

05-S-1376



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June 30, 2006

VIA HAND DELIVERY

Hon. Jaclyn Brilling
Secretary
State of New York Public
Service Commission
Three Empire State Plaza, 14th Floor
Albany, New York 12223-1350

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

Dear Secretary Brilling:

Please find enclosed an original and five (5) copies of the City of New York's Reply Statement in response to the statements and testimony filed with the State of New York Public Service Commission ("Commission") by other parties with respect to the Joint Proposal that was filed in the above-captioned proceeding on June 2, 2006. Copies of the aforementioned reply statement are being served on the active parties list via e-mail and U.S. Mail. Dr. Alan Rosenberg is the sponsor for the City's Statement and Reply Statement and will be available for cross-examination, if requested.

Please have the extra copy of the Reply Statement 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/MHB/slg
Enclosures

cc: Hon. Rafael Epstein (via hand delivery; w/enc.)
Kevin Lang, Esq. (via hand delivery; w/enc.)
Active Parties in Case 05-S-1376 (via e-mail and U.S. Mail; w/enc.)

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ORIGINAL

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 05-S-1376

**REPLY STATEMENT OF NEW YORK CITY
IN SUPPORT OF THE JOINT PROPOSAL**

Dated: June 30, 2006

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PRELIMINARY STATEMENT

In accordance with the schedule established by Administrative Law Judge Rafael A. Epstein (“ALJ Epstein”) in Case 05-S-1376, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Steam Service, the City of New York (the “City”), one of the largest customers on the Consolidated Edison Company of New York, Inc. (“Con Edison” or the “Company”) steam system, hereby submits this Reply Statement in response to the Statements and Testimony filed with the State of New York Public Service Commission (“Commission”) by other parties with respect to the Joint Proposal¹ pending in this proceeding.

Following extensive settlement negotiations that extended from March through June, 2006, a Joint Proposal was filed in this proceeding on June 2, 2006. The Joint Proposal represents a resolution of all of the outstanding issues in this proceeding and is supported by a vast majority of the active parties. On June 16, 2006, seven parties, including the City, filed statements supporting the Joint Proposal.² Significantly, the proponents of the Joint Proposal, of which the City is one, represent a broad spectrum of Con Edison’s steam customers and entities that are affected by Con Edison’s steam tariffs.

¹ Citations to the Joint Proposal are preceded by the notation “Joint Proposal.” Citations to the Statements in Support or Opposition to the Joint Proposal are preceded by the party’s name (e.g., “County of Westchester”).

² The other parties that filed comments supporting the Joint Proposal were: Department of Public Service Staff (“Staff”), Con Edison, Consumer Power Advocates, ConsumerPowerline, New York Energy Consumers Council, Inc. and Pace Energy Project.

Despite widespread support for the Joint Proposal, two parties -- the County of Westchester ("County") and TransGas Energy Systems LLC ("TGE") (collectively, "Opponents") -- filed statements opposing the Joint Proposal. For the reasons set forth below, the positions advocated by the County and TGE in opposition to the Joint Proposal should be rejected. The Joint Proposal fairly and equitably balances all of the competing interests in this proceeding and should be approved, without modification.³

ARGUMENT

POINT I

THE COMMISSION SHOULD REJECT THE COUNTY OF WESTCHESTER'S PROPOSED ERRP COST ALLOCATION

The Joint Proposal provides that for RY1, carrying charges on the East River Repowering Project ("ERRP") (i.e., return on investment, depreciation, and property and other taxes) will continue to be allocated and recovered through the steam fuel adjustment clause ("FAC") in the manner approved by the Commission in Con Edison's last steam proceeding rate plan, except that the total carrying charges on capital costs allocable to steam shall be based on actual total capital costs (including AFUDC) not to exceed \$788.3

³ The Joint Proposal submitted in this proceeding provides that its provisions are not separable, but, instead, interdependent, and the proponents of the Joint Proposal have reserved the right to change their positions if individual provisions of the Joint Proposal are modified (Joint Proposal, p. 40). The changes sought by the County (a \$38 million steam rate increase) and TGE (a requirement that Con Edison negotiate contract terms with it based on certain parameters) certainly would destroy the delicate balance struck in the Joint Proposal and could cause proponents, such as the City, to oppose such a modified Joint Proposal.

million.⁴ The Joint Proposal also provides that, commencing in RY2, the steam department's share of ERRP carrying charges will be transferred into base rates on an earning neutral basis, subject to any amount disallowed by the Commission based on its review of the construction and related costs of the ERRP. (Joint Proposal, p. 9)

In testimony opposing the Joint Proposal,⁵ the County advocates that the Commission depart from precedent and modify the way that ERRP costs are allocated between the electric and steam departments (Radigan, p. 9). Specifically, the County advocates for an adjustable ERRP cost allocation methodology where fuel costs for the electric department's portion of the ERRP are capped at the value of the energy produced by the ERRP, as determined by its sales into the wholesale energy market. (Radigan, p. 15)

Initially, it bears emphasizing that the ERRP cost allocation methodology incorporated into the Joint Proposal is the same methodology approved by the Commission, over the County's opposition, in Case 03-S-1672. In fact, the "incremental cost" allocation methodology embodied in the Joint Proposal here has been reaffirmed by the Commission for many years. The Commission first approved the "incremental cost" allocation between the Electric and Steam Departments in Case 27276.⁶ There, recognizing the Electric

⁴ Joint Proposal, p. 9; see also, 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, "Order Adopting the Terms of a Joint Proposal," p. 4 (issued September 27, 2004) ("2004 Steam Rate Order").

⁵ The County submitted testimony and exhibits from Frank W. Radigan. Citations herein to Mr. Radigan's testimony will be as follows: "Radigan, p. _____."

⁶ Consolidated Edison Company of New York, Inc. – Steam Rates, Opinion No. 78-27, issued November 14, 1978.

Department's growing need for the electricity provided by the combined steam/electric generating stations, as well as the potential for a destructive, massive exodus from the steam system, the Commission approved the allocation of all joint electric and steam production costs to the Electric Department except those related to the incremental cost of producing steam (Opinion No. 78-27; 18 NYPSC 1770). The Commission again extended the "incremental cost" allocation principle in Case 99-S-1621,⁷ over Westchester's objections, stating that "the long-standing allocation of cost between electric and steam has been reasonable."

In disposing of the County's arguments in Case 03-S-1672, the Commission approved the ERRP cost allocation methodology at issue here:

In this case, Westchester claims a 'more proportionate' allocation of the East River Repowering Project costs is warranted because of the specific circumstances related to this facility. Contrary to Westchester's allegations, we find that the ERRP was selected and is being constructed for the substantial benefits it will provide for both the electric and steam systems. Westchester is incorrect to assert that the facility's primary or exclusive benefits only extend to the steam system.

The electric system will receive substantial benefits from this in-City electric plant because it will serve load pockets on Manhattan's East Side and elsewhere in the borough. Consequently, we find that upon its completion and commencement of operations, the ERRP will become an essential component of both the electric and steam systems.

(2004 Steam Rate Order, pp. 26-27.)

⁷ Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Steam Rates, Opinion No. 00-15, issued December 1, 2000 ("Opinion No. 00-15").

Importantly, in approving the ERRP cost allocation in the last proceeding, the Commission specifically recognized that the electric department's share of the ERRP costs might exceed the market value of electricity generated at the plant:

While the prevailing market prices for electricity in New York City do not match, or cover entirely, the amount of ERRP-related costs allocated to the electric department, they do, in fact, eliminate a substantial portion of them from further consideration. Moreover, the portion that is not covered is roughly matched by the amount of Waterside-related costs that Consolidated Edison will be able to avoid. (footnote omitted) On these bases alone it is fair to conclude, and we find, that the cost allocations are fair.

(Id.) In addition, the Commission cited to the following, incremental benefits to “entirely eliminate” the argument that the ERRP did not make economic sense for the electric department: sharing of First Avenue proceeds; improved operational efficiencies; reduced environmental emissions; improved economic development and, importantly, avoided transmission and distribution system reinforcements in the East River load pocket in Manhattan. (2004 Steam Rate Order, pp. 27-28) Based on all these considerations, in the last steam rate proceeding the Commission approved the “incremental approach” for allocating ERRP costs that is included in the Joint Proposal pending here (2004 Steam Rate Order, p. 28).

In the face of this considerable precedent, the County argues that the ERRP allocation methodology is unfair because it results in the electric department paying fuel costs that exceed the market value of the electricity produced by the ERRP (Radigan, p. 9).

Because of this “inequity,” the County advocates that steam rates be increased by \$37 million (Id.).⁸

The County’s distaste for the ERRP plant (Radigan, pp. 9-10) is both obvious and irrelevant.⁹ The fact that ERRP cost more to build and more to operate than was forecasted does not provide a basis for changing the well-grounded ERRP cost allocation methodology. The substantial benefits that the ERRP provides to the electric department, relied upon by the Commission in the 2004 Steam Rate Order, are still there. That the market prices of the fuel used at ERRP, or the energy and capacity prices paid for the ERRP’s output, during ERRP’s first year of operation did not maximize profits from the plant to the County’s liking has no bearing on the equity of the ERRP cost allocation – these are uncontrollable market influences.¹⁰ The County’s position that the ERRP cost allocation should be adjusted annually (Radigan, p. 15) to ensure that the electric department is fully

⁸ The County’s shopworn railings about past subsidies are a red herring (Radigan, p. 3). The electric rent payments for 74th and 59th Street Stations have been eliminated in this proceeding, consistent with the directive from the 2004 Steam Rate Order (2004 Steam Rate Order, p. 28), and despite the fact that stranded electric investment may remain on the steam department’s books. (See Opinion No. 00-15, p. 18). And, the ERRP cost allocation here is the same as the one approved in the 2004 Steam Rate Order, and based on a methodology that “fairly distributes the cost of ERRP based on principles of cost causation” (Joint Proposal in Case 03-S-1672, p. 16).

⁹ The City also has concerns about the final costs of the ERRP but understands that any adjustment to those costs must be pursuant to a finding of imprudence by the Commission, which remains a possibility. The prudence of the ERRP investment, however, should not determine how the costs should be allocated.

¹⁰ The County’s use of the ERRP operating statistics during its first year of operation is questionable, at best. The first year of operation for any plant necessarily includes ramp-up problems that may affect operational efficiencies. In addition, markets during the Fall and Winter of 2005 were distorted by the effects of hurricanes Katrina and Rita.

protected from the vagaries of the natural gas and electric markets is inconsistent with Commission precedent and cost causation principles and should be rejected.¹¹

The County also claims that, based on one year of operating information, the ERRP's fuel costs as allocated to the steam system are lower than those of the other Con Edison steam-electric stations. (Radigan, p. 11) The County contends that the discrepancy between the fuel cost of the ERRP and that of Con Edison's other steam-electric stations is the result of how the company calculates its heat rate at these facilities. (Radigan, p. 13) This argument is based on the unsustainable presumption that the heat rate at the ERRP, a new, state of the art facility, should be consistent with the heat rates of facilities that were constructed decades ago, and at least one of which (Waterside) no longer exists. The ERRP has different capital costs, equipment vintage, efficiencies and technology when compared to Con Edison's other sources of steam, so better heat rates should be anticipated.

It is uncontroverted that the ERRP cost allocation method included in the Joint Proposal is the same incremental cost approach approved by the Commission in the last steam rate proceeding. The first year operational results of the ERRP, with which the County is displeased, do not undermine in any way the wisdom of the Commission's prior decision. Movement in commodity prices affects the cost of electricity and steam produced by the ERRP, and should play no role in selecting the proper ERRP cost allocation. The

¹¹ The County's position also totally ignores the potential impact on the delivered price of electricity (i.e., commodity and delivery costs could be expected to increase) if the steam rate increase that the County would impose here and in future rate proceedings would lead, as some have suggested, to the ultimate demise of the steam system, and the concomitant addition of 375 MWs of peak load to the electric system.

County's objections to the ERRP cost allocation set forth in the Joint Proposal should be rejected.

POINT II

THE JOINT PROPOSAL PROVIDES ADEQUATE SAFEGUARDS FOR EXAMINING FUTURE OPTIONS FOR PROCURING STEAM

Pursuant to the Joint Proposal, Con Edison is required to prepare an investment grade evaluation of two Hudson Avenue repowering options as identified in Phase I of the Steam Production Study, or only one option if the Company believes there is a clear and convincing option. (Joint Proposal, p. 32) The purpose of the evaluation is to develop a detailed scope for the project including cost and performance information to a level of detail that would be sufficient to support an investment decision to construct a replacement plant for Hudson Avenue. (Id.)

The Joint Proposal also provides for the creation of a Steam Resource Plan. (Id., at 34) The Steam Resource Plan will examine and discuss various resource options that Con Edison may utilize to satisfy its future steam demand, including maintaining and/or rebuilding existing boilers, constructing a new boiler or cogeneration facility or purchasing competitively-produced steam from a third party. If the Company does not prepare and submit a Steam Resource Plan within the time period specified in the Joint Proposal, it will be subject to a \$2 million revenue adjustment.

1. The County's Objections to the Steam Production Analysis Should Be Rejected

In his testimony, Mr. Radigan first observes that "any new production studies should be conducted with full input from all interested parties, including Westchester." (Radigan, p. 6) With respect to the Steam Resource Plan, Mr. Radigan concludes that no new steam resource decision should be made until a "full and open review" is conducted. (Radigan, p. 7) Inexplicably, Mr. Radigan then prejudices the results of the Steam Production Study and the Steam Resource Plan by proclaiming that, due to perceived problems at the ERRP, "Con Edison should seek to acquire any additional capacity from other sources rather than procure additional steam itself" (Radigan, p. 16).

As noted above, the Joint Proposal provides that Con Edison must develop a Steam Resource Plan and, as part of that plan, the Company must examine a number of supply options, including "competitively procured capacity." (Joint Proposal, p. 34) The County's position that the Company should be precluded from analyzing any self-supply options is unreasonable and further demonstrates the County's general antipathy toward Con Edison's steam customers. Steam customers could be severely harmed if Con Edison is not allowed to seek the least cost option, which could well be a self-supply option. Moreover, to preclude all future self-supply options would ensure that third party suppliers, would have a superior negotiating position in any dealings with Con Edison. In short, the County's position would help to ensure that steam customers absorb potentially unfair and excessive rates. Accordingly, inasmuch as the Steam Resource Plan adequately outlines the various options that Con Edison should examine if it is determined additional steam capacity is

needed, the Commission should reject the County's argument to only examine capacity from external sources.

With respect to the County's concerns about the overall steam planning process, the Joint Proposal already ensures that a "full and open" review will take place. The Steam Production Study provisions of the Joint Proposal are intended only to ensure that Con Edison will complete, in a timely fashion, a thorough analysis of two of the Hudson Avenue repowering options identified from Phase I of the Steam Production Study that was ratified by the Commission in the 2004 Steam Rate Order. The rationale for selecting the preferred options must be presented to the Steam Business Development Task Force, which includes the County and TGE. In addition, interested parties will be updated as milestones are met and will receive copies of the investment grade evaluations when they are filed with the Commission (Joint Proposal, pp. 32-33).

Importantly, the results of the investment grade evaluations of the preferred Hudson Avenue repowering options do not pre-ordain that one of those options will be chosen to satisfy future resource needs. Instead, those self-supply options will be measured against other supply options, including potential third-party supply agreements, in the Steam Resource Plan (Joint Proposal, p. 34). That Plan must examine and evaluate all resource options and identify and support a recommended option. (Id.) In sum, the Joint Proposal provisions requiring an investment grade evaluation and the preparation of a Steam Resource Plan simply require the utility to evaluate all potential sources of steam on a level playing field and make a rational decision.

Finally, the Steam Resource Plan must be filed with the Commission, at which time it will be subject to review and comment by interested parties. Of course, DPS Staff also will review the Plan and provide their comments. In short, the process in the Joint Proposal for evaluating future steam supply resource options fully protects the rights of interested parties to review and comment on Con Edison's decision. Accordingly, the County's objections to the process should be rejected.

2. TGE's Objections to the Joint Proposal Should Be Rejected

In its Statement, TGE professes to be concerned that the process outlined in the Joint Proposal regarding the Steam Production Study "is unfair to entities that seek to supply steam to Con Edison at competitive prices." (TGE, p. 3) TGE proposes that Section I of the Joint Proposal be modified to provide that "Con Edison will agree to negotiate with TransGas . . . the potential terms of a steam sales agreement based upon Con Edison's full avoided steam production and capacity costs. . . Con Edison's rationale for accepting or rejecting the potential terms [of a steam sales agreement] shall be provided in the Steam Resource Plan with supporting cost details." (TGE, pp. 8, 9) TGE's proposal even anticipates the assistance of Staff and/or a DPS administrative Law Judge to negotiate what admittedly are "potential" contractual terms.

Initially, TGE's proposed addition to the Joint Proposal is not necessary. As noted above, the Joint Proposal already provides that Con Edison must evaluate self-supply and third party supply options against each other as part of the Steam Resource Plan and then "fully support and justify" the utility's future resource selection (Joint Proposal, p. 34).

Presumably, Con Edison will be unable to complete the comparative analysis required under the Joint Proposal, or satisfy any relevant prudency standard, without determining the terms and conditions under which available third party supply options can be secured. Thus, the Joint Proposal already ensures that third party supply options will be fairly evaluated, and TGE's proposed modification should be rejected.

Inasmuch as the Joint Proposal already ensures a balanced review of all supply options, including TGE's, the City suspects that the driving force behind TGE's proposed addition to the Joint Proposal is its desire to control Con Edison's ability to evaluate TGE's proposal. For example, TGE's proposed change would dictate that Con Edison's "full avoided steam production and capacity costs" would be the basis for pricing any third party supply option, including TGE's. (TGE, pp. 8-9) The City disagrees with TGE's attempt to bind Con Edison, in the Joint Proposal, to how it may negotiate the terms and conditions of any third party supply contract. The Joint Proposal should not be utilized to introduce restraints on Con Edison's ability to strike the best deal for customers.

TGE's proposal also contemplates a cumbersome negotiating process, including the potential involvement of third party facilitators or mediators. Again, this is not necessary – as set forth in detail above, the Joint Proposal ensures that eligible third party suppliers will be included in the comparative analysis required for the Steam Resource Plan. If TGE or another supplier feels that it is shortchanged during that process, it can make its views known to the Commission and seek appropriate redress.

POINT III

THE COUNTY OF WESTCHESTER'S ALLOCATION METHODOLOGY FOR ACCOUNTING FOR THE PROCEEDS OF THE FIRST AVENUE PROPERTIES SHOULD BE REJECTED

In its testimony, the County proposes to modify the method for allocating the proceeds from the sale of the First Avenue Properties, including Waterside. The County proposes that the electric system should receive a share of the proceeds of the sale of the First Avenue Properties in direct proportion to prior expenditures for those facilities. (Radigan, p. 17) Under the County's proposal, \$3.3 million will be allocated to the electric system and \$0.2 million to the steam system, while under the Joint Proposal approximately \$2.3 million will be allocated to the electric system and \$1.2 million to the steam system. (Id.)

The City supports the First Avenue allocation methodology utilized by Con Edison in its July 25, 2005 filing in Case 01-E-0377, and incorporated into the Joint Proposal. Prior Commission decisions clearly linked the First Avenue sale proceeds with the incorporation of the ERRP into rates (See 2004 Steam Rate Order, p. 27) and the Con Edison methodology simply recognizes that linkage.¹² Accordingly, the County's objection should be rejected.

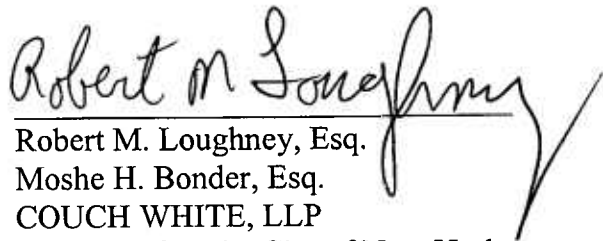
¹² Inasmuch as the Commission has not ruled on Con Edison's filing, the issue presented by the County may be more properly decided in Case 01-E-0377.

CONCLUSION

For all the reasons set forth herein and in the City's Statement in Support, the Commission should reject the positions advocated by the Opponents and approve the Joint Proposal without modification.

Dated: June 30, 2006
Albany, New York

Respectfully submitted,



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CERTIFICATION OF SERVICE

I hereby certify that on this day a true copy of the above document was served upon the attorney of record for each party by mail/by hand/overnight delivery.

Date: 6/30/06 Shari Z. Glindberg