

*brief*

STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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*Secretary*

July 19, 2004

VIA HAND DELIVERY

Hon. Jaclyn A. Brillling  
Secretary  
New York State Public Service Commission  
Three Empire State Plaza  
Albany, NY 12223-1350

Hon. William Bouteiller  
Administrative Law Judge  
New York State Public Service Commission  
Three Empire State Plaza  
Albany, NY 12223-1350

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 and Judge Bouteiller:

Enclosed please find an original and 5 copies of Department of Public Service Staff's Post Hearing Brief for the above-captioned proceedings. In accordance with your Honor's directives and the Commission's rules, copies of this statement are being served on the active parties by electronic and first class mail.

Sincerely,

*Kimberly A. Harriman*

Kimberly A. Harriman  
Assistant Counsel

Enclosures

cc: Active Parties to Cases 03-G-1671 and 03-S-1672

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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.

**POST-HEARING BRIEF OF THE STAFF OF THE  
NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE**

Kevin Lang  
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PUBLIC SERVICE COMMISSION

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**POST-HEARING BRIEF OF THE STAFF OF THE  
NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE**

BACKGROUND

On May 28, 2004, a Joint Proposal was filed in the above-entitled proceedings that establishes rate plans for Consolidated Edison Company of New York, Inc.'s (Con Edison) gas and steam businesses for three- and two-year periods, respectively. By oral ruling from the Administrative Law Judge, statements in support of the Joint Proposal were filed on June 10, 2004 by Con Edison, Department of Public Service Staff (Staff), the City of New York, consumer groups, environmental groups, marketers and others. Testimony in opposition to the Joint Proposal was filed on June 16, 2004, by the Utility Workers of America, AFL-CIO Local 1-2 (Union) and on June 17, 2004 by the County of Westchester (Westchester). A statement in opposition to the Joint Proposal was filed on June 17, 2004 by TransGas Energy Systems, LLC (TG&E).

Westchester's opposition to the Joint Proposal focused on the allocation of costs of the company's steam production facilities between Con Edison's steam and electric ratepayers. The Union's opposition focused on the company's use of contract labor and the safety of the steam main being constructed under First Avenue. TG&E based its opposition to the Joint Proposal on the lack of an avoided cost calculation for the East River Repowering Project (ERRP). TG&E did not participate in the evidentiary hearing on the Joint Proposal, and per the Administrative Law Judge's ruling from the bench at the close of the hearing, TG&E's comments are not addressed herein.

An evidentiary hearing was held on June 22 and 23, 2004, at which the party's positions on these issues were explored and challenged.

## DISCUSSION

### POINT I

#### THE JOINT PROPOSAL'S ALLOCATION OF COSTS BETWEEN STEAM AND ELECTRIC RATEPAYERS IS RATIONAL AND REASONABLE

Westchester raises several objections to the Joint Proposal's recommended allocation of costs between Con Edison's steam and electric ratepayers. First, Westchester objects to the proposed allocation of the costs associated with the ERRP and urges the reversal of the traditional cost allocation methodology. Second, Westchester seeks the transfer to steam ratepayers of all costs assessed to electric ratepayers for the 74<sup>th</sup> and 59<sup>th</sup> Street Steam Stations. For the reasons set forth below, Westchester's objections are without merit, and none form the basis for the Commission to reject or modify the Joint Proposal.

A. The Joint Proposal Appropriately Allocates ERRP  
Costs Between Electric And Steam

When completed, the ERRP will, *inter alia*, replace the steam and electric output of Con Edison's Waterside Generating Station (Waterside), thereby permitting Con Edison to close Waterside and effect the sale of the property, which was recently approved by the Commission in Case 01-E-0377<sup>1</sup> as being in the public interest. The Joint Proposal allocates the costs of the ERRP between the steam and electric businesses. (Joint Proposal, pp. 14-17 and Appendix F). It generally provides that costs solely related to the production of steam be allocated to the steam business and all other costs be allocated to the electric business. Based on information known about the project to date, this allocation methodology results in about two-thirds of the project's costs being allocated to electric and one-third to steam.

Westchester argues that an inappropriate percentage of ERRP's costs are being allocated to electric, primarily the amount of fuel. Westchester contends that electric ratepayers should

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<sup>1</sup> Case 01-E-0377, Consolidated Edison Company of New York, Inc. – Sale of First Avenue Properties, Order Approving Transfer Subject to Conditions (issued May 20, 2004) (Waterside Order).

only pay for the fuel associated with the heat rate as initially proposed by the company – 7,200 to 7,500 BTUs per kilowatt, not the final project expected heat rate of 11,390 BTUs per kilowatt. Westchester, in seeking to modify the Joint Proposal and shift additional fuel costs from electric to steam ratepayers disregards the benefits electric ratepayers derive from ERRP and the Commission's policy goal of preserving the steam system.

During the evidentiary hearing, several witnesses offered estimates on the total ERRP costs allocable to electric ratepayers and the resulting level of energy sales that would be derived from ERRP's operation (Tr., pp. 269-70, 321, 416). For example, Staff witness Van Cook estimated that the sales of electric energy from ERRP would amount to \$159 million, while the ERRP costs attributed to electric ratepayers would be approximately \$219 million (Tr., pp. 269-270). While Westchester would prefer that the Commission focus solely on this numerical assessment, such an assessment is flawed and misleading. In order to determine the reasonableness of the allocation, the Commission should look at the big picture and assess all aspects of the basis for the allocation. In addition to production costs and energy sales proceeds, the Commission should consider the following attributes of the ERRP.

ERRP is a modern, efficient generating facility. On a proportional basis, it will burn less fuel than Waterside (*i.e.*, it will use less fuel to produce each kilowatt of electricity than at Waterside), and, more significantly, its operation will result in fewer air emissions and better air quality for all New Yorkers. That is, the operation of the ERRP will allow for the retirement of the old, far less efficient, and more polluting generating units at Waterside. The record adduced during the ERRP Article X proceeding indicates that the ERRP, in conjunction with the retirement of Waterside and mitigation measures at the existing generating units at the East River Station, will provide a net reduction in the concentrations of SO<sub>2</sub>, VOCs, NO<sub>x</sub>, CO, and PM<sub>10</sub> emissions.<sup>2</sup> Reductions in these air emissions are very critical for New York City and Westchester County given their designation by the Environmental Protection Agency as a severe non-attainment area for air quality.

Additionally, although ERRP was primarily designed to provide efficient and lower cost steam, it was also designed to produce more electricity than Waterside and to serve the needs of all of Con Edison's customers as efficiently as possible. The ERRP will add almost 350 MW to

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<sup>2</sup> Case 99-F-1314, Consolidated Edison Company of New York, Inc. – East River Repowering Project Article X Application, Recommended Decision (issued June 28, 2001) at p. 75.

the East River load pocket and 200 MW to the in-City load pocket.<sup>3</sup> Further, the addition of the ERRP in an area of three concentrically located load pockets will enable Con Edison to defer future transmission reinforcements (Tr., pp. 180, 315).

Westchester attempted to rebut the presence of a load pocket in the East River area and the benefit provided to that load pocket by the ERRP (Tr., pp. 467-70). However, during cross-examination, Westchester's witness conceded that he is not an expert on load pockets (Tr., p. 481) and that the addition of the ERRP is an advantage for the East River load pocket (Tr., p. 487). It cannot be disputed that the cost of new transmission facilities can be very large, and that the avoidance of such expenditures due to the location of the ERRP in the East River area provides electric ratepayers a tangible benefit.

Further, in addition to allowing Con Edison to retire Waterside, the ERRP provides the company the ability to sell the Waterside site. The record in Case 01-E-0377 establishes that the inclusion of the Waterside site in the sale of the First Avenue Properties (*i.e.*, the Waterside and Kips Bay Generating Station sites, a former Con Edison office building site, and a Con Edison parking lot, comprising about 9.2 acres in total) increased the overall value of the four properties. While the total sale price is not yet known, due to its relationship with the rezoning of the properties, current estimates place it in the range of \$583 to \$689.7 million.<sup>4</sup> While the Commission has not specified the accounting and rate treatment for the proceeds, past practice for divestiture proceeds has been to first write down or write off the remaining book value of the property sold, and Staff does not believe a different approach would be taken for this sale. As of December 31, 2005, the remaining book value of Waterside is estimated at \$178.5 million.<sup>5</sup> The net proceeds from the sale will inure 100% to the benefit of Con Edison's customers, and although the Commission has not yet allocated those proceeds between electric and steam, Waterside's costs were allocated 95% to electric and 5% to steam (Tr., p. 166). Thus, if the Commission were to follow the same allocation approach for the Waterside proceeds as it did for

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<sup>3</sup> Case 01-E-0377, supra, Order Approving Transfer Subject to Conditions (issued May 20, 2004) at p. 3.

<sup>4</sup> *Id.* at p. 10.

<sup>5</sup> *Id.*



the allocation of the proceeds attributable to the other First Avenue properties (*see* Waterside Order, pp. 78-79), electric ratepayers would receive 95% of the net gain.<sup>6</sup>

B. 59<sup>th</sup> and 74<sup>th</sup> Street Steam Stations

The Joint Proposal continues the allocation of costs to electric ratepayers for the 59<sup>th</sup> and 74<sup>th</sup> Street Steam Stations (Joint Proposal, pp. 15-16). This proposal is consistent with the provisions of Opinion No. 00-15 and reasonable given the rate increases that steam ratepayers are already facing.

Westchester argues that because the Stations no longer produce electricity, their costs should be transferred entirely to steam (Tr., pp. 420, 458-59). In making this argument, though, Westchester incorrectly asserts that the Commission decided in Opinion No. 00-15 that the Stations' costs would be transferred upon operation of ERRP.

The Commission acknowledged in Opinion No. 00-15 that the eventual transfer of the Stations' costs entirely to steam was reasonable given the retirement of electric generation components. However, the Commission also determined that the rate impacts associated with the transfer was a paramount concern. In order to ameliorate that concern, the Commission held that the transfer should wait "until the First Avenue Properties are sold and the benefits of the ERRP can be factored into steam rates."<sup>7</sup> These conditions have not yet occurred, so, as contemplated by the parties and the Commission in 2000, the historic allocation continues to apply (as they did in the last rate case, the signatories to the Joint Proposal in this rate case continue to support allocating the Stations' costs to steam once both conditions have been achieved). Other than the same general assertions it made in the last case, which the Commission rejected, Westchester has not offered any basis for modifying this provision of the Joint Proposal.

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<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at p. 20 (emphasis added).

C. The Joint Proposal Is Consistent With Preservation Of The Steam System

Westchester claims that the Joint Proposal's allocation of costs of the ERRP and other production facilities improperly continues the electric system's "subsidy" of the steam system. Westchester asserts that the subsidy should be terminated and that more production costs should be shifted to the steam system. This recommendation is without merit and should be rejected.

In Opinion No. 00-15, the Commission expressed concern over the ongoing viability of the steam system.<sup>8</sup> In that case, the Commission was faced with a request by Westchester to shift electric system costs to the steam system. The Commission rejected the request on the basis that the associated benefit to the electric ratepayers would amount to a 1% rate reduction while the steam ratepayers would suffer a 20% rate increase.<sup>9</sup> Further, the Commission specifically noted that the "depression of steam system demand [by increasing rates 20%] will have a negative impact on electric ratepayers particularly at a time when the demand for electricity in NYC is already high relative to supply."<sup>10</sup>

The Joint Proposal provides that steam ratepayers will receive in each of the two years of the Steam Rate Plan an increase in steam rates of 4.5%. In comparison, in Opinion No. 00-15, the Commission increased steam rates in the first year by 4.4%, then froze the rates at that level for three subsequent years.<sup>11</sup> Westchester's proposal would shift approximately \$115 million in costs to steam (Tr., pp. 421, 465), more than five times the first rate year's rate increase of \$21 million, and thus increase steam rates over 23%. Such an increase would be harmful to steam ratepayers and further exacerbate the difficulties faced by the steam system, and thus, the proposal should be equally rejected as it was by the Commission in Opinion No. 00-15. Moreover, as discussed below, implementation of this proposal could increase electric ratepayers' costs, thereby inappropriately, and unnecessarily, harming both electric and steam customers.

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<sup>8</sup> Case 99-S-1621, Consolidated Edison Company of New York, Inc. – Steam Rates, Opinion and Order Adopting Terms of Settlement, Opinion No. 00-15 (issued December 1, 2000).

<sup>9</sup> *Id.* p. at 20.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at p. 3.

If the Commission adopts Westchester's proposal, steam ratepayers will realize an approximate 23% rate increase. Steam is already marginal in terms of economics (*e.g.*, the number of steam customers has been in a steady decline for years), and such an increase could cause many steam customers to switch to electric or natural gas service. Electric demand in New York City is already high, and there is little new supply being added to that market. The basic principles of economics dictate that the transfer of steam customers to the electric system, many of whom are large commercial buildings, will further increase demand and drive energy prices higher. Specifically, the loss of steam cooling could increase electric load by 433 MW, which could cause the annual market price of capacity to increase by \$200 million and possibly increase annual energy prices by \$100 million (Tr., p. 311). Further, the impact of shifting more costs to steam ratepayers and the subsequent ramifications of the collapse of the steam system would not be borne by electric ratepayers alone; the gas system could experience an increase in winter demand, as steam heating customers left the system, necessitating an increase in gas infrastructure (Tr., p. 311).

Westchester conceded that it failed to consider the impacts of its proposal or perform any analysis of the effect it would have on the electric system if the steam system were to shut down (Tr., p. 579). Thus, Westchester's proposal makes sense only if viewed in a vacuum. The Commission, however, does not have such a luxury. It must, and always does, examine the big picture and determine what is in the best interests of all ratepayers. As the foregoing discussion demonstrates, the potential impacts on the electric and gas system as a result of the collapse of the steam system are not inconsequential. The Joint Proposal attempts to prevent such an occurrence by preserving the steam system for the benefit of all Con Edison ratepayers. This approach is consistent with that taken by the Commission in Opinion No. 00-15, and the opposition to the Joint Proposal does not credibly support taking an alternate approach.

Further, it should not be overlooked that the decision of the Commission to accept the Joint Proposal does not set in perpetuity the allocation methodology for ERRP costs. The Joint Proposal's allocation of ERRP costs is applicable only for the two-year term of the Steam Rate Plan. Although the Joint Proposal commits its signatories to continue to advocate for an allocation based on the principle of cost causation (Joint Proposal, p. 17), the Commission is not prohibited from reexamining the allocation in the future, should circumstances warrant it. Also, it is possible that at the end in the proposed rate plan, the proceeds from the First Avenue

Properties will be available and could possibly be used to mitigate the impact of the allocation on both electric and steam ratepayers.

## POINT II

### THE UNION'S OBJECTIONS TO THE JOINT PROPOSAL ARE WITHOUT MERIT

The Union raises two primary concerns with the Joint Proposal—that Con Edison did not provide certain information regarding the cost differential between internal and contract labor costs, which information it believes could change the revenue requirement set forth in the Joint Proposal, and that the Joint Proposal lacks operating and maintenance procedures for the steam main that will convey steam produced from the ERRP along First Avenue. It also raises some tangential issues. For the reasons set forth below, none of the Union's objections have merit, and none form any basis for the Commission to reject or modify the Joint Proposal.

#### A. Labor Issues

The Union opposes the extent of Con Edison's use of contract labor and contends that the company should be ordered to terminate the use of such personnel and hire new employees instead. The Union also claims that the productivity adjustment is inappropriate. Neither of these issues have merit. As to the former, although the Union contends it was denied the opportunity to fully pursue this issue (Tr., p. 74), the record demonstrates that the Union never sought discovery on information that related to the boroughs in which Con Edison's steam and gas businesses are located (Tr., p. 113-115 and Exhibit 8; *see also* Cases 03-G-1671, et al., supra, Ruling Concerning Discovery (issued March 26, 2004)). Further, the decision of whether to use internal or contractor labor is primarily a management decision, with which the Commission should not intercede unless there is an impact to customers or on the company's ability to provide safe and adequate service at just and reasonable rates. Here, Staff submits that there is no reason for the Commission to intercede. Con Edison's gas and steam businesses have been operating under rate plans where the company is able to keep savings generated by efficiencies in its operations. If the Union's contention was valid, in order to maximize shareholder value Con Edison would have utilized internal labor to a much greater extent, and contractor labor to a much lesser extent. The fact that it did not do so, when other indications Staff observed are that

the company attempted to maximize shareholder value wherever and whenever possible, suggests that the Union's analysis is flawed.

As to the latter point, the productivity adjustment is the same as that specifically agreed to by the Union in the last steam case (Tr., p. 112; *see also* Opinion No. 00-15), and the Union's witness testified that the Union "probably" would have agreed to it in this case had the Union not disputed any other issues (Tr., p. 81). Further, the Union did not offer any facts, studies, or other proof that the productivity factor was adversely impacting safety—its sole basis for this conclusion was the unsubstantiated opinion of its consultant (Tr., pp. 109-12). For these reasons, Staff submits that no credible basis exists to justify changing or eliminating the productivity adjustment.

B. The Steam Main

On cross-examination, it was established that the Union's witness on this issue, Richard Koda, is not an engineer and lacks competence to testify to technical issues (Tr., pp. 94, 99). His testimony is offered solely as that of a lay witness and is allegedly based on statements he heard from union members who were unnamed and unavailable for questioning (Tr., pp. 100, 105-06). Mr. Koda did not conduct any studies of the potential for an explosion in the steam main, and he was not aware of whether his client had done so (Tr., pp. 105-06). Presumably, had the Union conducted such a study, it would have provided it as support for its position in these proceedings.

There are important technical differences between the subject main and the steam main at issue in the Gramercy Park explosion that make the Union's reference to that incident inapposite (Tr., pp. 101-05). The type of valve used on the Gramercy main is different from the type of valve used on the First Avenue main, reenergization procedures have been changed, and Staff has been advised by the company that because of that incident, union employees are no longer permitted to reenergize a steam main without a company engineer or manager present. For these reasons, an explosion of the type that occurred at Gramercy Park could not occur in the First Avenue steam main.

The Union's testimony regarding the steam main should be accorded no weight. As noted above, the Union's witness lacked the technical competence, as well as the personal knowledge, to offer any credible opinions about the potential risks of the steam main, and the Union did not offer any legitimate factual basis for its claims. Furthermore, the Union conceded

that the lack of details in the Joint Proposal on operating and maintenance procedures for the steam main was not an impediment to its approval by the Commission (Tr., pp. 107-08). Should the Union wish to pursue this matter, it could do outside of these proceedings via a documented, properly supported petition to the Commission.

C. Other Issues

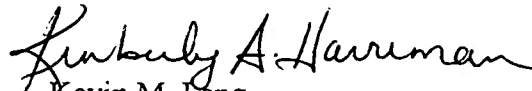
The Union makes a broad statement that Con Edison's management structure is inefficient and recommends that an audit of management's operations be conducted to review its allegation (Tr., p. 61). However, the Union did not offer any facts to support its allegation or any basis or support for its conclusion that the company's revenue requirement for management labor can be reduced. Curiously, although it claimed that the revenue requirement should be reduced, the Union did not propose any corresponding revenue adjustment (Tr., p. 108). The Union had the opportunity to conduct discovery on this issue and develop such an adjustment. That it did not offer any adjustment suggests that the claim lacks merit. Given the Union's failure to satisfy its burden of proof on this issue, coupled with the opposition to such an audit expressed by the company and Staff (Tr., pp. 98-99), the recommendation should be rejected.

Similarly, the Union also proposed that the allocation of common costs be adjusted, but it did not conduct discovery on the issue and offered no adjustment or alternate allocation methodology (Tr., p. 108). It failed to satisfy its burden of proof on this issue, and its baseless allegation should be rejected.

CONCLUSION

For the foregoing reasons the Administrative Law Judge should reject the meritless objections of Westchester and the Union and recommend to the Commission that the Joint Proposal be adopted in whole without modification.

Respectfully submitted,

  
Kevin M. Lang  
Kimberly A. Harriman  
Assistant Counsels

Dated: July 19, 2004  
Albany, New York