STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of KeySpan Gas East Corp. dba Brooklyn Union Gas L.I. for Gas Service.	**CASE 16-G-0058**
Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Brooklyn Union Gas Companies' dba National Grid NY for Gas Service.	**CASE 16-G-0059**

REBUTTAL TESTIMONY OF WILLIAM D. YATES, CPA

FOR

PUBLIC UTILITY LAW PROJECT OF NEW YORK, INC.

Dated: June 10, 2016

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I. INTRODUCTION AND OVERVIEW

Q. ARE YOU THE SAME WILLIAM D. YATES WHO SUBMITTED DIRECT TESTIMONY IN THIS PROCEEDING ON BEHALF OF THE PUBLIC UTILITY LAW PROJECT OF NEW YORK, INC. (PULP)?

A. Yes.

Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?

A. My rebuttal testimony focuses on three sets of issues raised by one or more of the respective direct testimonies of the Utility Intervention Unit (UIU) Rate Panel, the Department of Public Service (DPS) Staff Policy Panel, the DPS Staff Consumer Service Panel, and the DPS Staff Gas Rates Panel. I provide no response to the testimony of the DPS Staff Site Investigation and Remediation Panel other than to state now that its conclusion "that KEDLI and KEDNY have provided adequate support for full rate recovery of their SIR program costs" (on page 26) is misguided for the reasons I presented in my direct testimony. It appears, for instance, that the Staff SIR Panel misunderstood the Commission's Order in Case 11-M-0034 in suggesting on page 16 of its testimony that cost sharing is warranted only "if it is determined that a utility is not exerting appropriate efforts to control SIR costs."

My testimony first discusses the alternative performance incentive mechanisms proposed by Staff and the Companies to reduce residential service terminations and arrears, and then concludes that each proposal is incomplete in the absence of independent verification that all terminations conducted during a test period were in compliance with Home Energy Fair Practices Act (HEFPA) and that these HEFPA-compliant terminations represents a reduction from fully-compliant terminations in an appropriate prior test period. I assert that no performance incentive mechanism should be implemented until an independent working group with the authority to audit the Companies' payment agreement and termination activity concludes that such activities are in compliance with HEFPA.

Second, my testimony explains my support for the UIU's analytic approach to cost of service. PULP strongly endorses the UIU's recommendation that the Commission should reject the Companies' flawed method of allocating an excessive share of gas distribution main costs to residential and small commercial customers. Instead, the Commission should adopt the UIU's approach to allocation because it properly allocates costs based upon the demands placed on the distribution system by each customer class. I also agree with the UIU Rate Panel's recommendations regarding revenue allocation, as they logically follow from its cost of service analysis. Regarding rate design, I largely agree with the UIU Rate Panel's discussion about customer charges and block structures since the UIU provides additional support for the recommendations I made in my direct testimony on those subjects. However, from PULP's perspective on the dire situation of

the Companies' large number of low income customers, I believe the UIU's recommendations are insufficiently modest.

Third, my testimony rejects the Staff Policy Panel's proposed Earnings Sharing Mechanism (ESM). I find it flawed in both concept and design. Given the seriousness of the impact of the Companies' deferred payment agreement (DPA) and termination practices and the magnitude of the Companies' SIR obligations, as discussed in my direct testimony, as well as the substantial increase in headcount and in residential customers' delivery bills proposed by Staff, this is certainly the wrong time to depart from established practice in one-year litigated rate plans.

Q. ARE YOU SPONSORING ANY EXHIBITS IN SUPPORT OF THIS REBUTTAL TESTIMONY?

A. No.

II. PERFORMANCE INCENTIVES TIED TO TERMINATIONS

Q. PLEASE SUMMARIZE YOUR UNDERSTANDING OF THE COMPANIES' AND OF STAFF'S PERFORMANCE INCENTIVE PROPOSALS.

A. As described by Staff's testimony, the Companies propose an incentive mechanism to reduce residential service terminations. Under the proposal, KEDNY would receive $1.4 million if terminations were reduced below 38,000 per year, a 5 percent reduction from the five-year average of 39,903. Alternatively, KEDNY would receive $2.1 million if terminations were reduced below 37,000 per year, a 7.5 percent reduction from the five-year average. Under the proposal, KEDLI would receive $730,000 if terminations are reduced to below 13,300, a five percent reduction from the approximately 14,000 terminations in Calendar Year 2015. Alternatively, KEDLI would be entitled to $1.04 million if terminations were reduced below 13,000, a 7.5 percent reduction from the 2015 average. The Companies state that the incentive levels are equal in value with the costs that would be incurred if the terminations had been performed. (Staff Consumer Policy Testimony, Page 41)

The Staff's proposal for KEDNY recommends a maximum positive revenue adjustment (PRA) of $1.26 million if KEDNY achieves both of the following targets for the rate year: an uncollectible level of no more than $12.4 million and residential service terminations for nonpayment of no more than 34,600 customers. If uncollectibles rise to $19.7 million or more and terminations rise to 41,000 customers or greater, a maximum negative revenue adjustment (NRA) of $1.26 million should be applied. The Staff proposal for KEDLI recommends a maximum PRA of $840,000 if KEDLI achieves similar targets for the rate year, with an uncollectible level of no more than $8.9 million and residential service terminations for non-payment of no more than 8,700 customers. If

uncollectibles rise to $11.7 million or more and terminations rise to 10,000 customers or more, a maximum NRA of $840,000 should be applied. Partial positive or negative revenue adjustments are possible if targets are partially met (Staff Consumer Policy Testimony, Pages 42-47 and Exhibit __CSP-4).

Q. DO YOU THINK EITHER OF THE PROPOSALS BY THE DPS STAFF OR THE COMPANIES TO IMPLEMENT AN INCENTIVE MECHANISM TO REDUCE TERMINATIONS SHOULD BE ADOPTED IN THEIR CURRENT FORMS?

A. No. Neither the Staff nor the Companies' proposal is satisfactory because they would implement an incentive mechanism to reduce terminations without first demonstrating that all terminations conducted by the Companies are already in compliance with HEFPA. In my testimony in this proceeding, I recommended that an independent working group be established to ensure that HEFPA requirements are followed for customers of the Companies whose accounts were eligible for termination or whose accounts are actually been terminated. And as a generic principle, PULP has already expressed support for incentive mechanisms for reducing terminations which require an independent verification that all terminations conducted during a test period were in compliance with HEFPA and represent a reduction from fully-compliant terminations in an appropriate prior test period (Case 14-M-0101, *Reply Comments in Response to the Staff White Paper on Ratemaking and Utility Business Models (Track Two)* at 11). If

such verification could be achieved, PULP would be supportive of a suitable incentive mechanism to enhance customers' ability to retain essential service beyond the statutory payment agreement and termination provisions of HEFPA. However, it would be inappropriate to reward the Companies for "reduced" terminations in any years that either 1) included non-HEFPA compliant terminations or, 2) were lower than prior test years because prior test years included non-HEFPA compliant terminations.

Q. PLEASE ELABORATE ON YOUR OBJECTION TO THESE PROPOSALS.

In my direct testimony in this proceeding, I provided evidence that the Companies' customers had insufficient access to DPAs (Yates-KEDNY, Pages 30-36; Yates-KEDLI, Pages 26-31). This evidence was provided by the Companies' Collection Activity Reports (CARs), which showed a steadily declining number of DPAs Made and percentage of customers in arrears covered by DPAs; and in responses to PULP information requests suggesting that the training of collections staff, particularly with regards to oral DPAs, was not adequate to ensure compliance with HEFPA. (PULP-21 LBJ-21 BULI-XX; PULP-49 LBJ-49 BULI-649) For KEDNY, I recommended that an independent working group be established with the authority to audit all of KEDNY's accounts "Eligible for Field Action" as of December 31, 2015 and terminations from January 1, 2016 to the present. For KEDLI, I recommended that an independent working group have the authority to audit all of the KEDLI's residential terminations from

January 1, 2014 through the present. Such audits would help ensure the Companies' compliance with HEFPA; in particular, to monitor and track whether customers responsible for these accounts were provided the opportunity to negotiate and execute affordable DPAs. (Yates-KEDNY, Page 9; Yates-KEDLI, Page 9) Audit results could also determine an appropriate annual level of terminations upon which to assess future performance. However, without the verification provided by compliance audits, no such determination can be made and it is inappropriate to establish an incentive mechanism.

Q. ASSUMING AN INDEPENDENT AUDIT WAS CONDUCTED THAT DETERMINED THAT ALL TERMINATIONS DURING A SUITABLE TEST PERIOD WERE HEFPA-COMPLIANT, WOULD YOU APPROVE OF THE INCENTIVE MECHANISM PROPOSED BY STAFF?

A. Yes. However, for KEDLI, I would recommend that Staff review its "positive revenue adjustment" (PRA) and "negative revenue adjustment" (NRA) targets for terminations to account for the fact that until 2014, much of the Companies' termination activity was tied up with the operations services agreement (OSA) between the Companies' parent (National Grid USA) and the Long Island Power Authority (LIPA). As part of this arrangement, the Companies' relied on National Grid USA field operations personnel to effectuate terminations for combined electric customers of LIPA and gas customers of KEDLI. For this reason, until 2014, when National Grid USA's OSA with LIPA expired

and KEDLI became fully responsible for its own field operations activity, the monthly CARs submitted by KEDLI to the Public Service Commission may - or may not – have fully reflected the terminations of KEDLI gas customers. This question should be resolved in the development of termination PRA and NRA targets.

In general, Staff's approach has several advantages over the Companies' proposed performance incentive to reduce terminations. For both KEDNY and KEDLI, Staff proposes a balance of both PRAs and NRAs based on annual targets for terminations and uncollectibles. The first way that Staff's proposal is balanced is that they would subject the Companies to incentives that reward good performance while discouraging poor performance. The second is that both terminations and uncollectibles are considered in Staff's incentive mechanism. Staff requires that terminations be reduced without creating more uncollectibles. To achieve such a goal, the Companies must ultimately work with customers who are having difficulty paying their bills by, for example, negotiating affordable DPAs, enrolling them in an enhanced Reduced Rate Program (if applicable), and/or providing the customer with information about HEAP or energy assistance (one-shot) grants. In this way, Staff's proposal aligns with PULP's position that *positive incentive mechanisms must be based on performance that exceeds the statutory protections required by HEFPA*.

Staff's proposal is also meritorious in that it sets targets for terminations and uncollectibles based on one standard deviation from normalized seven year averages.

(Staff, Exhibit __CSP-4, Page 2) This would better align positive and negative incentives with the Companies' terminations and uncollectibles behavior over a full business cycle. In addition, setting targets one standard deviation above or below "average" over such a period would require performance that "deviates" meaningfully from average before the Companies could be eligible for a PRA in the case of positive results or subject to an NRA in the case or poor performance.

Q. ASSUMING AN AUDIT WAS CONDUCTED THAT DETERMINED THAT ALL TERMINATIONS DURING A SUITABLE TEST PERIOD WERE HEFPA-COMPLIANT, WOULD YOU APPROVE OF THE INCENTIVE MECHANISM PROPOSED BY THE COMPANIES'?

A. No. There are several problems with the Companies' proposal, including:

1. The Companies propose only a positive revenue adjustment; there are no consequences if terminations are above average in any given year. Consequently, KEDNY could have received performance revenue in a year such as 2015, when exogenous factors artificially lowered its terminations, but not be penalized in a subsequent year when it "caught up" on terminations.
2. Unlike Staff's proposal, the Companies' proposal does not balance incentives to limit both terminations and uncollectibles.

3. The Companies uses a simple five-year average instead of a normalized seven year average upon which to base their performance. This limitation of this approach is obvious as evidenced by the fact that KEDNY already proposes to disregard its artificially low level of terminations from 2015 and instead use average terminations from 2010–14 as the basis for setting targets for performance revenue. The Companies' would then capture both 2010 and 2011, the two peak years of terminations after the unprecedented financial crisis of 2008-9, instead of only 2009. The result would be a significant upward distortion of targets upon which to base performance revenue (Yates-KEDNY, Exhibit 2c, Pages 1-7)
4. The Companies' targets for lower terminations do not represent sufficiently meaningful reductions for compensation. For KEDNY, the Companies' proposes that it earn partial compensation if terminations fall below 38,000 and full compensation if terminations fall below 37,000. Using these criteria, KEDNY would have earned full compensation in eight of the twelve years from 2003 – 2014. The long term average of this period is 34,105 terminations. (Yates-KEDNY, Exhibit 2c, Page 1-7) The Companies' proposes that it be awarded performance earnings based on targets that are at 8 – 14% higher than this long term average. Further, in none of the years that the Companies' would have earned performance compensation would it have earned only partial compensation; the interval of 1,000 terminations between partial and full compensation is not sufficiently meaningful to be used as a performance criterion.

For KEDLI, the Companies' proposes that it earn partial compensation if terminations fall below 13,300 and full compensation if terminations fall below 13,000. These targets are set just below the level of 13,528 actual terminations in 2015. (Yates-KEDLI, Exhibit 2c, Page 1-7) As discussed earlier, before setting targets for performance revenue there is a need to review KEDLI data prior to 2014 to determine the extent to which the CARs may, or may not, reflect the actual level of KEDLI termination activity.

Q. WHAT ARE YOUR RECOMMENDATIONS REGARDING THE ADOPTION OF AN INCENTIVE MECHANISM?

A. Based on the findings I discuss throughout my direct testimony, I recommend that certain actions should be taken before any performance incentive mechanism to reduce residential service terminations and collectibles can be considered. In the context of this rate case, the Companies should agree, or the Commission should require the Companies to:

1. In Case 16-G-0059, establish an independent working group with the authority to audit all of the Companies' accounts "Eligible for Field Action" as of December 31, 2015 (Yates-KEDNY, Exhibit 2b, page 143) and terminations from January 1, 2016 to the present, to ensure Companies' compliance with the Home Energy Fair Practices Act (HEFPA); in particular, to monitor and track whether customers

responsible for these accounts were provided the opportunity to negotiate and execute affordable DPAs.

2. In Case 16-G-0058, establish an independent working group with the authority to audit all of the Companies' residential terminations from January 1, 2014 through the present (Yates-KEDLI, Exhibit 2b, page 143 - 158), to ensure the Companies' compliance with the Home Energy Fair Practices Act (HEFPA); in particular, to examine whether customers responsible for these accounts were provided the opportunity to negotiate and execute affordable deferred payment agreements (DPAs).
3. Alternatively, as the less preferred option, establish the independent working group described above and direct the working group to conduct an audit of all terminations in all years that would be included in any calculation of performance incentive mechanism targets, again ensuring the Companies' compliance with HEFPA; in particular, to verify that customers responsible for these accounts were provided the opportunity to negotiate and execute affordable DPAs.

In the event that an independent working group determines that the terminations in one of the options above were fully HEFPA-compliant, I would recommend adoption of Staff's performance mechanism to reduce terminations. If the approach in Options 1 and 2 are taken instead of Option 3, I would recommend phasing in revenue adjustments on a pro-rata basis over a period of seven years, at which time normalized seven-year averages will be available to be calculated and updated.

III. COST OF SERVICE, REVENUE ALLOCATION AND RATE DESIGN

Q. DO YOU HAVE ANY REACTIONS TO THE TESTIMONY OF THE STAFF GAS RATES PANEL AND THE UIU RATE PANEL REGARDING COST OF SERVICE?

A. Yes. The Staff Gas Rates Panel (at pages 43-44) suggests it has some concerns with the Companies' approach to cost of service. Staff indicates, however, that it has chosen not to challenge the Companies' approach because, Staff says, its revenue allocation and rate design recommendations have the effect of mooting those concerns. From my perspective, it would have been useful for Staff to discuss its problems with the Companies' approach in more detail and to offer alternatives. It is possible that all or some of Staff's revenue allocation and rate design recommendations may not be adopted. If that were to happen, the parties, the ALJs and the Commission, would all benefit from understanding Staff's difficulties with the Companies' approach to cost of service. Further, it is useful for residential consumer advocates to know whether (and, if not, why not) Staff in these proceedings agrees with the decision of Staff in Orange & Rockland's 2014 gas rate proceeding (Case 14-G-0494) to classify distribution mains as 100% demand-related, with the costs allocated based upon peak usage rather than the number of customers.

In contrast, the UIU Rate Panel presents a robust discussion of cost of service issues and an alternative cost of service approach that makes sense and is fairer than Companies' proposal to residential and small commercial customers. On page 16 of its testimony, the UIU Rate Panel explains: "The Companies chose to classify a large fraction of delivery costs as 'customer-related.' They consequently allocated most of these costs to classes with the largest number of customer accounts, and this led them to design rates that place a greater burden on smaller customers relative to larger customers." The UIU Rate Panel identifies on page 26 of its testimony the Companies' treatment of FERC Account 376: Distribution Mains as particularly troubling because the classification of approximately 40 percent of these costs as customer-related has a huge impact on the costs borne by residential ratepayers. I support the UIU Rate Panel's alternative approach to allocation of these costs, which is grounded on the concept that "the system is designed to meet peak demand, so peak demand is the simplest and best proxy for what 'causes' these costs to be incurred." (Direct Testimony of UIU Rate Panel at 35.) I also agree with the UIU's conclusion that the Companies' approach places an improperly large share of the distribution systems' costs on residential customers and provides a disincentive for residential customers to engage in energy conservation.

Q. DO YOU HAVE ANY REACTIONS TO THE TESTIMONY OF THE STAFF GAS RATES PANEL AND THE UIU RATE PANEL REGARDING REVENUE ALLOCATION?

A. Yes. The Staff Gas Rates Panel recommends on page 45 of its testimony that all firm service classes receive the same percentage increase. While this recommendation has some superficial appeal, PULP does not endorse it because it is grounded on a flawed cost of service approach, as discussed above. I prefer the UIU Rate Panel's recommendation on page 44 of its testimony that the Commission should take steps to constrain the impact of the revenue increase on those classes of customers, such as residential non-heat, that are over contributing to the system average rate of return. I also agree with the UIU that value of service rather than cost of service is the proper way to allocate costs of the distribution mains to TC, IT, DG and EG customers.

Q. DO YOU HAVE ANY REACTIONS TO THE TESTIMONY OF THE STAFF GAS RATES PANEL AND THE UIU RATE PANEL REGARDING RATE DESIGN?

A. Yes. I disagree with the Staff Gas Rates Panel's endorsement on page 46 of its testimony of the Companies' proposed minimum charge rates and increasing the volumetric blocks by an equal percentage. In my direct testimony (at pages 43-45) I explained why the Commission should reduce the minimum charges to $10.00 for residential customers and transition towards an inclining block structure. The UIU Rate Panel provides additional

support for my recommendations in the rate design portion of its testimony, stating on page 47, for instance, that "we recommend that the Commission steer the Commission away from high customer charges (or minimum bills) and low tail block rates" so as to provide customers with more control over their usage and encourage energy conservation. I am, however, not persuaded that the UIU's modest approach to actually achieving these important public policy goals is adequate or fair to residential customers.

IV. STAFF'S PROPOSED EARNINGS SHARING MECHANISM

Q. PLEASE SUMMARIZE THE PROPOSAL OF THE STAFF POLICY PANEL TO IMPLEMENT AN EARNINGS SHARING MECHANISM IN THE CONTEXT OF A ONE-YEAR RATE PLAN.

A. Staff proposes to allow the Companies to retain 100 percent of earnings between Staff's recommended ROE of 8.6 percent and 9.1 percent, one-half of earnings above 9.1 percent and 9.6 percent, one-quarter of earnings above 9.6 percent and 10.1 percent, and one-tenth of earnings above 10.1 percent.

Q. DO YOU AGREE WITH THE PROPOSAL OF THE STAFF POLICY PANEL TO IMPLEMENT AN EARNINGS SHARING MECHANISM FOR A ONE-YEAR RATE PLAN?

A. No, I do not. The Staff Policy Panel offers two reasons for its proposal on page 12 of its testimony. It states that an ESM "will ensure that customers receive a portion" of any benefits realized from the hiring of more than 300 new employees and new initiatives proposed by the Companies. The Staff Policy Panel also states that "should the Companies choose to 'stay out,' or not seek new rates to be effective immediately after the rate year, i.e., January 1, 2018, an ESM will ensure that customers only pay for a reasonable ROE. I believe this reasoning is seriously flawed.

Regarding the first justification, Staff does not explain why customers should not receive a portion of benefits resulting from the new hires and new initiatives, for which they are bearing 100 percent of the costs, as soon as the earned ROE exceeds the allowed ROE. Staff also does not offer safeguards to prevent the Companies from keeping overearnings that could result if the Companies do not implement all of the new headcount allowance or new initiatives that Staff would allow in rates.

Regarding the second justification, Staff does not explain why it believes an ROE of 9.1 percent is "reasonable" when it also asserts that the appropriate ROE, derived pursuant to the Commission's traditional Generic Financing Methodology, is 8.6 percent. As I discussed in my Direct Testimony, the Companies have a serious issue with decreased

use of DPAs and higher numbers of terminations. PULP may be willing to entertain narrowly focused positive incentives based on measurable outcomes, but this proposed giveaway of customers' money for amorphous achievements is unacceptable.

The Staff Policy Panel notes on pages 10-11 of its testimony that the 134 basis point difference between the Companies' requested ROE of 9.94 percent and Staff's recommended ROE of 8.60 percent is worth about $31.8 million in revenue requirement for KEDNY and about $24.7 million for KEDLI. Based on my calculations, Staff's 50 basis point adder is worth about $12 million for KEDNY and about $9 million for KEDLI. I believe these amounts of customer money are better spent on providing rate relief and energy saving measures to low income customers, as I described in my Direct Testimony, rather than rewarding the Companies for simply doing their jobs.

PULP is amenable to discussing incentives related to specific targeted goals. However, the sheer magnitude of Staff's recommended revenue increase, along with the increased number of terminations and Staff's recommendation regarding SIR cost recovery, makes it impossible for me to support this significant deviation from established practice.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.