

NEW YORK STATE
PUBLIC SERVICE COMMISSION

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Proceeding on Motion of the Commission to :
Implement Transmission Planning Pursuant to the : Case 20-E-0197
Accelerated Renewable Energy Growth and :
Community Benefit Act :
-----X

**PETITION OF
NEW YORK STATE ELECTRIC & GAS CORPORATON AND ROCHESTER GAS
AND ELECTRIC CORPORATION FOR APPROVAL TO SEEK AUTHORIZATION
FROM THE FEDERAL ENERGY REGULATORY COMMISSION TO UTILIZE 100%
CONSTRUCTION WORK IN PROGRESS IN RATE BASE FOR
THEIR PHASE 2 LOCAL TRANSMISSION PROJECTS**

Petition

Authorization to Include 100% CWIP in Rate Base for Phase 2 Transmission Projects

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I. Introduction

New York State Electric & Gas Corporation (“NYSEG”) and Rochester Gas and Electric Corporation (“RG&E” and together with NYSEG, the “Companies”) hereby submit this petition to the New York State Public Service Commission (the “Commission”) for approval to seek authorization from the Federal Energy Regulatory Commission (“FERC”) to utilize 100% Construction Work in Progress (“CWIP”) in rate base for their Phase 2 local transmission projects (collectively, the “Phase 2 Projects”) approved by the Commission in its February 16, 2023 Order Approving Phase 2 Areas of Concern Transmission Upgrades (“Phase 2 AOC Order”).¹ Upon approval from the Commission, the Companies would file a request with FERC seeking to include 100% CWIP to help mitigate the financial burden and impacts on the Companies’ cash flow and credit metrics. Commission approval is required as a precursor to seeking FERC authorization to include CWIP in rate base pursuant to Section 3.3 of the Cost Sharing and Recovery Agreement (“CSRA”) approved by the Commission in Case 20-E-0197 on May 12, 2022.²

¹ Case 20-E-0197, Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act, Order Approving Phase 2 Areas of Concern Transmission Upgrades (February 16, 2023).

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Good cause exists for the Commission to authorize the Companies to utilize 100% CWIP in rate base. Most fundamentally, and as explained further below, the request is necessary to save customers nearly \$290 million in estimated costs associated with the Phase 2 projects. This treatment is needed because of the level of capital investment to construct the projects substantially exceeds the Companies' historical investments in transmission. For NYSEG, its 2024 expected combined CLCPA Phase 1 and Phase 2 transmission investment is expected to be over three times NYSEG's 5-year average transmission investment from 2018 – 2022, growing to over four times the 5-year average by 2026. This exponential growth in capital expenditures will put significant strain on the Companies' cash flows and credit metrics given the sheer magnitude of the capital investment required. The Companies already face challenges related to maintaining credit metrics that meet the threshold for investment grade ratings, which would be exacerbated if the Companies were required to defer cash recovery of returns until Phase 2 Projects enter commercial operation. The inclusion of 100% CWIP in rate base for the Phase 2 Projects as an alternative to recovering Allowance for Funds Used During Construction ("AFUDC") will improve the Companies' cash flow and credit metrics during project development and construction, which, in turn, directly benefits customers in terms of lower cost of debt. The inclusion of 100% CWIP in rate base will also benefit customers by reducing the overall cost of financing the Phase 2 Projects and helping to avoid rate shock. The Companies will track capital costs for the Phase 2 Projects separately from other capital costs and cost recovery of Phase 2 Projects shall occur via the CSRA mechanism. This means the inclusion of 100% CWIP in rate base for the Phase 2 Projects will not affect retail delivery rates charged by the Companies.

commence on the in-service date of the Approved Transmission Project (provided the Transmission Owner shall recover its cost of financing construction—the Allowance for Funds Used During Construction or "AFUDC") until the end of the useful life of the Approved Transmission Project. Recovery of Approved Transmission Project costs during construction—referred to as the Construction Work in Progress incentive or "CWIP"—shall be recoverable under this Agreement only if approved by the NYPSC. Costs of Approved Transmission Projects that are abandoned for reasons beyond the control of the Transmission Owner shall be recovered commencing on the date of a abandonment." The Companies also intend to seek the Abandoned Plant incentive in the same FERC filing.

In summary, the Companies seek the Commission’s approval to obtain FERC authorization to utilize 100% CWIP in rate base during the development and construction phases of the Phase 2 Projects approved in the February 16, 2023, Phase 2 AOC Order.

II. Background

On July 18, 2019, the Climate Leadership and Community Protection Act (“CLCPA”) was signed into law, followed by the signing of the Accelerated Renewable Energy Growth and Community Benefit Act (“AREGCBA”) on April 3, 2020. The CLCPA established specific renewable and zero-emission energy targets for New York State to reduce carbon emissions from the electricity sector. Specifically, it provides that 70 percent of electricity be produced from renewables by 2030 (the “70 x 30” target) and that the state achieve a 100 percent reduction in greenhouse gas emissions from the electricity sector by 2040 (the “100 x 40” target). Taken together, the acts established ambitious renewable and zero-carbon energy goals, and, among other things, provide a vision for how to expand New York’s electric transmission system to enable the necessary expansion of clean energy supplies in the state to achieve such goals.

The May 14, 2020 Order in Case 20-E-0197 (“Initiating Order”) formally initiated one of the two proceedings required under the ARECGBA, specifically to establish a distribution and local transmission capital plan for each utility.³ The Commission directed New York utilities, including the Companies, to submit a comprehensive report to the Commission on November 2, 2020 (the “2020 CLCPA Study”), that identified local transmission and distribution investments that the utilities propose. In the 2020 CLCPA Study, the utilities recommended dividing local transmission projects into phases. Phase 1 projects would be those responsive to the Initiating Order’s discussion of “Business as Usual” transmission projects⁴ that are projects already needed under existing planning criteria, but which also have the benefit of adding incremental headroom for renewable energy. Phase 2 projects would include those incremental transmission projects

³ Case 20-E-0197, Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act, Initiating Order at p. 3.

⁴ Case 20-E-0197, Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act, Initiating Order at Initiating Order at p. 8.

that are being proposed primarily to increase system headroom in support renewable energy development.

On September 9, 2021, the Commission issued the Phase 2 Order.⁵ In that order, the Commission identified specific “Areas of Concern” in New York “characterized by the presence of existing renewable generation that is already experiencing curtailments and a strong level of developer interest that exceeds the capability of the local transmission system.”⁶ To address the local transmission deficiencies in the Areas of Concern, the Commission ordered the Companies, along with Central Hudson Gas & Electric Corporation (“Central Hudson”) and Niagara Mohawk Power Corporation d/b/a National Grid (“National Grid”), to “consult with Department of Public Service Staff regarding presentation of a minimum of two options for each Area of Concern that identifies the most cost-effective Phase 2 upgrades on a dollar per megawatt basis, which shall be filed within 180 days of the issuance of this Order.”⁷

Consistent with the Phase 2 Order, on March 8, 2022, the Companies, joined by Central Hudson and National Grid, consulted with Department of Public Service Staff and submitted a joint petition for approval of Phase 2 local transmission projects designed to address the transmission system deficiencies identified in the Phase 2 Order. On February 16, 2023, the Commission issued the Phase 2 AOC Order which approved an estimated \$2.25 Billion investment by the Companies in the Phase 2 Projects. On May 3, 2023, New York Independent System Operator, Inc. on behalf of the Companies filed proposed formula rates with FERC which are pending.⁸

III. The Companies’ Financial Need for 100% CWIP in Rate Base

The Companies are significantly investing in New York’s clean energy future, and the Phase 2 Projects are incremental to the already substantial planned investment in transmission

⁵ Case 20-E-0197, Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act, Order on Local Transmission and Distribution Planning Process and Phase 2 Project Proposals (September 9, 2021)

⁶ Case 20-E-0197, Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act, Phase 2 Order at p. 34.

⁷ Case 20-E-0197, Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act, Ordering Clause Number 6.

⁸ FERC Dockets ER23-1816-000 and ER23-1817-000.

infrastructure, including planned CLCPA Phase 1 transmission investments. The Phase 2 transmission investments, when coupled with CLCPA Phase 1 transmission investments, will usher in a period of historic development and construction of transmission for the Companies. The combined annual investment in CLCPA Phase 1 and Phase 2 transmission for NYSEG is projected to be in excess of \$340 Million in 2024, \$350 Million in 2025 and \$450 Million in 2026 as compared to 5-year annual average transmission plant additions of around \$104 Million from 2018 - 2022.⁹ For NYSEG, total gross transmission plant in service was \$1.7 Billion as of December 31, 2022¹⁰. The Phase 2 Projects alone are over 30% higher than the total of all NYSEG transmission gross plant in service as of December 31, 2022. This is an unprecedented level of capital investment that the Company will need to fund.

The magnitude of the necessary investment in CLCPA transmission over the next few years will exacerbate the cash flow and credit metrics challenges facing the Companies, which, if left unchecked, will increase the cost of debt for customers. The \$2.25 Billion portfolio of approved Phase 2 Projects includes several large projects with long development and construction schedules, all being developed simultaneously along with the Phase 1 transmission projects. Dollars will need to be invested at a rapid pace, but cost recovery will not commence until projects enter commercial operation under traditional ratemaking treatment with higher overall costs to customers via the inclusion of AFUDC. At the scale contemplated for the Phase 1 and Phase 2 transmission investments, the Companies anticipate reaching a point in the next few years where they have more than \$1 Billion in net capital expenditures for plant additions that are not yet in service, and thus, not generating any cash flow under the traditional approach.

The Companies need the type of financial relief that the inclusion of 100% CWIP in rate base for the Phase 2 Projects will provide. It will be harmful to the cash flows and credit metrics of the Companies to utilize AFUDC for capitalization of all the capital costs for both Phase 1 and Phase 2 transmission. The Companies' cash flows and credit metrics are already under pressure, and the exclusive use of AFUDC for capitalization of these significant investments will cause further pressure and put the Companies' investment grade credit ratings at risk. As shown in

⁹ NYSEG FERC Form 1 filings from 2018 – 2022, pp 204-207, line 58(c).

¹⁰ NYSEG 2022 FERC Form 1, pp 204-207, line 58(g).

Table 1 below, NYSEG’s Cash from Operations less Changes in Working Capital / Debt (“CFO Pre-WC / Debt”) metric has already been below the expected range for investment grade ratings from 2020 – 2022, falling to 2.3% by year-end 2022, substantially less than in-state peer companies Orange and Rockland Utilities, Inc., Consolidated Edison Company of New York, Inc., and Niagara Mohawk Power Corp which have CFO Pre-WC / Debt ratios ranging from roughly 14%-19%. RG&E’s CFO Pre-WC / Debt has also been below investment grade for 2021 – 2022. Ratings agencies have referred to NYSEG’s financial metrics as extremely weak, referring to NYSEG’s ratio of CFO pre-WC to debt of approximately 5% as being among the lowest in the industry. The rate case Joint Proposal settlement will significantly improve the Companies’ credit metrics, however they are still projected to be below investment grade level for CFO Pre-WC / Debt during some time periods covered by the rate plan and that excludes the significant cash flow impacts of the Phase 2 Projects. Granting the use of 100% CWIP for the Phase 2 Projects will help mitigate the additional pressure on the Companies’ cash flows and credit metrics caused by the incremental \$2.25 billion dollars of investment. A downgrade in the Companies’ credit rating will increase cost of debt to customers.

TABLE 1 - Cash from Operations (CFO) less Changes in Working Capital (WC) / Debt



Peers' comparison:

¹ Orange and Rockland Utilities, Inc. (Baa2), FY'22

² Consolidated Edison Company of New York, Inc. (Baa1), FY'22

³ Niagara Mohawk Power Corp (Baa1), FY'22

There is ample precedent for allowing CWIP for large transmission projects in New York. The allowance of 100% CWIP in rate base for transmission in New York has been supported by the Commission, and awarded by FERC, in the recent past for transmission investments in the State. In FERC Docket No. ER15-572, New York Transco was granted the 100% CWIP incentive by FERC for the Edic to Pleasant Valley 345 kV Line, with the segment of the project awarded to New York Transco now known as the New York Energy Solution (a/k/a Segment B). In this docket, the Commission supported the use of CWIP as a risk-reducing incentive¹¹

Citing to FERC Order 679 (Promoting Transmission Investment through Pricing Reform), in its April 2, 2015 Order, FERC stated that “We find that allowing NY Transco to include 100 percent of CWIP in rate base “removes a disincentive to construction of transmission, which can involve very long lead times and considerable risk to the utility that the project may not go forward.””¹² FERC elaborated further on the value of the CWIP incentive:

*The cost and lengthy construction period involved in completing these projects will strain NY Transco’s cash flow and put upward pressure on NY Transco’s ability to finance construction. Granting the CWIP incentive will help ease this pressure and reduce project cost by providing upfront certainty, improved cash flow, and reduced borrowing costs as NY Transco moves forward with each project. Inclusion of CWIP in rate base “balance[s] the need for companies to recover carrying costs in a timely manner with the Commission’s cost responsibility principle, while reducing the rate impacts of new transmission projects on customers.”*¹³

The New York Power Authority (“NYPA”) has also received the 100% CWIP incentive for its approximately \$281 Million portion of Segment A of the Edic to Pleasant Valley

¹¹ Docket ER15-572, Protest of the New York Service Commission dated January 6, 2015, P. 18.

¹² Docket ER15-572, FERC Order on Transmission Formula Rate, Return on Equity, Cost Allocation, and Transmission Incentives, P. 80.

¹³ Ibid, P. 81.

transmission solution. In its November 21, 2019 Order on Transmission Rate Incentives in Docket No. EL19-88, FERC granted the 100% CWIP incentive stating that:

We grant NYPA's request to include the CWIP Incentive in rate base during the development and construction phase of Segment A. We find that NYPA has shown a nexus between the CWIP Incentive and its investment in Segment A. We further find that authorizing 100 percent CWIP recovery for Segment A will enhance NYPA's cash flow, reduce interest expenses, assist it with obtaining favorable financing, and improve the coverage ratios used by rating agencies to determine NYPA's credit quality by replacing non-cash AFUDC with cash earnings. These factors are comparable to those that the Commission has taken into consideration in authorizing the inclusion of CWIP in rate base for other utilities.¹⁴

Even more recently, National Grid received FERC authorization for 100% CWIP in rate base for the Smart Path Connect Project in Northern New York¹⁵, and the Commission did not oppose the use of CWIP for that project.¹⁶

The Companies note that the transmission investments in New York that have received 100% CWIP in rate base are relatively small compared to the \$2.25 Billion in investment authorized for the Companies in the Phase 2 AOC Order. Accordingly, the cash flow and financing needs expressed by FERC for New York Transco and NYPA are even more acute for the Companies.

IV. Customer Benefits of Allowing 100% CWIP in Rate Base¹⁷

The allowance of CWIP benefits customers by avoiding the buildup of large AFUDC balances which then become compounded in rates over the life of the investment. By replacing

¹⁴ Docket EL 19-88, Order Approving Transmission Rate Incentives, November 21, 2019 at P. 26.

¹⁵ Dockets ER23-973-001 and ER23-974-001, Order on Tariff Filings, and Establishing Hearing and Settlement Judge Proceedings, July 28, 2023 at P.12

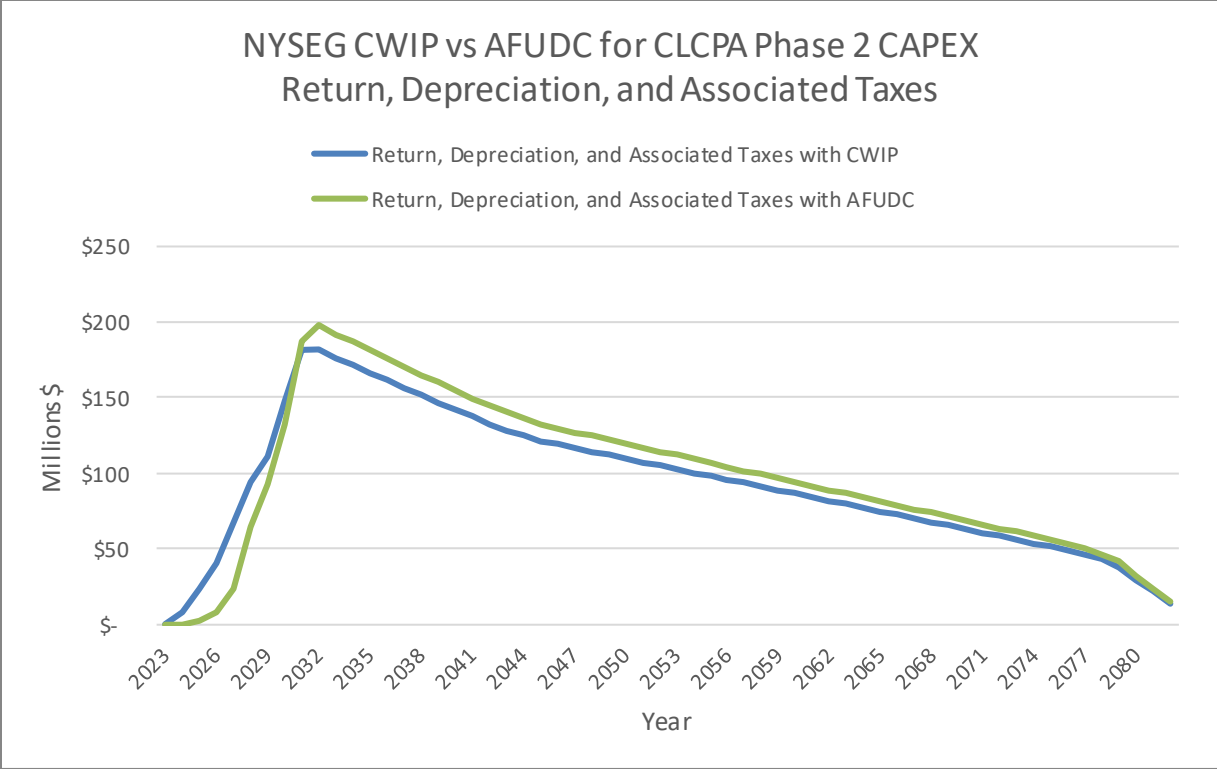
¹⁶ See Protest of the New York Public Service Commission dated March 25, 2022 in FERC Docket ER22-1201 and Comments of the New York Public Service Commission dated February 21, 2023 in FERC Dockets ER23-973 and ER23-974.

¹⁷ Some numbers below may not add exactly due to rounding.

AFUDC with CWIP, once the Phase 2 Projects are placed in service the Companies' return on investment for the life of the plant will only be calculated on the actual cost of the project excluding any non-cash carrying charges for AFUDC balance accrued during construction. This will substantially reduce the total cost of the Projects, and customer savings will persist through the life of the investment until it is fully depreciated. CWIP in rate base also assists in obtaining favorable financing, which directly benefits customers via lower overall debt costs ultimately to be borne by customers. Finally, CWIP in Rate Base can help reduce rate shock by smoothing out the eventual significant increase in rate base that would exist in a short timeframe under traditional capital investment cash recovery treatment.

The Companies estimate that project capital costs will be reduced by \$195 Million (\$179 Million at NYSEG and \$17 Million at RG&E) if capital outlays are recovered via CWIP instead of AFUDC. This is due to avoidance of incurring AFUDC carrying costs, which are placed into project capital cost and recovered as depreciation expense over the accounting life of the assets. A further savings to customers of \$79 Million (\$71 Million at NYSEG and \$9 Million at RG&E) will be realized from a lower return due to a lower rate base using CWIP instead of AFUDC. \$23 Million (\$21 Million at NYSEG and \$3 Million at RG&E) of savings also occur from reduction in costs to customers to collect associated income and gross receipt taxes. As such, once the Phase 2 Projects enter service, customer rates will continuously be lower over the subsequent decades if supported by CWIP than if paid for by AFUDC (see Figure 1).

Figure 1



The total nominal savings¹⁸ of \$298 Million (\$270 Million at NYSEG and \$28 Million at RG&E) for CWIP relative to AFUDC over the depreciation accounting period are presented in Tables 2 and 3 along with savings in real dollars. Two assumptions for inflation are provided; 2%, which is the Federal target inflation rate, and 3% which is approximately the long-run historic average inflation rate of the US. 2% is also the social discount rate utilized by New York in its calculation of the social cost of carbon. Finally, the relative present values as determined by discount at the WACC are provided.¹⁹

Table 2

Summary - NYSEG CLCPA Phase 2 Projects	Total (nominal)	Total (real) 2% inflation	Total (real) 3% inflation	Total (PV @ WACC)
Return, Depreciation, and Associated Taxes with CWIP	\$5,585	\$3,466	\$2,813	\$1,511
Return, Depreciation, and Associated Taxes with AFUDC	<u>\$5,855</u>	<u>\$3,572</u>	<u>\$2,872</u>	<u>\$1,486</u>
Project savings using CWIP instead of AFUDC	\$270	\$106	\$59	-\$24

¹⁸ Note that differences in property tax expense as assessed on capital value are not included in this estimate.

¹⁹ The WACC assumes 4.16% long-term debt rate and 9.2% ROE at a 48% equity ratio for NYSEG and a 4.59% long-term debt rate and 9.2% ROE at a 48% equity ratio for RG&E.

Table 3

<u>Summary - RG&E CLCPA Phase 2 Projects</u>	Total (nominal)	Total (real) 2% inflation	Total (real) 3% inflation	Total (PV @ WACC)
Return, Depreciation, and Associated Taxes with CWIP	\$437	\$260	\$207	\$100
Return, Depreciation, and Associated Taxes with AFUDC	<u>\$464</u>	<u>\$271</u>	<u>\$213</u>	<u>\$98</u>
Project savings using CWIP instead of AFUDC	\$28	\$11	\$6	-\$2

The use of CWIP will support the Companies to obtain favorable financing when financing the Phase 2 Projects and better position the Companies from a credit metrics standpoint to help avoid a downgrade. With AFUDC, the Companies face significant cash flow challenges that could result in a downgrade of debt ratings. The Companies estimate a one level downgrade (i.e., to BBB+/Baa2) would increase debt financing costs for customers by 14 basis points, while a two-notch downgrade to low investment grade would increase debt financing costs for customers by 64 basis points. This is an additional added cost for the Phase 2 Projects due to increased Company debt risk, estimated at \$2.3 Million for a one-notch downgrade or \$10 Million for a two-notch downgrade,²⁰ that will be passed onto customers if the Companies were to use AFUDC. These estimated costs are for Phase 2 investments only. Because the increase in debt financing costs would affect the Companies more broadly than just Phase 2 investments, total customer costs associated with a downgrade would be substantially higher.

Actual experience with a large project developed by a utility affiliate of the Companies, the Maine Power Reliability Program (“MPRP”) developed by Central Maine Power (“CMP”), demonstrates in practice how customers experience substantial savings from the use of CWIP. Commenced in 2010 and predominantly completed in 2016, the \$1.4 billion MPRP was the largest transmission construction project ever undertaken in Maine, more than quadrupling CMP’s transmission plant in service, with the construction of four new 345 kV substations, one new 115 kV substation, and related facilities linked by approximately 440 miles of new transmission lines. Similar to the circumstances currently facing the Companies, CMP’s ability

²⁰ Assuming 14 or 64 bps are added to the debt rate of the weighted average cost of capital.

to include 100% of CWIP in its rate base was necessary because of the size, capital-intensive nature, and time needed to construct the MPRP. The use of 100% CWIP reduced the cost of the Project by an estimated \$150 million, minimized the risk to the project of cash flow constraints, and reduced “rate shock” for customers in New England by replacing non-cash AFUDC with cash earnings and spreading the impact of new plant additions over the entire construction period. The MPRP project is an example of how the allowance of 100% CWIP in rate base can be a win-win for transmission owners and customers.

V. Controls

The Companies will implement accounting controls to ensure that they do not accrue AFUDC in CWIP for the Phase 2 Projects during any period when the CWIP incentive is in effect. The Companies have created new program codes in their SAP accounting systems, and all new capital orders for the Phase 2 Projects will be tagged with this unique program code. All capital orders tagged with the program code will be assigned an interest profile that prohibits the calculation of AFUDC on the capital assets. In accordance with the FERC Uniform System of Accounts, CWIP balances are typically subject to AFUDC, which increases the asset balance for the cost of funds used during construction in FERC Account 107. However, the use of the program code and interest profile discussed above will prevent the Companies’ SAP accounting system from calculating AFUDC on the tagged assets and will thus prevent double recovery of capitalization costs (i.e., both AFUDC and CWIP).

VI. Conclusion

The Companies are committed to making investments that support New York’s climate goals, and the development and construction of the Phase 2 Projects represent a significant step towards attainment of such goals. The Companies will be challenged to maintain their credit metrics without the financial relief that earning 100% CWIP in rate base will provide. An order from the Commission allowing the Companies to seek FERC authorization to include 100% CWIP in rate base will provide improved cash flow and risk reduction which will benefit both the Companies and customers. Accordingly, the Companies respectfully request an order from the Commission consistent with this petition.

Respectfully submitted,

NEW YORK STATE ELECTRIC & GAS
CORPORATION
ROCHESTER GAS AND ELECTRIC CORPORATION

By:

A handwritten signature in black ink is written over a horizontal line. The signature is stylized and appears to consist of several connected strokes, including a prominent vertical stroke on the left and a horizontal stroke on the right.

Dated: October 12, 2023

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⁴ Case 20-E-0197, Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act, Initiating Order at Initiating Order at p. 8.

that are being proposed primarily to increase system headroom in support renewable energy development.

On September 9, 2021, the Commission issued the Phase 2 Order.⁵ In that order, the Commission identified specific “Areas of Concern” in New York “characterized by the presence of existing renewable generation that is already experiencing curtailments and a strong level of developer interest that exceeds the capability of the local transmission system.”⁶ To address the local transmission deficiencies in the Areas of Concern, the Commission ordered the Companies, along with Central Hudson Gas & Electric Corporation (“Central Hudson”) and Niagara Mohawk Power Corporation d/b/a National Grid (“National Grid”), to “consult with Department of Public Service Staff regarding presentation of a minimum of two options for each Area of Concern that identifies the most cost-effective Phase 2 upgrades on a dollar per megawatt basis, which shall be filed within 180 days of the issuance of this Order.”⁷

Consistent with the Phase 2 Order, on March 8, 2022, the Companies, joined by Central Hudson and National Grid, consulted with Department of Public Service Staff and submitted a joint petition for approval of Phase 2 local transmission projects designed to address the transmission system deficiencies identified in the Phase 2 Order. On February 16, 2023, the Commission issued the Phase 2 AOC Order which approved an estimated \$2.25 Billion investment by the Companies in the Phase 2 Projects. On May 3, 2023, New York Independent System Operator, Inc. on behalf of the Companies filed proposed formula rates with FERC which are pending.⁸

III. The Companies’ Financial Need for 100% CWIP in Rate Base

The Companies are significantly investing in New York’s clean energy future, and the Phase 2 Projects are incremental to the already substantial planned investment in transmission

⁵ Case 20-E-0197, Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act, Order on Local Transmission and Distribution Planning Process and Phase 2 Project Proposals (September 9, 2021)

⁶ Case 20-E-0197, Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act, Phase 2 Order at p. 34.

⁷ Case 20-E-0197, Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act, Ordering Clause Number 6.

⁸ FERC Dockets ER23-1816-000 and ER23-1817-000.

infrastructure, including planned CLCPA Phase 1 transmission investments. The Phase 2 transmission investments, when coupled with CLCPA Phase 1 transmission investments, will usher in a period of historic development and construction of transmission for the Companies. The combined annual investment in CLCPA Phase 1 and Phase 2 transmission for NYSEG is projected to be in excess of \$340 Million in 2024, \$350 Million in 2025 and \$450 Million in 2026 as compared to 5-year annual average transmission plant additions of around \$104 Million from 2018 - 2022.⁹ For NYSEG, total gross transmission plant in service was \$1.7 Billion as of December 31, 2022¹⁰. The Phase 2 Projects alone are over 30% higher than the total of all NYSEG transmission gross plant in service as of December 31, 2022. This is an unprecedented level of capital investment that the Company will need to fund.

The magnitude of the necessary investment in CLCPA transmission over the next few years will exacerbate the cash flow and credit metrics challenges facing the Companies, which, if left unchecked, will increase the cost of debt for customers. The \$2.25 Billion portfolio of approved Phase 2 Projects includes several large projects with long development and construction schedules, all being developed simultaneously along with the Phase 1 transmission projects. Dollars will need to be invested at a rapid pace, but cost recovery will not commence until projects enter commercial operation under traditional ratemaking treatment with higher overall costs to customers via the inclusion of AFUDC. At the scale contemplated for the Phase 1 and Phase 2 transmission investments, the Companies anticipate reaching a point in the next few years where they have more than \$1 Billion in net capital expenditures for plant additions that are not yet in service, and thus, not generating any cash flow under the traditional approach.

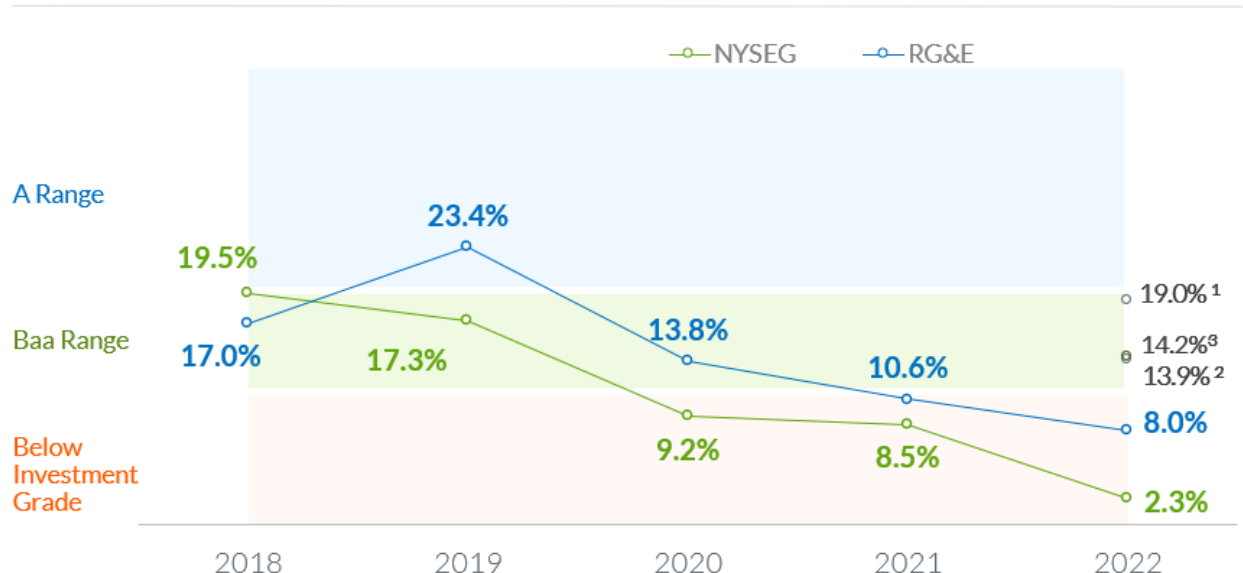
The Companies need the type of financial relief that the inclusion of 100% CWIP in rate base for the Phase 2 Projects will provide. It will be harmful to the cash flows and credit metrics of the Companies to utilize AFUDC for capitalization of all the capital costs for both Phase 1 and Phase 2 transmission. The Companies' cash flows and credit metrics are already under pressure, and the exclusive use of AFUDC for capitalization of these significant investments will cause further pressure and put the Companies' investment grade credit ratings at risk. As shown in

⁹ NYSEG FERC Form 1 filings from 2018 – 2022, pp 204-207, line 58(c).

¹⁰ NYSEG 2022 FERC Form 1, pp 204-207, line 58(g).

Table 1 below, NYSEG’s Cash from Operations less Changes in Working Capital / Debt (“CFO Pre-WC / Debt”) metric has already been below the expected range for investment grade ratings from 2020 – 2022, falling to 2.3% by year-end 2022, substantially less than in-state peer companies Orange and Rockland Utilities, Inc., Consolidated Edison Company of New York, Inc., and Niagara Mohawk Power Corp which have CFO Pre-WC / Debt ratios ranging from roughly 14%-19%. RG&E’s CFO Pre-WC / Debt has also been below investment grade for 2021 – 2022. Ratings agencies have referred to NYSEG’s financial metrics as extremely weak, referring to NYSEG’s ratio of CFO pre-WC to debt of approximately 5% as being among the lowest in the industry. The rate case Joint Proposal settlement will significantly improve the Companies’ credit metrics, however they are still projected to be below investment grade level for CFO Pre-WC / Debt during some time periods covered by the rate plan and that excludes the significant cash flow impacts of the Phase 2 Projects. Granting the use of 100% CWIP for the Phase 2 Projects will help mitigate the additional pressure on the Companies’ cash flows and credit metrics caused by the incremental \$2.25 billion dollars of investment. A downgrade in the Companies’ credit rating will increase cost of debt to customers.

TABLE 1 - Cash from Operations (CFO) less Changes in Working Capital (WC) / Debt



Peers' comparison:

¹ Orange and Rockland Utilities, Inc. (Baa2), FY'22

² Consolidated Edison Company of New York, Inc. (Baa1), FY'22

³ Niagara Mohawk Power Corp (Baa1), FY'22

There is ample precedent for allowing CWIP for large transmission projects in New York. The allowance of 100% CWIP in rate base for transmission in New York has been supported by the Commission, and awarded by FERC, in the recent past for transmission investments in the State. In FERC Docket No. ER15-572, New York Transco was granted the 100% CWIP incentive by FERC for the Edic to Pleasant Valley 345 kV Line, with the segment of the project awarded to New York Transco now known as the New York Energy Solution (a/k/a Segment B). In this docket, the Commission supported the use of CWIP as a risk-reducing incentive¹¹

Citing to FERC Order 679 (Promoting Transmission Investment through Pricing Reform), in its April 2, 2015 Order, FERC stated that “We find that allowing NY Transco to include 100 percent of CWIP in rate base “removes a disincentive to construction of transmission, which can involve very long lead times and considerable risk to the utility that the project may not go forward.””¹² FERC elaborated further on the value of the CWIP incentive:

*The cost and lengthy construction period involved in completing these projects will strain NY Transco’s cash flow and put upward pressure on NY Transco’s ability to finance construction. Granting the CWIP incentive will help ease this pressure and reduce project cost by providing upfront certainty, improved cash flow, and reduced borrowing costs as NY Transco moves forward with each project. Inclusion of CWIP in rate base “balance[s] the need for companies to recover carrying costs in a timely manner with the Commission’s cost responsibility principle, while reducing the rate impacts of new transmission projects on customers.”*¹³

The New York Power Authority (“NYPA”) has also received the 100% CWIP incentive for its approximately \$281 Million portion of Segment A of the Edic to Pleasant Valley

¹¹ Docket ER15-572, Protest of the New York Service Commission dated January 6, 2015, P. 18.

¹² Docket ER15-572, FERC Order on Transmission Formula Rate, Return on Equity, Cost Allocation, and Transmission Incentives, P. 80.

¹³ Ibid, P. 81.

transmission solution. In its November 21, 2019 Order on Transmission Rate Incentives in Docket No. EL19-88, FERC granted the 100% CWIP incentive stating that:

We grant NYPA's request to include the CWIP Incentive in rate base during the development and construction phase of Segment A. We find that NYPA has shown a nexus between the CWIP Incentive and its investment in Segment A. We further find that authorizing 100 percent CWIP recovery for Segment A will enhance NYPA's cash flow, reduce interest expenses, assist it with obtaining favorable financing, and improve the coverage ratios used by rating agencies to determine NYPA's credit quality by replacing non-cash AFUDC with cash earnings. These factors are comparable to those that the Commission has taken into consideration in authorizing the inclusion of CWIP in rate base for other utilities.¹⁴

Even more recently, National Grid received FERC authorization for 100% CWIP in rate base for the Smart Path Connect Project in Northern New York¹⁵, and the Commission did not oppose the use of CWIP for that project.¹⁶

The Companies note that the transmission investments in New York that have received 100% CWIP in rate base are relatively small compared to the \$2.25 Billion in investment authorized for the Companies in the Phase 2 AOC Order. Accordingly, the cash flow and financing needs expressed by FERC for New York Transco and NYPA are even more acute for the Companies.

IV. Customer Benefits of Allowing 100% CWIP in Rate Base¹⁷

The allowance of CWIP benefits customers by avoiding the buildup of large AFUDC balances which then become compounded in rates over the life of the investment. By replacing

¹⁴ Docket EL 19-88, Order Approving Transmission Rate Incentives, November 21, 2019 at P. 26.

¹⁵ Dockets ER23-973-001 and ER23-974-001, Order on Tariff Filings, and Establishing Hearing and Settlement Judge Proceedings, July 28, 2023 at P.12

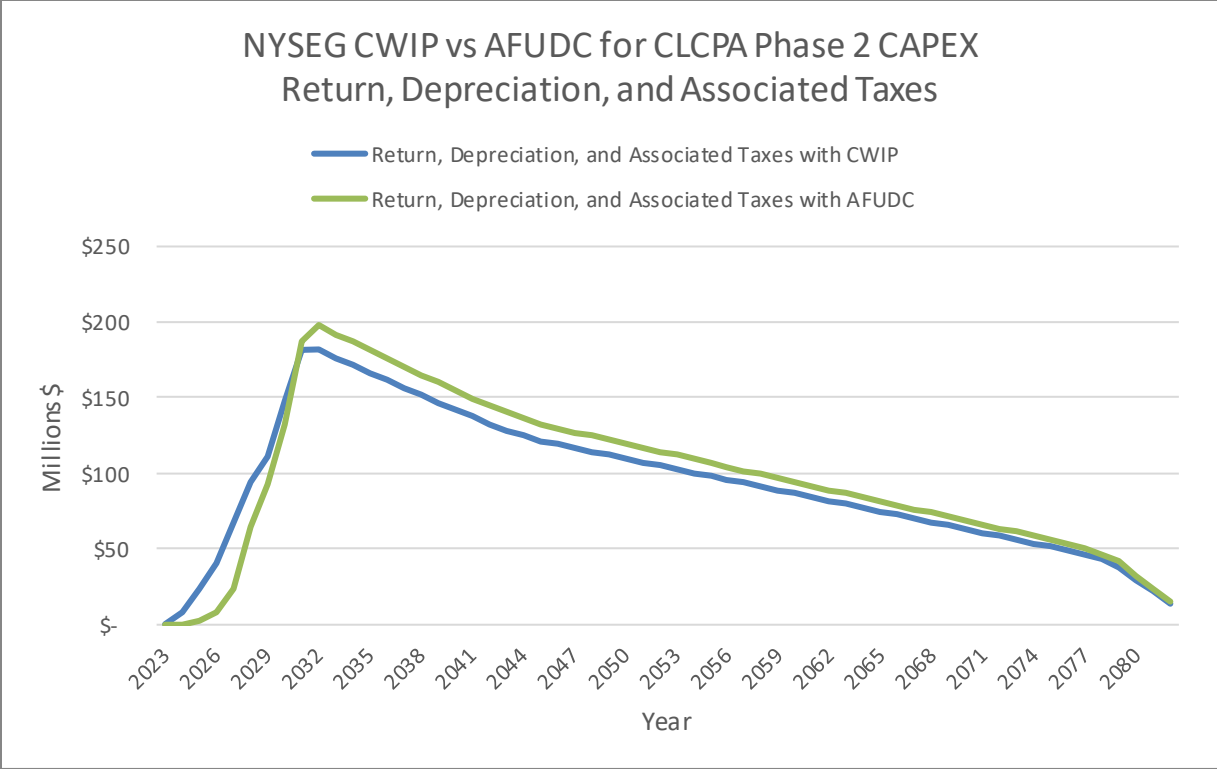
¹⁶ See Protest of the New York Public Service Commission dated March 25, 2022 in FERC Docket ER22-1201 and Comments of the New York Public Service Commission dated February 21, 2023 in FERC Dockets ER23-973 and ER23-974.

¹⁷ Some numbers below may not add exactly due to rounding.

AFUDC with CWIP, once the Phase 2 Projects are placed in service the Companies' return on investment for the life of the plant will only be calculated on the actual cost of the project excluding any non-cash carrying charges for AFUDC balance accrued during construction. This will substantially reduce the total cost of the Projects, and customer savings will persist through the life of the investment until it is fully depreciated. CWIP in rate base also assists in obtaining favorable financing, which directly benefits customers via lower overall debt costs ultimately to be borne by customers. Finally, CWIP in Rate Base can help reduce rate shock by smoothing out the eventual significant increase in rate base that would exist in a short timeframe under traditional capital investment cash recovery treatment.

The Companies estimate that project capital costs will be reduced by \$195 Million (\$179 Million at NYSEG and \$17 Million at RG&E) if capital outlays are recovered via CWIP instead of AFUDC. This is due to avoidance of incurring AFUDC carrying costs, which are placed into project capital cost and recovered as depreciation expense over the accounting life of the assets. A further savings to customers of \$79 Million (\$71 Million at NYSEG and \$9 Million at RG&E) will be realized from a lower return due to a lower rate base using CWIP instead of AFUDC. \$23 Million (\$21 Million at NYSEG and \$3 Million at RG&E) of savings also occur from reduction in costs to customers to collect associated income and gross receipt taxes. As such, once the Phase 2 Projects enter service, customer rates will continuously be lower over the subsequent decades if supported by CWIP than if paid for by AFUDC (see Figure 1).

Figure 1



The total nominal savings¹⁸ of \$298 Million (\$270 Million at NYSEG and \$28 Million at RG&E) for CWIP relative to AFUDC over the depreciation accounting period are presented in Tables 2 and 3 along with savings in real dollars. Two assumptions for inflation are provided; 2%, which is the Federal target inflation rate, and 3% which is approximately the long-run historic average inflation rate of the US. 2% is also the social discount rate utilized by New York in its calculation of the social cost of carbon. Finally, the relative present values as determined by discount at the WACC are provided.¹⁹

Table 2

Summary - NYSEG CLCPA Phase 2 Projects	Total (nominal)	Total (real) 2% inflation	Total (real) 3% inflation	Total (PV @ WACC)
Return, Depreciation, and Associated Taxes with CWIP	\$5,585	\$3,466	\$2,813	\$1,511
Return, Depreciation, and Associated Taxes with AFUDC	<u>\$5,855</u>	<u>\$3,572</u>	<u>\$2,872</u>	<u>\$1,486</u>
Project savings using CWIP instead of AFUDC	\$270	\$106	\$59	-\$24

¹⁸ Note that differences in property tax expense as assessed on capital value are not included in this estimate.

¹⁹ The WACC assumes 4.16% long-term debt rate and 9.2% ROE at a 48% equity ratio for NYSEG and a 4.59% long-term debt rate and 9.2% ROE at a 48% equity ratio for RG&E.

Table 3

<u>Summary - RG&E CLCPA Phase 2 Projects</u>	Total (nominal)	Total (real) 2% inflation	Total (real) 3% inflation	Total (PV @ WACC)
Return, Depreciation, and Associated Taxes with CWIP	\$437	\$260	\$207	\$100
Return, Depreciation, and Associated Taxes with AFUDC	<u>\$464</u>	<u>\$271</u>	<u>\$213</u>	<u>\$98</u>
Project savings using CWIP instead of AFUDC	\$28	\$11	\$6	-\$2

The use of CWIP will support the Companies to obtain favorable financing when financing the Phase 2 Projects and better position the Companies from a credit metrics standpoint to help avoid a downgrade. With AFUDC, the Companies face significant cash flow challenges that could result in a downgrade of debt ratings. The Companies estimate a one level downgrade (i.e., to BBB+/Baa2) would increase debt financing costs for customers by 14 basis points, while a two-notch downgrade to low investment grade would increase debt financing costs for customers by 64 basis points. This is an additional added cost for the Phase 2 Projects due to increased Company debt risk, estimated at \$2.3 Million for a one-notch downgrade or \$10 Million for a two-notch downgrade,²⁰ that will be passed onto customers if the Companies were to use AFUDC. These estimated costs are for Phase 2 investments only. Because the increase in debt financing costs would affect the Companies more broadly than just Phase 2 investments, total customer costs associated with a downgrade would be substantially higher.

Actual experience with a large project developed by a utility affiliate of the Companies, the Maine Power Reliability Program (“MPRP”) developed by Central Maine Power (“CMP”), demonstrates in practice how customers experience substantial savings from the use of CWIP. Commenced in 2010 and predominantly completed in 2016, the \$1.4 billion MPRP was the largest transmission construction project ever undertaken in Maine, more than quadrupling CMP’s transmission plant in service, with the construction of four new 345 kV substations, one new 115 kV substation, and related facilities linked by approximately 440 miles of new transmission lines. Similar to the circumstances currently facing the Companies, CMP’s ability

²⁰ Assuming 14 or 64 bps are added to the debt rate of the weighted average cost of capital.

to include 100% of CWIP in its rate base was necessary because of the size, capital-intensive nature, and time needed to construct the MPRP. The use of 100% CWIP reduced the cost of the Project by an estimated \$150 million, minimized the risk to the project of cash flow constraints, and reduced “rate shock” for customers in New England by replacing non-cash AFUDC with cash earnings and spreading the impact of new plant additions over the entire construction period. The MPRP project is an example of how the allowance of 100% CWIP in rate base can be a win-win for transmission owners and customers.

V. Controls

The Companies will implement accounting controls to ensure that they do not accrue AFUDC in CWIP for the Phase 2 Projects during any period when the CWIP incentive is in effect. The Companies have created new program codes in their SAP accounting systems, and all new capital orders for the Phase 2 Projects will be tagged with this unique program code. All capital orders tagged with the program code will be assigned an interest profile that prohibits the calculation of AFUDC on the capital assets. In accordance with the FERC Uniform System of Accounts, CWIP balances are typically subject to AFUDC, which increases the asset balance for the cost of funds used during construction in FERC Account 107. However, the use of the program code and interest profile discussed above will prevent the Companies’ SAP accounting system from calculating AFUDC on the tagged assets and will thus prevent double recovery of capitalization costs (i.e., both AFUDC and CWIP).

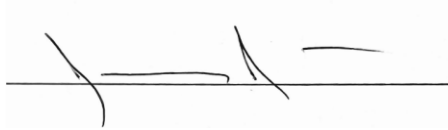
VI. Conclusion

The Companies are committed to making investments that support New York’s climate goals, and the development and construction of the Phase 2 Projects represent a significant step towards attainment of such goals. The Companies will be challenged to maintain their credit metrics without the financial relief that earning 100% CWIP in rate base will provide. An order from the Commission allowing the Companies to seek FERC authorization to include 100% CWIP in rate base will provide improved cash flow and risk reduction which will benefit both the Companies and customers. Accordingly, the Companies respectfully request an order from the Commission consistent with this petition.

Respectfully submitted,

NEW YORK STATE ELECTRIC & GAS
CORPORATION
ROCHESTER GAS AND ELECTRIC CORPORATION

By:

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Dated: October 12, 2023

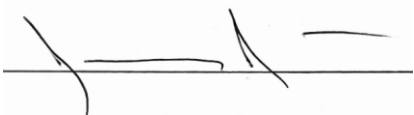
BEFORE THE STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

NEW YORK STATE
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission to Implement Transmission Planning Pursuant to the Accelerated Renewable Energy Growth and Community Benefit Act	: : : : :	Case 20-E-0197
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VERIFICATION

I, Jeremy E. Euto, Vice President of Regulatory of New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation, the corporations on whose behalf the foregoing petition is submitted; do hereby affirm that the contents of the attached Petition are true and correct to the best of my knowledge, information, and belief.



Jeremy J. Euto