BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Corning Natural Gas Corporation

Case 16-G-0369

October 2016

Prepared Testimony of:

Staff Policy Panel

Johanna Miller
Utility Engineer 2

William D. Wade
Utility Supervisor
Office of Electric, Gas and Water

Sonny Moze
Utility Consumer Program Specialist 4
Office of Consumer Services

Allison Esposito
Supervisor, Utility Accounting and Finance
Office of Accounting, Audits and Finance
State of New York
Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

Introductions and Qualifications

Q. Members of the Staff Policy Panel, or Panel, please state your names.

A. Our names are Johanna Miller, Sonny Moze, Allison Esposito and William D. Wade.

Q. Ms. Miller, are you the same Johanna Miller who provided testimony as part of the Staff Gas Infrastructure and Operations Panel in this proceeding?

A. Yes, and I discuss my credentials in that testimony.

Q. Mr. Moze, are you the same Sonny Moze who provided testimony as part of the Staff Consumer Services Panel in this proceeding?

A. Yes, and I discuss my credentials in that testimony.

Q. Ms. Esposito, are you the same Allison Esposito who provided testimony regarding various accounting issues in this proceeding?

A. Yes, and I discuss my credentials in that testimony.

Q. Mr. Wade are the same William D. Wade who provided testimony regarding gas safety in this proceeding?

A. Yes, and I discuss my credentials in that testimony.

Q. What is the purpose of the Panel’s testimony?

A. This Panel will: (1) present an overview of Staff’s recommended revenue requirement, including the cost of capital; (2) provide an overview of Staff’s recommendations regarding leak prone pipe and infrastructure enhancement; (3) provide an overview of Staff’s recommendations regarding rate design; (4) provide an overview of Staff’s recommendations regarding performance metrics and incentives; (5) present Staff’s position regarding the expansion area in the Town of Virgil, NY; and, (6) present Staff’s position regarding a potential multi-year rate plan.

Q. Is the Panel sponsoring any exhibits?

A. Yes, we are sponsoring one exhibit.

Q. Please briefly describe Exhibit __ (SPP-1)?

A. Exhibit __ (SPP-1) contains the Company’s response to information request (IR) DPS-343, referenced later in this testimony.

Summary of Staff's Revenue Requirement

Q. Please summarize Corning Gas Corporation's (Corning) requested revenue requirement.

A. In its September 7, 2016 Corrections and Updates filing, the Company proposed a revenue requirement increase of $5,846,128 for the Rate Year ending May 31, 2018. However, this increase includes approximately $1,712,000 of costs that are currently being collected via a surcharge and which the Company proposes to roll into base rates. The overall impact of the Company's rate increase is therefore approximately $4,134,128.

Q. What is the $1,712,000 of surcharges comprised of?

A. The $1,712,000 includes $575,000 related to the safety and reliability surcharge, $723,000 related to the property tax reconciliation and $414,000 related to the large customer reconciliation.

Q. What base rate revenue requirement does Staff recommend?

A. We recommend a base rate increase of $831,085, or $5,015,043 million less than the amount requested by the Company. After reducing this increase by $780,000 currently collected through surcharges that will be rolled into base rates, the total overall impact of Staff's revenue requirement is an increase of approximately $51,085.

Q. What is the $780,000 of surcharges comprised of?

A. The $780,000 includes the $1,712,000 of surcharges that the Company has included in base rates, as well as $932,000 of surcredits related to the local production revenues. The local production surcredits are discussed in more detail in Staff's Gas Rates Panel testimony.

Q. What major adjustments does Staff recommend making to the Company's proposed revenue requirement?

A. The major adjustments incorporated in Staff's revenue requirement are: (1) adjusting the allocation of costs between Corning and its affiliates; (2) decreasing the Company's amount of rate case expense to be recovered in rates; (3) decreasing costs related to pensions and other postretirement benefits (OPEB); and (4) decreasing Rate Year health insurance expense.

Q. Please briefly summarize the adjustments to the allocation of expenses between Corning and its affiliates.

A. There are two adjustments impacting revenue requirement. The first adjustment increases the O&M allocation credit by $951,608 from the Company’s proposed credit of $469,694 to $1,421,302. This adjustment decreases O&M expenses. The second adjustment increases the allocation credit in rate base by $899,351 from the Company’s proposed credit of $439,072 to $1,338,423. This adjustment decreases overall rate base. These adjustments are discussed in detail in the testimony of Staff witness Esposito.

Q. Please briefly summarize the adjustments to decrease the Company’s requested rate case expense.

Q. There are two adjustments to rate case expense. The first corrects an apparent double counting of the cost of the Company’s consultant, Moonstone Consulting. Corning proposed to collected Moonstone Consulting fees as both an annual outside services O&M expense and as part of the Company’s requested rate case expense for this proceeding. Staff recommends removing the portion in rate case expense, an adjustment of $297,100. This reduction is amortized over five years, resulting in a Rate Year revenue requirement reduction of $59,420. Staff witness Margaret Wright provides a detailed explanation of this adjustment. The second adjustment decreases the amount of rate case expense that the Company should be allowed to recover from its customers. This reduction of $372,900 reflects Staff’s assessment that Corning’s rate case expense, particularly its outside legal expense level, is unreasonably high. Staff witness Esposito provides a detailed explanation of the adjustment to decrease rate case expense to reflect a reasonable level of expense compared to rate case expense for another similar company.

Q. Please briefly summarize the adjustments decreasing costs related to pensions and OPEBs.

A. There are two adjustments, one to the pension deferral balance and one to the OPEB deferral balance. The first adjustment reflects the results of Staff’s review of the pension deferral through the fiscal year ending April 30, 2016. This adjustment creates a negative pension deferral balance, which, when amortized over five years, results in a downward adjustment to Rate Year revenue requirement of $255,981. The second adjustment reflects the results of Staff’s review of the deferred OPEB balance as of April 30, 2016. This adjustment creates a negative OPEB deferral balance, which, when amortized over five years results in a downward adjustment to Rate Year revenue requirement of $43,675. Staff witness Esposito provides a detailed explanation of this adjustment.

Q. Please briefly summarize the adjustment decreasing health insurance expense.

A. Following Commission policy, Staff increased the Historic Test Year’s health insurance costs by an inflation factor of 4.49%, rather than the 10% annual inflation rate the Company used. This change reduces the Company’s proposed Rate Year health insurance expense by $166,461. Staff witness Sean Malpezzi provides a detailed explanation of this adjustment.

Q. What return on equity (ROE) did Corning request?

A. The Company requested a 10.2% ROE.

Q. What ROE does Staff recommend?

A. The Staff Finance Panel recommends an ROE of 8.2%.

Q. What equity ratio did Corning request?

A. The Company requested an equity ratio of 50.03%.

Q. What equity ratio does Staff recommend?

A. The Staff Finance Panel recommends an equity ratio of 48%.

Q. What is the impact of Staff's recommended ROE of 8.2% and equity ratio of 48% on the Company's requested revenue requirement?

A. The impact of our recommended ROE and equity ratio versus Corning's request results in a decrease in revenue requirement of approximately $1.2 million.

Leak Prone Pipe Removal and Infrastructure Summary

Q. What are the current leak prone distribution pipe replacement targets?

A. As part of the Joint Proposal for Extension of Gas Rate Plan in Case 11-G-0280, Corning is required to replace a total of 33.0 miles of leak prone distribution pipe for CY 2015 through CY 2017 combined. Additionally, the Company is required to replace at least 10.6 miles of leak prone distribution pipe for each CY for subsequent calendar years beyond CY 2017.

Q. Did Corning propose any changes to the current leak prone distribution pipe replacement targets?

A. Yes. In its corrections and updates provided on September 8, 2016, the Company suggested lowering the annual target for removal of leak prone distribution pipe to 7.5 miles and lowering the annual target for services to 350. The Company did not adjust its budgets to reflect this suggestion.

Q. What leak prone pipe removal target does Staff recommend for the Rate Year?

A. The Staff Gas Safety Panel recommends the Company continue replacing 10.6 miles of leak prone pipe in the Rate Year.

Q. Does Staff recommend any measures related to infrastructure enhancement?

A. Yes, the Gas Programs and Supply Panel recommends a multifaceted infrastructure enhancement program. Of note, one component of it is a budget of $50,000 for rebates to customers converting to natural gas. A second component recommends developing a neighborhood gas main extension pilot.

Summary of Staff's Rate Design Recommendations

Q. How did the Company propose to allocate its requested rate increase?

A. The Company proposes to allocate the incremental revenue by an equal percentage to all service classes, also referred to as SCs. This results in an increase of approximately 30% to each service class.

Q. How does Staff propose to allocate the revenue requirement increase?

A. The Staff Gas Rates Panel proposes that the increase in revenue requirement be allocated equally to all service classes, except for SC 8 – Hammondsport, which will see a greater increase to bring the rates for that service class in line with those of SC 8, as part of a long term merger of those two service classes.

Q. What is a minimum charge?

A. A minimum charge is a fixed charge that customers must pay each billing cycle. The minimum charge includes the first block of gas. As an example, for residential customers, it includes up to the first three therms of gas consumed.

Q. Does the Company request increases in any of the minimum charges?

A. Yes. The Company proposes to increase the minimum charges for all service classes in the Rate Year, ranging from an increase of twenty-five to fifty percent depending on the service class.

Q. Does Staff agree with this proposal?

A. No. The Staff Gas Rates Panel recommends maintaining the current minimum charge for all customer classes except Bath SC 3 and Bath SC 4.

Performance Metrics and Incentives

Q. Does the Panel expect that the natural gas industry will look the same in the future as it has in the past?

A. No. On February 26, 2015, the Commission issued its Order Adopting Regulatory Policy Framework and Implementation Plan in Case 14-M-0101, Proceeding on Motion of the Commission in Regard to Reforming the Energy Vision, also known as the REV Proceeding. In that order, the Commission was clear that the changes contemplated in REV must ensure that the State be able to achieve or exceed its goals to protect the environment through increased use of energy efficiency and renewable energy, coupled with market enabling measures that integrate those resources in a manner that achieves both economic and environmental sustainability. While the REV proceeding is mainly focused on the electric industry, it will have impacts on the natural gas industry in New York. The goals of increased efficiency, and economic and environmental sustainability are important for the natural gas industry.

Q. What impact does REV have on earnings opportunities for utilities?

A. In its White Paper on Ratemaking and Utility Business Models in the REV proceeding, issued on July 28, 2015, Staff stated that achieving the comprehensive outcomes envisioned in the REV proceeding can be ensured in part by creating earnings opportunities for utilities at each point where they can produce increased customer value, including capital efficiency, operating cost efficiency, peak reduction and enabling customers to manage their bills. Staff then recommended a combination of financial incentives that consist of new revenue opportunities, practical adjustments to conventional ratemaking methods, and concrete targets with new positive-only, symmetrical and bidirectional earnings impacts.

Q. What existing performance metrics and incentives are in place for Corning?

A. Corning has several gas safety performance measures and a Customer Service Performance Incentive (CSPI).

Q. Please describe the current gas safety performance measures.

A. As fully explained in the Staff Gas Safety Panel’s testimony, Corning has gas safety measures for non-compliance of pipeline safety regulations, infrastructure enhancement by replacing leak prone pipe, leak management, damage prevention, and emergency response performance measures.

Q. Does Staff propose any changes to these existing measures?

A. Yes. As fully explained in the Staff Gas Safety Panel's testimony, Staff recommends discontinuing the leak prone service metric and establishing a combined negative revenue adjustment (NRA) which includes both leak prone distribution pipe and leak prone services. Additionally, Staff recommends changes to the damage prevention metric by reducing the total damages target.

Q. Please describe the current CSPI.

A. As fully explained in the Staff Consumer Services Panel's testimony, Corning's current CSPI consists of two metrics: the number of annual PSC Complaints and the score on an annual Customer Satisfaction Survey. If the Company's performance on either measure falls below specified thresholds it would incur an NRA, with a maximum potential NRA of $36,000, or approximately eight basis points.

Q. Does Staff propose any changes to these existing measures?

A. Yes. As fully explained in the Staff Consumer Services Panel’s testimony, Staff recommends continuing the negative-only incentive for the two customer service metrics, with revised targets for the PSC Complaint metric, and increasing the total potential NRAs to $60,000, which is the equivalent of 13 basis points.

Q. Did Corning propose any positive incentives, also known as an earnings adjustment mechanism, or EAM?

A. Yes. Company witness John Stewart proposed implementing an EAM.

Q. Please explain the Company’s proposed EAM.

A. Company witness Stewart recommends implementing an EAM which awards Corning an additional 60 basis points in any year the Company can exceed all of the thresholds established for safety, reliability and customer satisfaction performance metrics, 30 basis points in any year that the Company exceeds all but one metric and 15 basis points in any year the Company can exceed all but two metrics. As a less preferred alternative, Mr. Stewart recommends that the Commission direct parties to collaborate to develop positive and negative incentives for safety, reliability and customer service metrics.

Q. What is the basis for Mr. Stewart's request?

A. Mr. Stewart lays out five reasons to establish an EAM. First, Mr. Stewart states that "the Commission has demonstrated interest in establishing incentives that offer more than just penalties."

Q. Do you agree with this statement?

A. Yes. In the "Order Adopting a Ratemaking and Utility Revenue Model Policy Framework" issued on May 19, 2016 in Case 14-M-0101, also referred to as the REV Track 2 Order or the Order, the Commission discusses the potential for new financial incentives or EAMs. On page 66 of the REV Track 2 Order, the Commission explains that, "EAMs deal not with conventional basic service, but with new expectations. Meeting these expectations will require innovative management and new forms of cooperation with third parties and customers. Meeting the expectations will also require overcoming implicit disincentives that exist in the cost-of-service model. For these reasons, as well as the reasons articulated by Staff, positive incentives may be warranted.”

Q. What is Mr. Stewart’s second reason to establish an EAM?

A. Mr. Stewart asserts that, “The Commission has stated that EAMs in REV should be based on outcomes that are important to customers and consistent with policy objectives.”

Q. Do you agree with this statement?

A. Yes, however Mr. Stewart does not capture all that the Commission said. On page 2 of the REV Track 2 Order, the Commission states that the new regulatory model under REV should align shareholder financial interests with consumer interests. In setting forth the goal of new incentives, as stated on page 60 of the REV Track 2 Order, the Commission clearly states that EAMs must “encourage achievement of new policy objectives and counter the implicit negative incentives that the current ratemaking model provides against REV objectives.”

Q. What is Mr. Stewart’s third reason for establishing an EAM?

A. Mr. Stewart states that “the Commission has stated that incentives now in place should be reviewed.”

Q. Do you agree with this statement?

A. Yes, however, Mr. Stewart once again ignores the context. On page 58 of the REV Track 2 Order, the Commission states that “existing measures should generally be retained, although specific measures…should be examined in rate cases and, if they have little remaining value, should be adjusted or eliminated”. Thus, the Commission’s directive is to review existing metrics to determine if they still have value, not to simply establish an EAM in place of existing metrics. We will discuss this distinction further in response to Mr. Stewart’s fifth reason to establish an EAM.

Q. What is Mr. Stewart’s fourth reason for establishing an EAM?

A. Mr. Stewart states that “incentives offering rewards (with or without penalties) make common sense from a fundamental regulatory perspective."

Q. Do you agree with this statement?

A. Yes, to a degree. Consistent with the REV Track 2 Order, we believe that there are circumstances that positive incentives are warranted, typically to promote new policy objectives or to address financial disincentives in the traditional cost-of-service model. As such, we have recommended a number of new incentives, consistent with these goals, which we will discuss later.

Q. What is Mr. Stewart's fifth reason for recommending an EAM?

A. Mr. Stewart states, "the current battery of incentives that are applied to Corning have the combined policy goal of assuring not only safe and reliable service but also satisfied customers and as such are ripe for consideration under some form of EAM that would be more effective in fostering achievement of that policy goal."

Q. Do you agree with this statement?

A. No. This assertion, that an EAM should be applied to the Company's existing incentives is fundamentally flawed.

Q. Why do you contend that this assertion is flawed?

A. Mr. Stewart frequently refers to the REV proceeding to support his recommendation for an EAM. However, the REV Track 2 Order clearly differentiates between existing metrics and new performance standards.

Q. What does the REV Track 2 Order state regarding existing metrics?

A. On page 58, it states that existing metrics, which are typically negative only, should be retained and possibly adjusted or eliminated if they have little remaining value.

Q. What does it state regarding new EAMs?

A. Page 59 of the REV Track 2 Order states that Staff’s proposal in that case, to create new incentive measures, “is directed not to traditional basic service, but to new types of performance expectations.” The Commission continues that “some of these new expectations run counter to conventional methods of operation and, importantly, also run counter to the implicit financial invectives that are embedded in the cost-of-service ratemaking model.” The Commission concludes that if “cost-of-service calculations are to remain the basis of utility rates for the foreseeable future, then creating new earning adjustment opportunities are both a fair and a necessary means of promoting change.”

Q. Does the Commission discuss this distinction between new and existing metrics anywhere else in the Order?

A. Yes, on page 60 of the REV Track 2 Order, the Commission reiterates that EAMs serve a different purpose from existing performance standards. The Order states that EAMs “must both encourage achievement of new policy objectives and counter the implicit negative incentives that the current ratemaking model provides against REV objectives.”

Q. Does the Commission address this distinction anywhere else?

A. Yes. On page 66 of the REV Track 2 Order, the Commission states that “EAMs deal not with conventional basic service, but with new expectations” - again differentiating between the two categories of service the Commission seeks to incent.

Q. What does Mr. Stewart’s testimony state regarding the REV Track 2 Order’s language about existing incentives?

A. On page 11 of his testimony, Mr. Stewart states that “the Commission did not address the applicability of REV concepts to current utility incentives.” However, this is simply not true. As we’ve described, the Commission has clearly and repeatedly stated that EAMs should be applied to new, not existing, performance standards.

Q. Do you have any additional comment on Mr. Stewart’s EAM proposal?

A. Yes. Providing positive incentives to the Company based on the thresholds Mr. Stewart proposes would give incentives to the Company for achieving merely minimum levels of performance, which in many cases is a level slightly lower than its recent performance.

Q. Please provide an example.

A. As explained in the testimony of the Consumer Services Panel, the PSC Complaint Rate metric is set based on the Company’s historic performance with targets set two standard deviations below that historic level of performance. This ensures that the Company does not incur an NRA for performance in the range of its recent experience. However, it would be inappropriate to provide Corning with a positive incentive merely because it met this and other minimum performance thresholds.

Q. Does the Panel agree that there should be positive incentives for Corning?

A. Yes. We agree that the Commission has expressed an interest in establishing positive incentives where appropriate and we therefore recommend a number of positive incentives in this proceeding. However, we recommend targeted incentives for new performance goals, rather than a broad-based EAM applied to existing incentives. Our recommendation is therefore consistent with both the REV Track 2 Order and the Commission’s overall policy goals.

Q. What new incentives does Staff recommend?

A. Staff recommends five new positive incentives. The Gas Safety Panel recommends a new positive incentive for damage prevention. The Gas

Program and Supply Panel recommends two new positive incentives, one for leak management and one for customer growth. The Gas Infrastructure and Operations Panel recommends a new incentive for lowering unit costs. The Consumer Services Panel recommends a new symmetrical incentive for the Company’s performance regarding residential customer terminations and uncollectibles.

Q. Please briefly describe the damage prevention positive incentive.

Q. This new incentive would complement the existing negative incentives regarding damage prevention. The existing incentives impose an NRA if the Company exceeds limits on excavation damages to the Company's facilities. This new incentive would provide a positive EAM if the Company achieves a significantly lower number of excavation damages to its facilities. Specifically, Corning would earn a positive revenue adjustment of four pre-tax basis points should the Company limit total excavation damages to less than 1.50 damages per 1,000 one-call tickets.

Q. Why is there a need for a positive revenue adjustment for damage prevention?

A. As explained in the Staff Gas Safety Panel testimony, while excavator error and no-call damages are not entirely within the Company's control, The Company can minimize these damages in several ways. These include influencing excavator behavior through education and outreach efforts to excavators, continuing to bill excavators for repair costs when the excavator is at fault, inspecting pipelines as frequently as necessary during and after excavation activities to verify the integrity of the pipeline when the operator has reason to believe damage could be done by the excavation activities, and referring problem excavators to Department Staff for enforcement purposes. However, there may be excavators resistant to the Company's current outreach and education efforts. The Company should seek new ways to reach these problem excavators and a positive revenue adjustment would provide an incentive for the Company to do so.

Q. Please briefly describe the leak management positive incentive.

A. As explained in the Gas Programs and Supply Panel’s testimony, Staff recommends that the Company receive a PRA, up to an annual maximum of five pre-tax basis points, for eliminating, by the end of the following calendar year, the highest methane emitting Type 3 leaks from the previous year’s ending leak backlog.

Q. Please briefly describe the unit cost incentive.

A. As explained in the Gas Infrastructure and Operations Panel’s testimony, Staff recommends the development of unit cost trackers for budgets that have specific benchmark costs and deliverables. If the Company completes the work in a specific category at an average cost which is lower than the established unit cost, a maximum of ten pre-tax basis points may be provided to the Company.

Q. Please briefly describe the residential terminations and uncollectibles incentive.

A. Staff recommends a positive financial incentive for the Company to identify and implement new measures to reduce residential service terminations for nonpayment while decreasing, or maintaining, the dollar amount of bad debt from residential accounts. Staff also recommend a negative revenue adjustment if either residential terminations or residential bad debt increase significantly. The proposal is further explained in the Consumer Services Panel’s testimony.

Q. Please briefly describe the gas enhancement performance incentive.

A. As further explained by the Staff Gas Programs and Supply Panel, Staff recommends a positive incentive of one basis point for each additional 25 customers the Company is able to achieve relative to Staff’s Rate Year customer growth forecast, capped at a total of five basis points.

Q. Does the panel agree with Mr. Stewart’s recommendation that the Commission should direct interested parties to collaboratively develop positive and negative incentives?

A. Not at this time. As just discussed, Staff has proposed a number of both positive and negative incentives in our testimony that meet the Commission’s policy goals and, as such, no collaborative is necessary at this time. If the

Company wants to propose additional metrics in the next rate proceeding, it is free to do so.

Town of Virgil Expansion

Q. Please briefly describe Corning's franchise expansion in the Town of Virgil.

A. In Case 09-G-0252, the Commission granted Corning a Certificate of Public Convenience and Necessity approving the exercise of its gas franchise in the Town of Virgil, predicated upon certain conditions. Through a series of Commission Orders, Corning was required to accelerate the depreciation on the plant it installed in the Town of Virgil by $1,000,000 over the first seven years of operation in the new franchise area via a mandatory surcharge. The Commission further ordered that, in the event the Company did not collect the full $1,000,000 in accelerated depreciation, the Company's shareholders would be responsible for any shortfall.

Q. What is the current status of the Virgil surcharge?

A. The Virgil surcharge will cease at the end of

November 2016. Corning forecasts the balance for accelerated deprecation at this time will be $533,000; approximately $467,000 below the $1,000,000 level.

Q. What does Corning propose regarding the treatment of the Virgil surcharge in this case?

A. On page four of the Additional Direct Testimony of Firouzeh Sarhangi/L. Mario DiValentino, Corning proposed to extend the time frame for recovery of the cost of the Company’s service expansion in the Town of Virgil, from seven years to ten years.

Q. Does the Panel believe this issue should be addressed in the current rate proceeding?

A. We recommend this issue be handled outside of this rate proceeding in a separate petition to the Commission. In response to IR DPS-343, Corning stated it will file a petition to the Commission requesting a modification to the time frame for recovery of the Town of Virgil expansion costs.

<u>Multi-Year Rate Plan</u>

Q. What did the Company provide in its pre-filed testimony to support a potential multi-year rate plan?

A. On pages 10 through 14 of Company witnesses Firouzeh Sarhangi and L. Mario DiValentino testimony, they proposed a three year levelized rate plan and a surcharge for the subsequent two years. All together the Company sets forth a proposal for the next five rate years, or for the period from June 1, 2017 through May 31, 2022.

Q. Has Staff reviewed the Company's multi-year rate plan proposal?

A. While we have reviewed it at a high level, our review of the Company's filing has focused on the Rate Year ending May 31, 2018.

Q. What period does Staff's testimony address?

A. Our testimony sets forth recommendations for a single Rate Year. We believe that a one year period is appropriate for a litigated case.

Q. Is Staff open to pursuing a multi-year rate plan in this proceeding?

A. Possibly. We are open to pursuing a multi-year rate plan through a negotiation process with the Companies and other interested parties. Any potential multi-year rate plan must be in the public interest.

Q. Does this conclude your testimony?

A. Yes, at this time.