Case No. 16-G-0369

CORNING NATURAL GAS CORPORATION

REBUTTAL TESTIMONY

OF

FIROUZEH SARHANGI AND L. MARIO DIVALENTINO

ACCOUNTING AND POLICY PANEL

November 15, 2016

Q. Ms. Sarhangi, please state your full name and business address.

A. My name is Firouzeh Sarhangi and my business address is 330 West William Street, Corning, NY 14830.

Q. Are you the same Firouzeh Sarhangi who presented direct testimony on behalf of Corning Natural Gas Corporation ("Corning" or the "Company") in this proceeding?

A. Yes, I am.

Q. Mr. DiValentino, please state your full name and business address.

A. My name is L. Mario DiValentino and my business address is 4547 Lake in the Woods Drive, Spring Hill, FL 34607.

Q. Are you the same L. Mario DiValentino who presented direct testimony on behalf of Corning in this proceeding?

A. Yes, I am.

Q. Ms. Sarhangi and Mr. DiValentino, what is the purpose of your rebuttal testimony?

A. We are primarily responding to Staff's direct case and the proposed adjustments recommended therein. We will indicate where we agree and where we disagree with Staff's recommendations. Although we have tried to be thorough in our response, it is possible that we may not refer specifically to every single point of disagreement. Accordingly, silence as to any particular matter should not be construed as acceptance. In the course of responding to Staff, we are presenting updates to the Company's direct case to address major changes in data that were not known at the time of the initial filing on June 17, 2016. These matters include some of the items that were identified in Corning's September 7, 2016 update filing, as well as additional items that have become known since then. Presenting updates at this time is consistent with the Commission's *Statement of Policy on Test Periods in Major Rate Proceedings*, 17 NY PSC 25R (November 23, 1977). The subjects we will address (or note where addressed in our direct testimony), by witness or panel, include the following areas. In some cases, we note our agreement with Staff and, in others, we describe our disagreement with some or all of Staff's positions.

Staff Gas Rates Panel

- Operating Revenues

Witness Wright

- Accumulated Deferred Income Taxes
- Payroll
- Rate Case Expense
- Productivity

Witness Gadomski

- Incentive Compensation

Witness Malpezzi

- Inflation
- Health Insurance Costs
- Uncollectible Costs
- Accumulated Deferred State Income Taxes
- Building Services

Staff Gas Infrastructure and Operations Panel

- Updated Expenditure Levels

Witness Esposito

- Classification of Fringe Benefits
- Pension and Other Post-Employment Benefit ("OPEB") Expense
- Health Insurance – Pay As You Go
- Affiliate Allocations
- Rate Case Expense
- Postage
- Property Taxes

Staff Finance Panel

- Overall Rate of Return

Q. In the course of your analysis of Staff's proposed direct testimony and exhibits, did the Company propound any interrogatories to Staff?

A. Yes. Even before receiving Staff's filing on October 28, 2016, we submitted to Staff, as well as the other active parties, an interrogatory (CNG-DPS-1) requesting, for each witness and panel, "all workpapers, spreadsheets, source documents, and any other materials that were used or otherwise relied upon in the development of the respective witness's or panel's testimony and any exhibits sponsored by such witness or panel." In addition, on November 1, 2016 (within one business day of receipt of Staff's case), we propounded an additional 17 interrogatories (CNG/DPS-2 through CNG/DPS-18); on November 2, 2016, we propounded an additional 11 interrogatories (CNG/DPS-19 through CNG/DPS-29); on November 3, 2016, we propounded another 41 interrogatories (CNG/DPS-30 through CNG/DPS-70); and, on November 4, 2016, we propounded 10 more (CNG/DPS-71 through CNG/DPS-80).

Q. Have you received responses to all of the interrogatories Corning submitted to Staff?

A. With one possible exception, yes. As of the close of business on November 14, 2016, the deadline for responses to our last group of interrogatories, we had received responses to all except one, which we were informed would be provided on November 15, 2016.

Q. Have the Company witnesses been able to analyze the responses received for purposes of determining whether they may have an impact on the Company's rebuttal evidence?

A. Because, as of the time of preparation of our testimony and exhibits, we have had many of the Staff responses for only a few hours, we cannot say definitively whether our review of those responses, and possible follow-up on them, will have an impact on the positions taken in our rebuttal presentation.

Q. To the extent that you have not had sufficient time to practicably analyze those responses and factor them into your testimony, how do you propose to handle such responses?

A. On behalf of the Company, we are specifically reserving the right to submit additional evidence addressing any issues presented by the Staff responses within a reasonable time after this submission.

Q. Are you sponsoring any exhibits?

A. Yes. We are sponsoring the following exhibits: Exhibit __ (CAP-R-1), which replicates Staff's rate of return calculation and supporting schedules (summarizing the Staff adjustments accepted by the Company and the adjustments which the Company rejects, which are specifically discussed later in this testimony); Exhibit ___ (CAP-R-2), addressing affiliate allocations; Exhibit ___ (CAP-R-3), providing a health insurance update; Exhibit ___ (CAP-R-4), showing the basis points associated with incentives and penalties; Exhibit ___ (CAP-R-5), a pension and OPEB illustrative; Exhibit ___ (CAP-R-6), showing the relative weight of financial performance incentives; and Exhibit ___ (CAP-R-7) containing a Staff response to a Company interrogatory regarding rate case costs.

PRELIMINARY COMMENTS

Q. Before turning to your item-by-item response to the Staff Panels and individual witnesses, do you have any overall comments?

A. Yes. In reviewing the totality of Staff's proposed evidence, we are troubled that Staff consistently appears to take every opportunity to prevent Corning's shareholders from earning a reward for the risks they have taken and continue to take and for the performance they have achieved – high levels of performance that primarily benefit the customers of the regulated utility business.

Q. Do you have specific examples in mind?

A. Yes. Other witnesses will address the details of various Staff positions that we find troubling; but we can cite two examples that starkly illustrate this point: Staff's proposed capital structure; and Staff's insistence that only "new" performance measures are entitled to positive incentives.

Q. Please describe the first example.

A. The Staff Finance Panel's proposed 48% equity ratio is addressed in detail in Company Witness Bulkley's rebuttal testimony; but, in addition to the weak basis described by Ms. Bulkley, that proposal runs counter to the Commission's objectives of encouraging greater equity investment in Corning. In effect, Staff's equity cap ignores that policy goal. The limitation proposed by Staff contravenes the Commission's encouragement to the Company to pursue an aggressive infrastructure replacement program. While Staff seems fine with the Company's willingness to take the risk associated with that program, as well as with system expansion generally (also consistent with Commission policy), Staff refuses to recognize the need for support for the necessary borrowing to accomplish those objectives by ensuring an adequate equity ratio. The fact that current banking agreements allow an equity ratio that is lower than the Company's proposed 50.03% does not answer the question. If the Company is expected to sustain Commission-mandated infrastructure investment programs, it must remain attractive to investors and have an equity ratio that reflects those objectives, not simply what will pass muster with one bank today.

Q. Please describe your second example.

A. While the Staff Policy Panel acknowledges that the REV Proceeding (Case 14-M-0101) fosters the concept of positive incentives for utility performance, rather than just negative ones (p. 16), the balance of negative revenue adjustments ("NRA") to positive revenue adjustments ("PRA") in Staff's presentation is overwhelmingly tilted in favor of NRAs. To illustrate this point, we have prepared Exhibit ___ (CAP-R-4) which shows the various NRAs and PRAs in Staff's proposed evidence, along with their basis point impacts. The balance of total NRA basis points to PRA basis points is 201 to 40. Translated into dollars, based on the value of each basis point, the comparison is $934,111 in NRAs versus $185,893 in PRAs. In other words, under Staff's proposed incentive system, the Company is subject to more than five times in penalties what it could achieve in rewards. This is hardly an even-handed proposal. Indeed, when viewed against the background of Staff's woefully inadequate proposed Return on Equity of 8.2%, the Company is exposed to a ROE as low as 6.19% and can only benefit up to 8.60%.

Q. How does Staff justify its approach?

A. The Policy Panel asserts that the Commission's statements in the REV proceeding require that only "new" measures be subject to rate treatment that would allow PRAs because "old" measures should remain under a NRA-only regime (p. 20).

Q. Do you agree with that reading?

A. No. We do not read the Commission's pronouncements as meaning that any pre-existing mechanisms must remain as NRA-only; but, even if one were to read the Commission's language that way, the Commission also made clear (and the Panel acknowledges) that negative incentives may need to be adjusted or eliminated if they have little remaining value. Accordingly, even using Staff's starting point that negative adjustments should remain in place, that premise does not lead to the conclusion that those NRAs should not be modified to add a PRA side or be eliminated altogether. In short, it is counterintuitive and illogical to claim that, just because a particular performance measure was implemented in the "bad old days" when all "incentives" were negative, it is forever locked into a time warp and can never be balanced with a positive element – a positive element that, under the logic of REV, is far more likely to encourage better performance.

Q. Do you have any further comments on these examples?

A. Yes. By focusing on these two relatively stark examples of Staff's overall approach to this case, we do not intend to suggest that others are any less egregious. As described in the remainder of our rebuttal testimony, as well as in that of the other Company witnesses, Staff has taken advantage of virtually every opportunity to prevent the Company from recovering the full amount of its reasonable costs of doing business and to earn a return on investment that is commensurate with the risks borne by shareholders.

Q. Do you agree with the Staff assertion that the rate model used in New York limits risk, thereby justifying lower returns?

A. No. The argument in the past had been that New York lowered risk by using a future test year, providing reconciliations for pensions and allowing fuel cost recovery through adjustment clauses. The Staff Finance Panel's Exhibit ___ (FP-9), Table 1, shows that the New York model is not much different from that of 22 other jurisdictions. Nevertheless, the allowed rates of return in other jurisdictions are higher. The days when the New York rate model was considered the "gold standard" in ratemaking are long gone.

STAFF GAS RATES PANEL

Operating Revenues

Q. Has the Staff Gas Rate Panel ("GRP") made adjustments to the Company's operating revenues?

A. Yes. The GRP has made two adjustments to the Company's forecast. The first relates to the number of years to be used for the weather normalization calculation on customer bills. The Company proposed a ten-year weather normalization period consistent with the period approved by the Commission for Central Hudson. The GRP proposes a 30 year period which is the period currently used by Corning. The difference between the two methods, when applied to sales, results in an upward adjustment to revenues by Staff of $104,985. The second adjustment relates to moving local production transportation revenues currently passed back to customers via the Delivery Rate Adjustment ("DRA") and to become an imputation into base rates. The additional revenues to be imputed in base rate is $887,551.

Q. Do you agree with these adjustments to operating revenues?

A. The Company, for the purposes of this case, will accept the weather normalization adjustment. As to the treatment of local production transportation revenues proposed by Staff, we object to imputation of those revenues into base rates. Additionally, even if the GRP proposal were adopted, we disagree as to the revenue level to be imputed.

Q. Please explain.

A. The current imputation includes local production revenues from Daily Access Fees, Meter Charge. The amount proposed in this case is $286,688. The GRP proposes to increase this amount by $887,551 to $1,174,239. The GRP recommends no change to the sharing mechanism associated with the local production transportation revenues and revenues from Daily Access Fees, Meter Charge. The recommendation is to move the customer share of the local production credit from the DRA to base rates. The amount that Staff utilized to set its target was based on historical revenue levels.

Q. Do you agree on the revenue imputation level recommended by the GRP?

A. No we do not. The Company has and will continue to experience declining revenues from local production transportation revenues. The reasons for this decline are detailed in Company witness Miller's rebuttal testimony. However, as indicated in Exhibit ___ (GRP-1) page 3 of 12 (Response to DPS-203 RQ-1, part 2), the Company provided the forecasted revenue and volumes by month for the rate year. The amount due customers is $146,000 in the rate year. Therefore the GRP imputation amount should have been adjusted downward by $741,551 ($887,551- $146,000). The total revenue imputation should be $432,688 ($286,688+146,000).

Q. Since the GRP is providing for reconciliation of these revenues, why is the imputation revenue level important?

A. The reconciliation that the GRP proposes puts the company at risk for 20% of any shortfall from the target (imputation) levels. It is not a 100% true up. The maximum amount for which the Company would be at risk under Staff's proposal would be $234,848.

Q. Does the GRP not provide a 20% incentive if the target levels are exceeded?

A. Yes. However, if the target levels are set unrealistically high, as the Staff proposal does, then there is only additional risk that the Company assumes. Again, Staff's proposal adds considerable additional risk on the Company that we believe has not been considered in the ROE recommendation.

Q. What is your recommendation on the GRP proposal?

A. We recommend that the current practice of returning local production transportation revenues achieved to customers should continue via the DRA. The local production imputation should be set based on revenues from Daily Access Fees, Meter Charge fees. No additional risk should be imposed on the Company. Therefore, the imputation amount should be set at $286,688 and the $887,551 "transfer" to base rates proposed by the GRP should not be made.

WITNESS WRIGHT

Accumulated Deferred Income Taxes

Q. Do you have comments regarding Staff witness Wright's presentation of Staff's revenue requirement?

A. Yes. Based on our review, it appears that not all the consequences of Staff's adjustments have been fully reflected in the calculation of its revenue requirement.

Q. Please explain.

A. Staff witnesses make several adjustments that have accumulated deferred tax consequences such as reduction to plant in service and elimination of rate case deferrals. Yet no adjustment is made to the accumulated deferred tax balance in Staff's Rate Base presentation.

Q. What is the impact of the accumulated deferred tax balance not being updated for the various Staff adjustments?

A. The Staff revenue requirement is understated.

Q. Can you report for the record by how much the Staff revenue requirement is understated?

A. No. We have not made that calculation. Since the adjustments made by Staff that affect the accumulated deferred tax balance have been reversed, it will have no effect on our revenue requirement presentation. However, for record clarity, Staff should update its revenue requirement to account for deferred tax consequences of its Rate Base adjustments.

Payroll

Q. Do you agree with Witness Wright's payroll adjustments?

A. For purposes of this case, we accept the adjustments for overtime and prevailing wages. As we discuss later in our testimony, however, the incentive compensation amount should be reversed.

Rate Case Expense

Q. Do you agree with Witness Wright's 2008 and 2011 Rate Case adjustments?

A. No. As stated in Exhibit ___ (MW-2), pages 6, 7 and 34, the Commission continued the 2008 and 2011 rate case amortization. The Company relied on the accounting treatment granted by the Commission. Any change in the manner that prior year rate case amortizations are accounted for should be made prospectively and not retroactively.

Q. Do you agree with the adjustment to 2016 rate case costs eliminating Moonstone Consulting costs?

A. We believe that the costs of Moonstone were correctly presented and includable in rate case costs. However, the Company would not object to the adjustment if it were done correctly.

Q. Please explain.

A. Staff believes that Moonstone works only for Coning Natural Gas - which it does not – and, therefore, its contract should be expensed. The Staff adjustment eliminates the Moonstone costs from rate case expense but fails to include the full value of the contract in outside services. To be internally consistent, Staff should have added $21,515 to outside services.

Q. Would you agree with Staff's Moonstone adjustment if an adjustment to outside services amounting to $21,515 were made?

A. Yes.

Q. Do you have additional comments on Staff's proposed adjustments to rate case expense?

A. Yes. We are addressing other aspects of those adjustments in our response to Staff Witness Esposito's testimony below.

Productivity

Q. Do you agree with Staff Witness Wright's Productivity adjustment?

A. No. We have addressed the fallacy of this adjustment in our direct testimony.

Q. Do you agree with the proposed adjustment for the supply specialist?

A. Yes, if the accumulated deferred tax consequences are properly reflected in rate base.

GADOMSKI

Incentive Compensation

Q. Do you agree with Staff Witness Gadomski's recommendation to deny incentive compensation?

A. No, we do not, for at least two reasons. First, the commentary on the Company's and his own analysis suggests that total compensation for the positions included in the incentive program is far below the compensation for the positions included in both the Company analysis that he revised, as well as his own analysis. Second, he is mistaken as to the importance and need for the Company's financial performance goal.

Q. Do you agree that outside compensation study is required to validate the need for an incentive compensation program?

A. No. We fail to see the need to spend money on a compensation study. It makes no sense for a company the size of Corning to spend the money on a compensation study rather than invest in infrastructure improvement. The Staff witness acknowledges that reasonable conclusions can be derived from the type of analysis that both the Staff witness and the Company performed. While the Staff witness relies heavily on the Commission 2011 order in Case 10-E-0362, we would note that allowing incentive compensation in rates has been permitted for at least the last five years. The initial requirement to benchmark total compensation was to ensure that utility compensation was comparable to compensation for similar positions in its service area. Since the Commission has allowed incentive compensation in rates for other utilities, it makes little sense to have a small company spend money on a compensation study. It makes far more sense that a small utility should look to neighboring utilities, such as New

York State Electric & Gas Corporation, National Fuel Gas Distribution Corporation and Niagara Mohawk Power Corporation, d/b/a NationalGrid, to see if those utilities have been permitted to include incentive compensation in rates.

Q. Why is the financial performance goal (net income) important and necessary?

A. Corning's history of financial weakness and near bankruptcy in 2005 clearly demonstrates that attention to financial strength and solvency is important to customers, as well as shareholders. The achievement of earnings targets enhances the Company's ability to access capital markets to fund the purchase of gas supply and to comply with infrastructure mandates from the Commission. The achievement of the net income financial goal benefits both the customers and shareholders. Staff suggests that the mere existence of that goal is in conflict with safety and reliability goals. It is not. The financial and service reliability goals complement each other and must be worked on simultaneously in order to achieve payout.

Q. Do you agree that Corning's incentive compensation plan is less (47%) weighted to customer service and reliability goals as shown on Exhibit (DSG-3)?

A. No we do not. Staff has combined all financial goals into Financial/unrelated which masks the fact that nearly all the financial goals are customer oriented. We have prepared a revised exhibit that shows the correct weighting, Relative Weight of Financial Performance Incentive Exhibit __ (CAP-R-6). The portion of Customer related goals is 77%.

Q. What is your recommendation as to incentive compensation allowance?

A. Based on the foregoing discussion, the $68,355 should be used in calculating the revenue requirement in this case.

<u>MALPEZZI</u>

<u>Inflation</u>

Q. Do you agree with witness Malpezzi's revision to the inflation rate?

A. Yes. We agree with his revised calculation.

<u>Health Insurance Costs</u>

Q. Do you agree with Mr. Malpezzi's projection of health insurance costs?

A. No we do not. The treatment of health insurance was discussed by us in our direct testimony. The Staff witness does not address any of the points we made in our testimony; rather he cites Commission orders going back to 1984. It is undeniable that the subject of health insurance costs is and has been a burning national and statewide issue. The affordability and availability of health insurance has stirred a fierce national debate. The costs have increased far greater than the general inflation rate. Currently there are reports of increases in premiums for health insurance available under the Affordable Care Act, ranging from 25% to 60%, depending on the plan and the state in which it is purchased. We would also note the conditions and relative cost have significantly changed since 1984. The fact that 32 years has passed since the first Commission order on this cost treatment should require us to take a fresh look at this cost treatment and question its relevance.

Q. Has the Company received a premium increase notice for its health insurance costs?

A. The Company health insurance costs will increase by 14% in 2017.

Q. In light of this notice, what do you recommend?

A. We recommend that health care costs be updated to actual costs through 2016 and that the 14% increase be applied to that amount through the twelve months ended May 31, 2018.

Q. What is the impact of your proposed update?

A. Exhibit ___ (CAP-R-3) shows that health insurance costs would increase to $685,996 or an increase of $86,467 over the 2016 costs of $580,533.

<u>Uncollectible Costs</u>

Q. Do you agree with witness Malpezzi's revision to uncollectible costs?

A. Yes. We agree with that revision.

<u>Accumulated Deferred State Income Taxes</u>

Q. Do you agree with the Accumulated Deferred State Income Tax ("ADSIT") adjustment?

A. No. The ADSIT adjustment of $7,964 is a cumulative change to December 2015. The amount will be reflected in the Company's cost of operation and will be considered in the Company's excess earnings calculation. The Staff treatment in this case assumes that the $7,964 will occur each and every year until rates are next changed. The Staff should have amortized the ADSIT benefit at least over a five year period ($1,593 annually) with a corresponding rate base impact.

Q. Would you accept Staff's adjustment if it were modified as you recommended in your previous answer?

A. Our preference is to reflect the ADSIT amount in the Company's cost of operation in the excess earnings calculation. The amount is not material and the Company's treatment eliminates the need for the administrative recordkeeping associated with the ADSIT deferral. However, if Staff prefers the amortization of the ADSIT deferral in base rates, the annual ADSIT amortization amount should be $1,593 and the Rate Base ADSIT unamortized balance should be $7,168.

Building Services

Q. Do you agree with witness Malpezzi's revision to Building Services?

A. Yes. We agree with that revision to Building Services-Accounts Payable Other.

GAS INFRASTRUCTURE AND OPERATIONS PANEL

Updated Expenditure Levels

Q. Have you reviewed the Gas Infrastructure and Operations Panel ("GIOP") testimony?

A. We have reviewed the calculations that Staff used in support of its various adjustments. Company witness Cook's rebuttal testimony addresses the proper level of budget expenditures the Company should be allowed.

Q. Do you have comments on the GIOP presentation?

A. As a general matter, we do not have any differences as to the methodology used to calculate the impact of the GIOP proposed adjustments on rate base. However, we do have a difference as to the starting point of the GIOP analysis.

Q. Please explain.

A. The GIOP fails to consider the actual capital expenditures for 2016. Therefore, the rate year utility plant in service is understated even if one were to accept (which we do not) all of the adjustments proposed by the GIOP.

Q. Have you updated the GIOP presentation to reflect the actual capital expenditures for 2016?

A. Yes, we have used the GIOP model provided to us in discovery. We updated the capital expenditures to reflect actual capital expenditures from January to August 2016. The September 2016 actuals will be available shortly and we recommend that the calculation be updated at that time for the September actuals. After the actuals were entered into the model (with no changes to Staff adjustments) it was run.

Q. What was the result of the model run?

A. The model run shows that rate base utility plant should be increased by $1,572,566 and accumulated deferred income taxes should be increased by $69,294. The net rate base increase is $1,503,272.

WITNESS ESPOSITO

Classification of Fringe Benefits

Q. Do you have an overall comment regarding Staff witness Esposito's reclassification of costs?

A. Yes. Ms. Esposito reclassifies fringe benefits between several elements of cost. The stated reason is to increase transparency. The Company does not object to the Staff recommendation but the Company believes that parties would have been better served if Staff had proposed that the Company make such a change in the next rate case. All of the reclassifications have no revenue requirement impacts, but they have added time to the analysis of Staff's revenue requirement.

Pension and OPEB Expense

Q. Has Ms. Esposito made adjustments to pension expense?

A. Yes, she makes three adjustments. Two relate to the reclassification issue discussed earlier which, instead of transparency, adds confusion to the analysis. The third adjustment relates to deferred pension balances. Staff recommends an annual amortization of $255,981.

Q. Can you comment on the adjustment?

A. Staff attempts to adjust the pension deferral amounts to take into consideration the amount of pension costs that it believes has been capitalized. Exhibit ___ (AAE-3), page 1 to 5, recasts the pension reconciliation from January 31, 2011 to April 30,

2016. The result of the calculation is a deferral balance of $1,279,907 or $625,402 increase from the December 31, 2010 balance.

Q. You agree with the calculation?

A. No. The Staff analysis is incomplete. The calculation presented does not consider the fact that pension expense per books is unaffected by taking the pension capitalized amount into consideration.

Q. Why does the pension expense per books not change?

A. Exhibit ___ (CAP-R-5) illustrates our point. Under the Staff proposal, inclusion of the pension cost capitalized results in pension expense of the allowed pension amount of $93,228. The pension expense (Company calculation) excluding the pension capitalized amount results in pension expense of the pension allowed amount $93,228.

Q. Why are the pension expense amounts the same under both calculations?

A. The pension reconciliation ensures that pension expense per books matches or equals the amount allowed in rates. The amount allowed in rates is set without regard to the amount to be capitalized. Therefore, under the Staff calculation, the amount capitalized is reflected in the cumulative deferral amount. Exhibit ___ (CAP-R-5) shows clearly that the difference in the deferral amount is the amount capitalized.

Q. Have customers been credited for the pension cost capitalized amount?

A. Yes. As Ms. Esposito indicates, the pension and OPEB amounts capitalized are included in Other O&M costs. She recommends that each capitalized fringe benefit be removed from Other O&M and identified in its separate cost components on the revenue requirement schedule.

Q. What is your position on the Staff adjustment?

A. The adjustment should not be made. As we have indicated, the Staff calculations capture for customers the amount of capitalized costs previously provided to customers. To now retroactively capture those benefits again without a corresponding increase in O&M costs is duplicative.

Q. Will the Company change its reconciliation for pensions and OPEBS as Staff recommends?

A. Yes. The Company will change its reconciliation procedure to account for the disaggregation of fringe benefit costs as Staff recommends on a going-forward basis.

Q. Does Staff make a similar adjustment for OPEBS?

A. Yes. Staff recommends an annual OPEB amortization of $43,675. For the reasons stated in our pension discussion above, we reject this duplicative adjustment.

<u>Health Insurance – Pay As You Go</u>

Q. Do you agree with the Staff adjustment, Health Insurance for PAYGO costs?

A. Yes. We agree to the proposed adjustment of $38,278.

<u>Affiliate Allocations</u>

Q. Have you reviewed Staff's allocations of costs to affiliates of Corning?

A. Yes we have. We find the allocations to be significantly overstated and not consistent with the operational and administrative support required by Corning's affiliates.

Q. Please explain.

A. Since the filing of this rate case, Corning Natural Gas Holding Corporation's (the "Holding Company") acquisition of Pike County Light and Power Company ("Pike" or "PCL&P") has been approved by Pennsylvania Public Utility Commission and the purchase from Orange and Rockland Utilities, Inc. ("ORU") is now complete. A General Manager ("GM") has been hired to manage the operations of Pike's electric and gas system, as well as Leatherstocking Gas Company, LLC's ("LGC") gas operations. ORU will provide billing and customer services under a Transition Services Agreement ("TSA") for a period of 18 months.

Q. Now that the Holding Company has control PCL&P how will it be operated?

A. As we have previously stated a GM has been hired and has begun to implement operational plans. First, as also indicated above, customer services will be provided by ORU for a period of up to 18 months (until March 2018). We would note that LGC customer services (billing, customer calls, collection, etc.) are provided by Mirabito Regulated Industries, the joint venture partner of the Holding Company. Therefore, no billing or customer service support will be needed by Pike during the operation of the TSA; nor will LGC require similar services. The Pike operations plans calls for gas and electric field personnel to be hired as Pike employees. In addition, an administrative assistant and two customer service personnel will be hired by Pike to perform customer service functions such receiving and posting customer payments, responding to customer calls and inquiries, collection and general administrative work. Similarly, a billing clerk will be hired to do Pike customer billings. These costs will be assigned directly to PCL&P. Field services functions will be handled by a third party engineering firm in Pike County, PA, thereby eliminating the need for field planning services from Corning. Finally, with full-time supervision being provided by the GM, the executive oversight will be charged directly. We estimate that the executive oversight direct charge will be ten per cent. If additional services are needed to augment Pike operations from Corning, they will charged directly. The support services required from Corning will be accounting and financial and some technical services.

Q. How does this operational plan impact the affiliate allocations?

A. On November 12, 2015,Corning submitted a petition in Case 12-G-0141 - Petition of Corning Natural Gas Corporation for Modification of Affiliate Standards (the "2015 Affiliate Allocation Petition") requesting the ability to use any of its office personnel to provide services to affiliates with appropriate charging of the cost to the affiliates. To date, that petition has not been approved. Therefore, for purposes of our affiliate calculation for the rate year (the twelve months ended May 31, 2018) we have assumed that the TSA with ORU will operate for its full term. As a consequence, no customer accounting services will be needed from Corning during this period. When TSA expires, as we have noted above, customer service functions will be conducted by dedicated Pike employees.

Q. Have you completed an analysis that shows the difference between your affiliate allocations and those proposed by Staff?

A. In order to show the difference between the Staff and Company calculations we used the work papers provided by Staff as a template for our analysis. Doing so provides a side-by-side comparison of the payroll, accounts payable, property taxes and plant components included in the calculation. Exhibit ___ (CAP-R-2), page 1, reports the results of our analysis. Staff calculates a credit adjustment of $1,421,302 as compared to the Company's credit adjustment of $542,232 for O&M expense. Staff calculates a credit adjustment of $1,338,423 as compared to the Company's credit adjustment of $627,470 for rate base.

Q. What are the major differences between the Staff and Company payroll and fringe benefit allocation calculations?

A. The payroll difference is driven by the allocation of all administrative and customer service personnel by Staff. As we have previously stated, the amount of support services to the affiliates will be primarily accounting and financial, some technical services and executive oversight. Exhibit ___ (CAP-R-2), page 2, details the positions included in both Staff's and the Company's approaches. The associated fringe benefit calculation is detailed on Exhibit ___ (CAP-R-2), page 1.

Q. What are the major differences between the Staff and Company accounts payable allocation calculations?

A. Exhibit ___ (CAP-R-2), page 3, details the difference in accounts payable allocation. The primary difference is that Staff has used an overall rate allocator based on its payroll analysis. The Company allocation considers its revised payroll and building allocation factors. It groups the accounts payable cost into building and payroll costs and allocates cost. These costs are then allocated based on a building or payroll factor as appropriate.

Q. What are the major differences between the Staff and Company property and plant allocation calculations?

A. Exhibit ___ (CAP-R-2), page 4, details the difference in property and plant allocation. Once again, the property and plant allocation differences between Staff and the Company are driven by the number of employee that will provide services to the affiliates.

Q. Do you have any additional comments regarding affiliate allocations?

A. Yes. We have no actual historical experience with affiliate allocations pertaining to the entities involved here. Staff and the Company are therefore faced with the task of estimating the credit adjustment for affiliate allocations to be used in setting Corning's base rates. The difference between the Company and Staff estimates for the credit adjustment is enormous. The Staff O&M credit is 2.62 times the Company's and the Staff Rate Base credit is 2.13 times the Company's.

Q. Does the Company have a recommendation on how to bridge this estimating gap?

A. Corning recommends that the Company's adjustment credits be used in setting rates in this proceeding. The credit adjustment for affiliate allocations imputed in rates would then be reconciled with the actual costs and that any difference would be deferred for future Commission disposition.

Rate Case Expense

Q. Do you agree with Staff's adjustment to the 2016 rate case allowance?

A. Absolutely not. The Staff adjustment on its face is arbitrary, capricious and confiscatory.

Q. Please explain.

A. The Staff adjustment directly impacts the Company's due process rights before the Commission. Because preparation, filing and prosecuting a rate case to its conclusion is the only means available to a regulated utility in New York to ensure that it has the opportunity to achieve the revenues required to realize the reasonable return on investment to which it is entitled under the United States Constitution, the Commission cannot deny the Company the reasonable costs of participating in that process. Staff's proposed adjustment directly impacts the manner and limits the resources that can be brought to bear in Corning's effort to legitimately prosecute a rate case. In fact, as we will discuss further below, the limitation on expenditures Staff would impose would have required the Company to stop entirely its prosecution of this case several weeks ago. In addition, quite apart from preventing Corning from participating in the only process available to it to seek adequate revenues to meet Commission mandates and other costs of doing business, the Staff approach is nothing less than an attempt by Staff to substitute its judgment for that of Company management, a practice that has long been recognized as unwarranted and illegal.

Q. Are you saying that Staff cannot question expenditures for rate case work?

A. Absolutely not. We fully appreciate that Staff's job is to audit Company expenditures and to question them where necessary. The point we are making here, however, is that Staff's approach to this category of expense is fatally flawed for a number of reasons.

Q. Please explain.

A. While Staff agrees that the estimated cost of the rate case is in line with the amount approved by the Commission in the last three rate cases, Ms. Esposito asserts that the amount, "for a company of this size seems excessive" (p. 54). Accordingly, she proposes to cap Corning's rate case cost allowance at the amount allowed a "similarly-sized utility," St. Lawrence Gas, Inc.

Q. Do you agree with Staff that St. Lawrence Gas is an appropriate benchmark for determining the reasonableness of Corning's expenditures?

A. No. While the St. Lawrence case may be appropriate as a source of comparisons, it should not be the only data point used to justify slashing Corning's rate case cost allowance by approximately 67%, particularly when the amounts agreed to by Staff and allowed by the Commission in past Corning cases are in the same range as the Company's proposed amount here.

Q. Are you suggesting that the fact that the Commission, in past Corning cases, allowed greater amounts than Staff recommends here should be decisive?

A. No, we are not. Our point is that, where the Commission, as well as Staff, has regularly found the Company's level of expenditures to be reasonable, and, if anything, the level of rate case activity in this proceeding is more intensive than in past proceedings (for example, having to answer hundreds of Staff "pre-filing" interrogatories), Staff cannot expect to prevail in its proposed adjustment by arguing that, based on the Company's size, the expense "seems excessive."

Q. Did the Company submit any discovery requests to Staff to explore the purported basis for Staff's adjustment to rate case expense?

A. Yes, we did. We submitted Interrogatory CNG/DPS-30, addressed to Staff witness Esposito, on November 3, 2016, to which Staff responded on November 10, 2016. A copy of the response is contained in Exhibit ___ (CAP-R-6). In that interrogatory, we asked Staff to state the amounts of the rate case expenses allowed by Commission rate orders for other major gas and electric utilities during 2014-2016, how many interrogatories those utilities received from Staff, and, with respect to St. Lawrence Gas, the extent of that utility's relationship with its corporate parent.

Q. Does Staff's response to CNG/DPS-30 support Staff's contentions?

A. No. In fact, it highlights the flaws in Staff's position. First and foremost, the response confirms that the superficial comparison to St. Lawrence Gas is the only basis for Staff's adjustment. In response to the first part of the interrogatory requesting the rate case expense amounts allowed by the Commission for other utility rate cases over the past two years, Staff objected on the ground that this information is publicly available to Corning and therefore outside the scope of discovery. Notwithstanding Staff's non-answer, it is readily apparent that Staff did not analyze the amounts allowed other utilities. Had Staff done so, the amounts would have been reflected in Staff's workpapers. As we noted earlier, the Company propounded Interrogatory CNG/DPS-1 to Staff requesting all workpapers for the Staff witnesses and panels. We received nothing pertaining to Ms. Esposito's rate case expense adjustment, much less anything that would indicate that she examined the allowances for utilities other than St. Lawrence Gas. (If Ms. Esposito reviewed those other allowances, then surely her workpapers would have included some evidence of her review.) Thus, this interrogatory response confirms that the adjustment depends entirely on a single data point.

Q. Does the response to CNG/DPS-30 (Exhibit ___ (CAP-R-7)) support any other conclusions?

A. Yes. It supports the fact that the size of a utility does not bear a linear relationship to the level of effort required in rate proceedings in New York. A quick look at the numbers of Staff interrogatories listed for various utilities in the response to part 2 of CNG/DPS-30 illustrates this point with respect to discovery. Particularly when one factors in the fact that all of the cases listed, except for St. Lawrence and National Fuel Gas Distribution Corporation, are either combination utility or multi-company cases, it is clear that the burden imposed by Staff-initiated discovery does not vary much at all by the size of the targeted utility. If anything, the list supports the more reasonable conclusion that the size of the utility has far less bearing on the cost of prosecuting a rate case than does the myriad of factors, such as discovery and issues raised by Staff and other parties, over which the utility has little or no control.

Q. Does Staff point to any particular costs within the rate case expense category as unreasonable or excessive?

A. No. As far as we can tell, Staff's conclusions rest entirely on the comparison described above.

Q. Are there any circumstances unique to Corning that would tend to make the Company's rate case expenses appear to be greater, either in relative or absolute terms, than those of other utilities?

A. Yes. As Staff is well aware, the Company does not maintain an internal staff of regulatory specialists tasked with preparing and carrying out much of the work associated with prosecuting a major rate proceeding. Because the Company tries to minimize the frequency of rate case filings – for the very reason that it is attempting to hold down the cost of those proceedings – it generally proposes three-year rate plans, so that it will not incur the cost of annual filings. As Staff knows, the Company would prefer to extend the "stay-out" period to five years or longer, if Staff would agree to entertain such a proposal; but, in the Company's experience, Staff has been unwilling to do so. While Staff has participated in proceedings to extend existing settlement agreements by up to two years, as in Case 11-G-0280, such extensions nevertheless result in what amounts to a partial litigation of the issues. Regardless of the length of the stay-out period, the Company believes that it is more cost-effective not to build up an internal regulatory staff to prepare and prosecute rate cases than it is to rely on outside providers on an as-needed basis. While the cost of outside services may appear to spike during rate cases, the Company has no on-going obligation to outside providers the rest of the time. In other words, Corning sees no benefit, and more likely detriments, in staffing up for the intensive activity involved in rate cases that only occurs at multi-year intervals. (Of course, if internal staffing were regarded as an appropriate course of action, any disallowance of outside costs would have to be reduced by the costs of internal staffing.)

Q. Do you have additional concerns about Staff's proposed adjustment?

A. Yes. As we noted at the outset of this section, because the cost associated with prosecuting a rate case is a necessary expenditure to ensure that a utility has the opportunity to achieve its constitutionally-guaranteed right to a fair return on investment (in part through recovery of legitimate costs of doing business), attempts to limit the recovery of such obviously necessary costs warrant special scrutiny. Corning has provided the factual data to support the costs it has incurred and its estimates of prospective costs for this function. Staff's perception that those costs "seem excessive" for a Company of Corning's size, based on a single superficial comparison, is hardly an adequate justification for Staff's meat-ax approach in chopping approximately 67% of the allowed cost. As we pointed out above, Staff's attempt to draw any relationship between company size and the cost of prosecuting rate cases is unsupported.

Q. What other concerns do you have about Staff's attempt to restrict the amount allowed for rate cases?

A. Whether specifically intended by Staff or not, such a limitation can be construed (or misconstrued) as an attempt to hobble the Company's ability to oppose Staff and other parties' positions. Because the Company, once it files its case, has virtually no control over level of activity that will be required to prosecute the case, through discovery, analysis of other parties' evidence, preparation of rebuttal evidence, preparation for hearings or settlement negotiations (or both), briefing and any additional process that may be required. Staff, more than any other party, controls the amount of work required to participate in a rate proceeding. Yet, Staff's approach to this issue shows absolutely no recognition of the role Staff plays in driving those costs. Under these circumstances, it is particularly egregious that Staff is the party pushing to restrict the Company's ability to defend itself.

Q. What would be the effect on Corning in this proceeding, if Staff's adjustment were adopted?

A. As we mentioned earlier in this section, the Staff rate case allowance amounts to $330,000. The expenditures to date in this proceeding total $377,277. Thus, the total rate allowance that Staff would have permitted has already been exceeded. Arbitrarily limiting the Company's ability to undertake the foregoing essential functions will result in rationing its participation in the proceedings or, if the Company chooses to undertake the activities management deems necessary to proceed properly, such limits will result in the confiscation of Company resources that are expended without recovery in rates. Such an outcome also smacks of retroactive ratemaking in that it would remove a cost recovery mechanism upon which Corning bases its planning and actions with respect to rate proceedings. Such severe action certainly cannot be justified on the basis of Staff's superficial "analysis."

Q. If Staff wished to pursue the subject of rate case expense, how do you believe that process should be carried out?

A. We believe that the only reasonable approach is to examine those costs prospectively. In contrast to raising this subject and making Draconian adjustments to an expense level that has regularly been agreed to by Staff and approved by the Commission in the past, a more reasonable approach would have been to treat this subject as one subject to future review in the Company's next rate case. If the Commission determines that this subject warrants closer examination, then it could require the Company to make an evidentiary presentation that would then provide a basis for review by Staff and other parties. Such a process would then provide a basis for determining whether any action is necessary and, if so, its nature and scope. To take action other than prospectively would represent nothing less than retroactive ratemaking that is also arbitrary, capricious and an abuse of discretion. Staff's proposed adjustment should be rejected in its entirety.

Postage

Q. Do you agree with Staff's Postage adjustment?

A. Yes, we accept Staff's Postage adjustment.

Property Taxes

Q. Do you agree with Staff's property tax adjustments?

A. No, we do not.

Q. What adjustments has Staff made?

A. Staff has made two. The first adjustment relates to Economic Obsolescence ("EO") and the second to the use of a five-year average to forecast Rate Year property tax expense.

Q. Why do you disagree with the EO adjustment?

A. Staff has not provided detailed workpapers that support its adjustment. Consequently, we reject the adjustment until such time as Staff provides the documentation for our review and we determine that such documentation indeed supports the adjustment.

Q. Do you agree with the use of a four-year average to forecast Rate Year property tax expense?

A. No. The Staff adjustment is based on the position that a 2011 increase of 13.87% is an outlier. Ms. Esposito supports that position on the ground that one-time investments occurred in 2011 for the Virgil expansion, mandated pipe replacement, connections to local production and the Caton Compressor Station. Staff goes on to assert, without any additional support, that these increases are "not representative of future changes and should not be included in the average for the Rate Year forecast" (pp. 71-72). In addition, there appears to be no definitional guidance in Staff's conclusory position. We would ask, for example, if 13.87% is excluded as an outlier why not 11.85%? Is there some unspoken line of demarcation between the two?

Q. Apart from lack of specific factual support, do you agree with Staff's rationale for excluding the 2011 property tax increase?

A. No. Under the Staff logic, each and every investment may be deemed a one-time event if the investment is viewed on individual, municipality-by-municipality basis. Staff fails to acknowledge that these types of investments occur on an annual basis and are encouraged and mandated by the Commission. The Company's pipe replacement program, as Staff is well aware, is 10 miles per year. The fact that pipe replacement occurs in different municipalities each year or the level of investment differs from year to year cannot be the basis for excluding its impact on property tax increases.

Q. What is your recommendation with regard to Staff's proposed property tax adjustment related to the use of a four-year average to forecast Rate Year property tax expense?

A. The adjustment should be rejected.

Q. Does the Company have a Commission-approved property tax reconciliation?

A. Yes.

Q. If the property tax reconciliation were continued in this case, would you accept Staff's property tax adjustment?

A. Yes, but only on that condition.

STAFF FINANCE PANEL

Overall Rate of Return

Q. Do you agree with the Staff Finance Panel's ("FP") overall Rate of Return ("ROR") of 5.53%?

A. No. Company witness Bulkley addresses the FP's woefully low Return on Equity ("ROE") recommendation of 8.2%. We have additional concerns about the long-term debt cost rate of 3.11% used by Staff in its overall ROR calculation.

Q. What are your concerns?

A. First, we have not been provided with the calculation that supports the 3.11% debt cost. The FP describes the reason for the decline in debt costs to 3.11% at pages 7 and 8 of its testimony. Exhibit __ (FP-3) presents the results of the capital structure that the FP recommends. No workpapers have been provided for us to be able to ascertain the basis for Staff's long-term debt costs. Essentially, those costs are unsupported.

Q. Even without the workpapers, do you believe that Staff's debt cost of 3.11% should be used in setting rates in this proceeding?

A. No. The 3.11% is below the rate that the Company is currently paying for long-term debt. Additionally, interest rates are trending up. Logically, there is no basis for recommending a debt cost that is well below current costs. Therefore, we recommend that the Company's 3.71% rate be used to set rates in this proceeding.

OVERALL IMPACT OF UPDATES AND ADJUSTMENTS

Q. Has Corning's revenue requirement changed based on the Company's updates, corrections and acceptance of some of Staff's proposed adjustments?

A. Yes. The Company's revenue requirement for the first rate year is $5,443,997 or an increase of 22% on total operating revenues.

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

A. Yes, it does, subject to our reservation of the right to comment on discovery responses received too late to be addressed in this testimony.