposal by Con Edison to increase electric rates. Con Edison, in a recent bill insert distributed to electric customers, acknowledged that it is proposing a 9.2% increase in residential electric rates. Nowhere did that insert disclose that the proposed increase does not include the increase in the price of electricity, the commodity, itself. Therefore, the full potential increases (delivery and commodity) for a residential electric customer can be expected to be substantially more than 9.2%. In addition, the Commission is also considering the adoption of a Renewable Energy

Portfolio Standard ("RPS"). It is anticipated that the adoption of the RPS will result in an increase in electric rates of from 1.5% to 2.25% in the Con Edison service territory.

**RATHER THAN PRODUCING SAVINGS TO BE ALLOCATED
ERRP INCREASES THE SUBSIDY TO BE PAID BY THE ELECTRIC SYSTEM**

It is true that steam system customers are better off with ERRP than with Waterside. However, electric system customers are worse off. (Tr. 465, ll. 12-13) An analysis of Mr. Chernick's "Net Economic Benefit" without his claimed capacity and energy market benefits, clearly establishes that ERRP produces a negative "Net Economic Benefit" of \$32 million per year for electric customers. (TR. 464-465) The total subsidy at ERRP is the subsidy now being paid by electric customers for the operation of Waterside plus an additional \$32 million annually. Con Edison estimates the current subsidy now being paid by electric customers annually for Waterside to be \$59 million. (Opinion 00-15, pp. 7, 8,17, 18) . If the JP is adopted as proposed, the electric customers will be forced to provide an annual subsidy to ERRP of \$91 million.⁴ (Tr. 645, ll. 23-24)

As acknowledged by all parties, the cost of ERRP far exceeds original estimates. In addition, the redesign of ERRP results in excessive heat rates for the production of electricity in order to provide additional heat to the steam system. Based on the proposed allocation of costs in the JP this additional heat is paid for by the electric system.

A review of Shansky Exhibit RS-2 (Revised) shows that Con Edison claimed a Total Economic Benefit for ERRP over Waterside of \$53 million per year. However, that factored in the claimed net real estate sales from Waterside of \$24 million. That figure assumed that Con Edison realized the maximum net amount from the sale of Waterside, something that is not

⁴ \$59 million plus \$32 million.

guaranteed. In Rasmussen Exhibit EJR-1, Con Edison claimed an annual fuel savings for the steam system from the operation of ERRP of \$64 million per year. Accordingly, the electric system is substantially worse off with ERRP than it was with Waterside.

To look at it another way, the total benefit from ERRP, not including the proceeds from the sale of Waterside, is \$29 million⁵ per year. If you then include the additional \$64 million fuel benefit claimed by Con Edison for the steam system you are left with the electric system being worse off by \$35 million per year (\$64 minus \$29 million). Since the electric system is already subsidizing Waterside to the tune of \$59 million per 1998/1999 Steam Plan, the electric system will end up subsidizing the steam system by at least \$94 million per year after ERRP is operational.

In addition, if the JP is adopted the electric system will be paying \$24.2 million for non-fuel operating costs at 59th and 74th Streets.

Moreover, the electric system will be paying costs at both Waterside and ERRP during the duration of the proposed two-year rate plan. When questioned, Mr. Shansky admitted that Con Edison in its calculation of the \$26 million annual property tax avoidance at Waterside did not include the fact that it would be retaining both Waterside and East River for the next few years. (T. 153, ll. 5-9) This will result in the electric system paying the substantial share of not just \$28 million per year for taxes at ERRP but also the vast majority of the \$26 million per year in taxes at Waterside during the upcoming rate plan. This just further increases the subsidy that the electric system will pay if the Commission adopts the terms of the JP.

⁵ Per RS-2 (Revised) the Total Economic Benefit of ERRP over Waterside is \$53 million per year (\$53 million minus projected maximum sales proceeds of \$24 million per year leaves only \$29 million per year).

These facts will result in those additional costs being transferred to the electric system if the JP is adopted. It would appear that the JP is silent, only because Con Edison did not divulge the fact, as to who would be paying for the continued carrying costs for Waterside, including taxes. The JP clearly intends that any costs not allocated to steam were the responsibility of the electric system. This approach clearly defines and limits the costs to be paid by the steam system but issues a blank check which the electric system will be forced to pay. These increases in the subsidy translate directly into higher electric costs for all businesses and residents in Con Edison's service territory.

All of these facts result in the electric system paying a larger subsidy than originally projected by Con Edison. This certainly is not a de minimis figure. One can only assume that until Waterside is sold that any costs or recovery of investment at Waterside will continue to be collected almost entirely from the electric system.

The fact is clear that the amount to be paid by the steam system pursuant to the JP is fixed while the amount to be paid by the electric system is unlimited.

THE METHOD USED TO ALLOCATE COSTS WAS FLAWED AND BIASED

Con Edison's used what it claimed was the incremental approach to allocate costs. Its failure to properly allocating costs between the steam and electric systems based on a proportional basis begs the question of which methodology is appropriate in this case. The proposed allocation is clearly an attempt to deprive the Commission of the opportunity to properly allocate costs between the systems. To state that they allocated costs on an incremental basis, actually a flawed interpretation of the incremental basis, would improperly shift costs to the electric system which should not be tolerated.

Con Edison's witnesses admitted that Schedule F allocates operating and maintenance costs that properly should be a Steam System cost to the Electric system. (Tr. 192 ll. 15 to Tr. 194 ll. 23). Con Edison's witnesses acknowledged that they did not allocate any of the Operating and Maintenance Costs ("O&M") for the Heat Recovery Steam Generators ("HRSGs"), even though they are used strictly for the steam system, to the steam system when they allocated costs in Schedule F of the JP. In fact, as written, Schedule F would allocate those costs 100% to the electric system. (Tr. 193, ll. 9-24 – Tr. 194 ll. 1-23) When questioned about this and other O & M costs for strictly steam equipment they attempted to justify the improper allocation of those costs to the Electric System as being de minimis. (Tr. 194 l. 24 – Tr. 196 ll. 1-6) The Con Edison witnesses then stated that they knew of no other costs that had been transferred to the electric system that were properly steam system costs. (Tr. 194 l. 24 to Tr. 195 ll. 1-5) Upon further questioning they admitted that there was at least another item (gas fired duct burners) that should have been allocated to steam but was allocated to electric. (Tr. 197 ll. 10-12).

Even though the operation of the steam system requires more than water treatment these same witnesses determined that of the 45 individuals working at ERRP only the five individuals dedicated to water treatment for the steam system should be allocated to the steam system. (Tr. 200 ll. 8-24). Accordingly, any other function related to the steam system had to be carried out by the electric system employees.

Absent evidence to the contrary, Con Edison presumed that costs would be incurred irrespective of steam and therefore charged to electric. (Tr. 213, ll. 3-9). Even when steam equipment required and was installed on its own concrete pad or required concrete for its support Con Edison allocated the cost to the electric system. (Tr. 215, ll. 23-24 – Tr. 216 ll. 1-8) None

of the costs for concrete were allocated to the steam system. Con Edison admitted that at least 58% of the miscellaneous steel, non-structural, had to be allocated to the steam system since it was used exclusively for steam equipment. (Tr. 217 ll. 4-10) but Con Edison still decided to allocate 100% of the structure to the electric system. (Tr.218, ll. 20-24).

The incremental approach, as used by Con Edison assumed that everything was an electric system expense unless it was identified by Con Edison to be one hundred percent exclusively a steam expense. (Tr. 223, ll. 20-24 – Tr. 224 ll. 1-4) This is contrary to the definition of incremental expense as set forth by the Commission in prior cases.

Con Edison utilized circular reasoning to justify the conclusion that it wanted to reach. The conclusion that it wanted to reach was that most, if not all, costs were chargeable to electric and therefore it charged all costs to electric. (Tr. 214, ll. .9-18) Based on that approach Con Edison stated that 2/3rds of the costs or more were allocable to electric and therefore proceeded to allocate any other costs 2/3 to electric and 1/3 to steam. By taking this approach, Con Edison has attempted to deprive the Commission of the ability to make a reasoned decision based on all the facts.

The use of the incremental approach is premised on the fact that the economies of scale of joint production of steam and electricity would produce savings which can be used to reduce the cost of steam production. This fundamental principal is grievously violated by the provisions of Appendix F.

In this case, Appendix F allocates costs in such a manner that electric customers are in effect paying for capacity and energy produced at ERRP at a rate far above the prices at which the same capacity and energy could have been acquired from the market or from long term contracts.

ERRP was undertaken for the primary purpose of producing steam. One has only to examine a few statements by Con Edison to demonstrate that steam is the primary product rather than a by product. For example Con Edison's Article X Pre-Application Report dated September 27, 1999 states, "The project will have the flexibility to vary its steam production to follow the steam system's demand profile. Although the provision of electricity to the grid is **ancillary**, the CTG/HRSG arrangement is very efficient and economic approach to steam generation, and is essential to the continued supply of steam at reasonable cost." (p. 3-4) The Commission should note that while ERRP may be an efficient and economic approach to steam generation it is neither an efficient nor economical plant for operation as a base load electric generator as Con Edison intends to use the plant because it requires far too much fuel for the production of each kWh of electric energy. If ERRP costs are allocated pursuant to the JP it will not be an economic source of electric generating capacity because the cost being allocated to electric is substantially more than a plant of equal capacity should cost.

Some members of P. S. C. staff seem to have been confused on this issue. For example, Staff witness Van Cook when asked during cross examination, "Isn't it true that the amount of money that Con Edison will receive from the generation of this electricity (referring to the electric output of ERRP) is less than the costs that are being charged to the electric system?" He responded, "No, I disagree." (Tr. 248) When subsequently asked, "We're looking at the total cost of the electric system is going to be charge at East River" to which he responded, "I just don't have that number with me right now. But I believe it's something in the order of about \$120 million, R 125 (sic) million.(Tr. 256)

Mr. Van Cook was then requested to provide the figures the following morning. He then testified, "Capacity sales, my estimate comes to about \$33 million; the energy sales comes to

\$126 million for a total of \$159 million of estimated sales into the electric wholesale market.”

(Tr. 269) He then testified that ERRP costs attributable to electric production on an annual basis as follows: “By my calculations, the amounts allocated to electric rate payers for fuel will be \$133 million; for rent will be \$66 million and for O and M will be \$20 million, for a total of \$219 million.”(Tr. 270) Thus, according to Mr. Van Cook’s figures the terms of the JP would charge electric customers \$60 million more to subsidize the cost of ERRP than the market value of the electric capacity and energy to be produced there. In fact, the above market costs associated with ERRP are substantially more than \$60 million annually. Nevertheless, it is clear that Staff agrees that ERRP costs, which would be assigned to electric customers pursuant to the JP, are far in excess of the market value of the plant’s electric output.

**ERRP FUEL COST ASSIGNED TO ELECTRIC PURSUANT TO APPENDIX F
OF JOINT PROPOSAL IS EXCESSIVE**

Con Edison designed ERRP to consist of two simple combustion turbines that require a very large amount of fuel to produce each kilowatt hour. Con Edison estimates that ERRP will need 11390 Btu to produce each kWh. (GTB Ex.) Combined cycle turbine generators are available which produce a kWh using less than 7200 Btu. (GTB Ex.) That is, the fuel required to produce one kWh at ERRP would produce 63 percent more electric power and energy in a plant designed to produce electric energy efficiently with the same amount of fuel. Fuel inefficient generators using simple combustion turbines are selected for service in electric power systems to generate only during peak load periods. Using combustion turbines for this purpose is logical because their significantly lower construction cost outweighs the cost of the additional fuel they consume because they are seldom required to run. However, at ERRP the combustion turbines

are expected to operate at an annual plant factor of 85 percent or substantially as base load generation.

The excess fuel consumed by the combustion turbines produces a substantial amount of heat which is then discharged to the Heat Recovery Steam Generators where it is used exclusively for the production of steam. Pursuant to Appendix F of the JP all of the heat discharged from ERRP's fuel inefficient turbine generators would be provided to the steam system free of charge. Adopting the JP would be analogous to extracting steam from an extraction turbine without the steam system paying anything for the fuel being used to produce the steam. Con Edison's choice of very fuel inefficient electric generators for ERRP does not justify assigning all of the fuel being used by those generators to its electric customers. Allocating fuel in this manner saddles electric customers with a substantially larger fuel bill than required to provide the same amount of electric energy from a plant that was designed to provide only electricity. Such allocation of fuel ignores the fact that the primary reason for constructing the plant is to provide steam and the selection of the electric generating equipment being installed there was determined by the objective of achieving that purpose.

According to Con Edison ERRP will provide the steam system with an estimated 13035 MMlb of steam annually (GTB Exh. 8 k-1) which is slightly less than half of Con Edison's forecast annual steam sendout. Fuel used at ERRP in the first rate year is estimated to cost \$158 million.(GTB Ex. 8 k-1) Of this total fuel cost Con Edison estimates that \$139 million will be assigned to electric production. (GTB Exh. 8 k-1) Had the plant been designed for efficient electric production the same amount of energy could have been generated spending only \$89 million for fuel assuming the same unit fuel price as was used in estimating the \$139 million assigned to electricity at ERRP. At ERRP a lot of the heat being used to produce steam is "waste

heat" only because of the plant design, which was dictated by the selection of the site based on the Company's requirement to produce steam. If the purpose of the plant had been to produce electricity, the site and the equipment would have been different, less expensive to construct and used much less fuel to generate the 2143 gigawatt hours annually expected to be produced by ERRP.

Con Edison estimates total fuel assigned to production of steam at ERRP, that is the amount that will be used by the duct burners, would be 2966 MMbtu (GTB Exh 8 k-1) for the year. Thus the steam produced at ERRP will contain over four times more energy than the energy in the fuel being assigned to steam production at ERRP. If the fuel allocated to steam was imputed on the basis of electric generation using a 7200 Btu/kWh heat rate the fuel allocated to steam would increase to 10771 MMbtu per year at a cost of \$69 million. Such imputed fuel assignment to steam would still result in steam paying for less Btu in fuel than the Btu contained in the steam being produced at ERRP. Such imputed fuel cost allocation would be fair to both electric and steam customers and compensate for the selection of combustion turbine generation at ERRP which so grossly increases the amount of steam the plant is able to produce using fuel that otherwise would be unjustifiably be paid for by electric customers.

To emphasize the egregious nature of the unjustified allocation of fuel costs advocated in Appendix F of the JP consider the fact that using the same fuel cost allocation strategy Con Edison would be able to produce all of its steam sendout with no fuel charge whatever to its steam customers by simply building more plants similar to ERRP and omitting the duct heaters being installed at ERRP.

**ERRP CAPACITY COST ASSIGNED TO ELECTRIC CUSTOMERS
PURSUANT TO APPENDIX F IS EXCESSIVE**

The capacity charge, as well as the fuel cost, assigned to electric generation pursuant to Appendix F is based on the erroneous assumption that no options were available for the production of electricity that would have been less expensive than ERRP for producing electricity. Choosing to build a plant that is much less fuel efficient for electric generation than plants offered by several vendors of electric generating equipment on a site that requires major structural modification at great expense to support the equipment that is being installed does not justify assigning most of those charges to electric generation as if that were the only means of supplying the additional electric capacity and energy. Con Edison estimates, pursuant to the JP, that its steam business unit will charge annual rent of \$66 million to its electric business unit for ERRP.(Tr. 125-126) In addition it will charge non-fuel operation and maintenance costs estimated at about \$15 million annually to its electric business unit for ERRP. The sum of these two or \$81 million annually corresponds to the capacity charges that electric customers would be paying for the 288 MW of capacity, \$281.25 per kW-yr, available from ERRP. This annual capacity charge is far in excess of current market prices of about \$130 per kW-yr. for capacity in New York City. It is also much in excess of the \$159 per kW-yr. the NYISO, has published as an administrative price that would be an appropriate capacity price when capacity reserve margin in the City is on target, i.e. neither excessive nor deficient.

Another measure of the excessive nature of such a capacity charge can be gleaned from the fact that NYPA is constructing an in-City combined cycle plant which it expects to have a DMNC rating of 490 MW. This plant is expected to begin commercial operation before next summer peak load so it is being constructed in the same general time frame as ERRP. NYPA's

budget for the plant is \$650 million or \$1326 per kW. NYPA's budget for this plant is not only 15 percent less than Con Edison's present estimated cost per kW for ERRP but NYPA's plant is a combined cycle plant with an air cooled condenser which will require about 7200 Btu of fuel to produce one kWh.

Con Edison reviewed the steam rates being charged by other east coast steam system in its April 15, 1998, steam system plan. There the Company compared its rates with those of seven other steam systems. At that time Con Edison's benchmark rate was about \$11.50 per M lb. The next lowest rate (Philadelphia) was about \$13 per M lb. The highest (New Haven) was over \$20 per M lb. The text of the report states, "The results indicate that Con Edison's rates are the lowest steam system rates in the Northeast. This finding is noteworthy given the concern about the high level of electric rates of New York Utilities relative to the national average."⁶ Indeed, high level of electric rates of 'New York Utilities' grossly understates the situation. Con Edison's electric rates are probably the highest for any utility in the continental United States. The JP would continue the spectacle of the steam system with the lowest steam rates in the Northeast being subsidized by electric customers paying the highest electric rates in the country.

ILLUSORY EFFECT OF ERRP ON MARKET PRICES

New York City witness Chernick has posited that ERRP will benefit electric customers by lowering market price for capacity by \$85 million annually and market price for energy by \$34 million annually.⁷

On its face, paying more for capacity and energy than the same amount of capacity and energy could be obtained from alternate sources will not produce a benefit to customers for

⁶ GTB Exh.14 pg 17-18.

⁷ Transcript p. 290

capacity and energy. Mr. Chernick's supposed benefit would be realized if, and only if, the increment of capacity and energy provided by ERRP could not be obtained otherwise.

Mr. Chernick agreed under cross examination that any increment of 125 MW, the DMNC capacity being installed at ERRP minus the capacity being retired at Waterside, would have the same effect on market prices so long as that capacity was available to supply loads in New York City. (Tr. 362-363) He further stated that, "And somehow or other, if you are going to get to (sic) the thousands of megawatts of additions that, say, the New York City Energy Task Force identified as being necessary, or desirable, anyway, you're going to have to build something. And when you build that something, it's going to reduce prices for the next thing. So it's true that anything you build affects prices for everything else that's built."(Tr. 264) This testimony definitely establishes that the benefits he attributes to ERRP are not derived from or dependent upon ERRP but simply upon having sufficient generating capacity available to serve New York City loads.

A similar flaw exists in Mr. Chernick's assessment of the effect of ERRP on the energy market. A contract supplier would have the same incremental effect on the market as energy produced at ERRP so there is no logic to imputing a market suppressing benefit for the output of ERRP. Had the Company believed such a market suppressing benefit would be realized they would have surely included such avoided costs as an additional benefit, it did not do so. (RS2-Revised)

THE CLAIM THAT THERE IS A LOAD POCKET REQUIRING THE CONSTRUCTION OF AN ELECTRIC PLANT AT THIS EXACT LOCATION IS UNFOUNDED AND IRRELEVANT

Not one witness was able to establish that there was a load pocket at ERRP that required the construction of a new electric generation plant at ERRP. ERRP was not specifically built to

serve a load pocket for electric generation (Tr. 179 ll. 12-14, Tr 180 ll. 3-16). If there was a load pocket at ERRP it was constrained to the same extent that the rest of the City is constrained. (Tr. 469-470) Therefore, if there is an East River load pocket it is in fact a City load pocket, which could be served by the construction of a facility anywhere in the City or by dedicated transmission lines from plants outside the City. (Tr. 470, Tr. 381)

The existence or non-existence of such a load pocket is irrelevant to allocation of costs for ERRP for the following reasons:

A load pocket cannot be eliminated by the addition of generation since the definition of a load pocket is an area for which the transmission system is unable to supply the entire load. (Tr. 467, ll.17-21)

Con Edison has stated that it has sponsored no testimony in this proceeding regarding the presence or absence of a load pocket at ERRP.⁸ This was restated by Mr. Lubling, "...that's why that Interrogatory had the introductory remark, saying that we did not sponsor any testimony on load pockets, that's a transmission issue." (Tr. 179) Mr. Shansky also testified, "And at the time of the Article X, we stated that the existence of ERRP at that location would have deferred the need for a **transmission reinforcement**. We have not, in this proceeding, sought to update that information." (emphasis added) ERRP was not specifically built to serve the load pocket.(Tr. 180, ll.3-16)

Chernick claimed that electric generation needed to be constructed in the load pocket but he did not state that it had to be at the ERRP site.⁹ In fact, he was unable to cite any reference by the New York Public Service Commission, the New York Independent System Operator, or

⁸ Response to Westchester Interrogatory 42

⁹ Response to WC Interrogatory WC 3,

the New York State Electric Reliability Council that there was an East River load pocket or that ERRP resolved a pressing electric capacity problem.¹⁰

The number of hours when the East River load sub-pocket was constrained annually is substantially identical to the number of hours when Con Edison's entire system south of Dunwoodie was constrained. This shows that the East River sub-pocket is not controlling the dispatch of generation nor is it a distinct load pocket.

Finally, the P. S. C. in issuing the permit for ERRP observed only that its construction would delay the time when transmission into the area would otherwise be needed. None of these factors rise to the level of justifying assigning the extraordinary costs advocated in the JP to electric customer for ERRP.

BUT FOR THE PRODUCTION OF STEAM CON EDISON COULD HAVE DISPOSED OF THE 59TH AND 74TH STREET PLANTS

Production of electricity terminated at 59th Street in either late 1995 or early 1996 (Tr. 169 ll. 14-17) and at 74th Street in 1999. (Tr. 169, ll. 11-13). The 74th Street station also serves as the office for Con Edison's steam business unit. Both of these stations have been transferred on Con Edison's books to its steam system. However, payment of fixed operation and maintenance costs and property taxes which have been paid by the electric system were to end when ERRP came on line. The JP now recommends that such payments continue to be paid by electric customers until Con Edison receives funds from the sale of First Avenue properties.

The electric system was also required to transfer, as accelerated depreciation, \$75 million for the Waterside and 74th Street plants in Con Edison's electric rate plan (Case 96-E-0897 et al.,

¹⁰ Response to WC Interrogatories WC 3 – WC 20

Consolidated Edison Company of New York, Inc., Order adopting Terms of Settlement Subject to Conditions and Understandings (issued September 23, 1997, Appendix A, p. 13)

In fact, the Commission acknowledged that Con Edison stated:

that following March 31, 2002, ... the subsidy is eliminated, for the subsidy related to the 74th Street plant (the "transferred costs") will be eliminated once the ERRP goes on line, and the subsidy related to the Waterside plant will be eliminated when it is retired and the First Avenue Properties are sold. (Opinion 00-15, p. 16)

Staff joins Con Edison in arguing that the electric-to-steam subsidy, which has been in effect since the 1970's, will be fully eliminated during the term of the proposed rate plan. With regard to the use of the First Avenue Property proceeds, Staff argues that the allocation of the "net gain" reflects the retirement of Waterside and an accounting for its costs, and further that even though ERRP will be in steam rate base, electric customers will receive an appropriate benefit through a **reduction** in the interdepartmental rents charged to the electric department. (*emphasis added*) (Opinion 00-15, p. 17)

The Commission's statement that they are "waiting until the First Avenue Properties are sold and the benefits of the ERRP can be factored into steam rates" (Opinion 00-15, p. 18) should not be read out of context. It must be read in context, taking into consideration the Commission's prior discussion of the separate treatment for ending the subsidy of 59th St. & 74th Street as opposed to the termination of the subsidy of Waterside. A reading of those discussions clearly shows that the intent of the Commission was to end the subsidy of 59th & 74th Street once ERRP went on line, while the subsidy of Waterside would terminate when it is retired and the First Avenue Properties are sold. (Opinion 00-15, p. 17)

Since 1999 the electric system has subsidized both of these two facilities by paying all operating expenses except for fuel. This has amounted to at least \$18 million annually (\$17 million for 74th Street and \$1 million for 59th Street) for a total to date of at least \$90 million. (Op. 00-15, p. 7). The parties to the JP want the electric system to continue the subsidy in an

amount of \$24.2 million per year or an additional \$48 million over the next two years. This would result in the electric system providing a subsidy of over \$114 million during which time no electricity has emanated from those facilities. And even if an attempt is made to produce electricity at these facilities it would be for the purpose of justifying the continued subsidy of the steam system without any consideration of the cost/benefits provided to the electric system.

In fact, the parties acknowledged in the Agreement & Settlement in Case 99-S-1621 (p. 9-10) that the Transferred Costs of the 74th Street and 59th Street steam stations should continue to be reflected in Con Edison's electric rates, and not be transferred to and included in steam rates, until such costs can be offset by the net benefits from ERRP that will inure to steam customers.

The subsidy or transfer of costs from the electric system to the steam system for 59th and 74th Streets was scheduled to terminate when ERRP went into service. (Opinion 00-15, p. 8) Even Con Edison's witness admitted that the subsidy of 59th and 74th Streets was supposed to end at the completion of ERRP. (Tr. 169 ll. 1-10).

But for the continued production of steam at these two facilities Con Edison could have disposed of these two sites, ceased incurring costs and distributed the proceeds from the sale of these two facilities to the electric and steam systems. (Tr. 191 ll. 21-24 - Tr. 192 ll. 1-5). Accordingly, there is no justification for the continued subsidization of these facilities by the electric system.

Electric customers have been paying these charges far too long. Delaying the end of this subsidy until the net proceeds from the sale of First Avenue are available raises the specter of a never ending subsidy by Con Edison electric customers.

**FUNDS FROM SALE OF FIRST AVENUE PROPERTIES CANNOT BE ALL THINGS
TO ALL PEOPLE**

Con Edison admits that 95% of the costs for Waterside were paid for by the electric system. (Tr. 166 ll. 1-7, Tr. 168 ll. 6-8). According to the Commission's own ruling in 01-E-0377 the net proceeds from the sale of Waterside should be allocated as they were incurred: 95% to the electric system.

There is no reason to wait until the proceeds are available from the sale of Waterside to end the subsidy of 59th Street and 74th Street. If the proceeds are allocated in a manner consistent with the Commission's decision in 01-E-0377 then only 5% of the proceeds from the sale of Waterside will be available for the steam system. Even if the proceeds were allocated and utilized in the manner suggested by Con Edison and as advocated in the JP those funds would be fully consumed or dedicated to subsidize ERRP. In fact, Con Edison relied on the full Real Estate Benefits from the sale of Waterside in its calculation of the economic benefits of ERRP over Waterside. (Exhibit RS-2) In fact, it used the maximum possible net benefit in its calculation though it admitted that the range of possible net benefits varied. If the benefits from the sale of Waterside are committed to write down ERRP's capital costs here are no funds left to pay the costs of 59th and 74th Streets and therefore there is no reason to postpone the elimination of the subsidy of those two facilities other than a blatant attempt to continue to transfer an additional \$48.4 million from the electric system to the steam system.

**CLAIM THAT MARKET PRICE IMPACT OF ADDITIONAL ELECTRIC OUTPUT AT
ERRP JUSTIFIES CONSTRUCTION OF ELECTRIC GENERATION AT ANY COST IS
FLAWED.**

Chernick claims an economic benefit for the purported decrease in price in the capacity market derived from the net addition of 125 MW of capacity provided by ERRP in the City. He

also claims that the increased generation from ERRP will result in a reduction in the LBMP price of electricity in the City. Upon questioning Mr. Chernick admits that the addition anywhere of in-city capacity will reduce the price in the capacity market. (Tr. 362, ll. 3-5)

As noted by the Commission in its order approving ERRP, PSL Article X requires that a generation project be consistent with the policies, long range energy planning, and strategies contained in the most recent New York State Energy Plan. According to the New York State Energy Plan, a new generating facility is consistent with the state's long-range plan for expansion of the electric power system if the new facility contributes to competition in electrical markets.

CLAIM THAT ADDITIONAL JOINT STEAM/ELECTRIC FACILITIES SHOULD BE BUILT IS A THINLY VEILED ATTEMPT AT ADDITIONAL SUBSIDIES OF THE STEAM SYSTEM.

Con Edison was required in the prior rate case to conduct studies (Agreement & Settlement Case 99-S-1672, p. 17-18) of possible future uses of the 74th Street, 59th Street and Hudson Avenue steam plants and sites. Con Edison has completed its studies and recommends the continued use of 59th & 74th for steam production only. The JP advocates converting those facilities into steam and electric generating facilities for the sole purpose of requiring the electric system to absorb the costs of generating steam for the steam system.

CONCLUSION

For the above reasons, the terms of the Joint Proposal as they relate to the allocation of costs between the Steam and Electric Systems should be rejected. The Commission should terminate the electric to steam subsidy. And at a minimum should input a heat rate at ERRP of not more than 7200 Btu per kWh.

Respectfully submitted,

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