05-E-1222
OHADR
A+F
OGC
OE+E
ORE
ORMD
OCS
OEDPC
Brief

STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

THREE EMPIRE STATE PLAZA, ALBANY, NY 12223-1350

Internet Address: http://www.dps.state.ny.us

PUBLIC SERVICE COMMISSION

WILLIAM M. FLYNN
Chairman
PATRICIA L. ACAMPORA
MAUREEN F. HARRIS
ROBERT E. CURRY JR.
CHERYL A. BULEY

DAWN JABLONSKI RYMAN
General Counsel

JACLYN A. BRILLING
Secretary

July 14, 2006

Honorable Jaclyn A. Brilling
NYS Department of Public Service
3 Empire State Plaza
Albany, NY 12223-1350

Re: Case 05-E-1222 – New York State Gas & Electric Corp. - Rates

Dear Secretary Brilling:

Pursuant to the Notice issued with the Recommended Decision in this proceeding and your e-mail of June 27, 2006, please find enclosed the Brief Opposing Exceptions of the Department of Public Service Staff. Copies have been provided to the Secretary. All parties have been served via e-mail with an electronic copy and hardcopies have been dispatched via next day to those parties that requested such service.

Respectfully yours,

Steven J. Kramer

Kimberly A. Harriman
Steven J. Kramer
Assistant Counsels

Enclosure

cc: Honorable William Bouteiller
Honorable Elizabeth Liebschutz
All Parties

2006 JUL 14 PM 3:14

EXEC-FILES-ALBANY
COMMISSION
PUBLIC SERVICE
RECEIVED

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 05-E-1222 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corporation for Electric Service

BRIEF OPPOSING EXCEPTIONS OF THE DEPARTMENT OF PUBLIC SERVICE STAFF

Kimberly A. Harriman
Steven J. Kramer
Assistant Counsels

New York State
Department of Public Service
Albany, New York 12223-1350

July 14, 2006
Albany, New York

RECEIVED
PUBLIC SERVICE
COMMISSION
EXEC-FILES-ALBANY
2006 JUL 14 PM 3:14

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 05-E-1222 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corporation for Electric Service

BRIEF OPPOSING EXCEPTIONS OF THE DEPARTMENT OF PUBLIC SERVICE STAFF

Kimberly A. Harriman
Steven J. Kramer
Assistant Counsels

New York State
Department of Public Service
Albany, New York 12223-1350

July 14, 2006
Albany, New York

Table of Contents

I. INTRODUCTION ..... - 1 -

II. REVENUE REQUIREMENT ..... - 2 -

A. *Sales and Revenue Adjustments* ..... - 2 -

B. *Asset Sale Gain Account* ..... - 4 -

C. *Incentive Compensation* ..... - 7 -

D. *Apprenticeship Program* ..... - 8 -

E. *Health Care Benefits – Inflation* ..... - 9 -

F. *Site Investigation and Remediation Expense and Rate Base Correction* ..... - 10 -

G. *Transportation Fuel* ..... - 11 -

H. *Productivity Adjustment* ..... - 13 -

I. *Trusts* ..... - 16 -

J. *Depreciation* ..... - 16 -

K. *Software Amortization* ..... - 17 -

L. *Construction Contingency* ..... - 18 -

M. *Ithaca Project* ..... - 19 -

N. *Increased Interest Rates* ..... - 20 -

III. ESTIMATE OF THE COST OF EQUITY ..... - 21 -

A. *Legal Standard Regarding Confiscation* ..... - 23 -

B. *Tests of Reasonableness* ..... - 25 -

C. *Absence of a Record Basis for the RD's ROE* ..... - 28 -

D. *GFC Methodology* ..... - 28 -

1. The DCF Approach ..... - 30 -

2. The CAPM Analysis ..... - 30 -

3. NYSEG's flawed CAPM and DCF ... - 31 -

IV. RATE DESIGN AND REVENUE ALLOCATION ... - 32 -

A. *Revenue Allocation* ... - 32 -

B. *Energy Charges* ... - 32 -

C. *Consolidation of HLF and Non HLF Classes* ... - 33 -

V. COMMODITY OPTIONS ... - 33 -

A. *Retail Conversion Factor* ... - 33 -

B. *Variable Price Option – Default Service* ... - 37 -

C. *Sharing Mechanism* ... - 38 -

D. *One-Year Term* ... - 39 -

VI. COST OF SERVICE STUDY ... - 39 -

A. *Call Center and Other Customer Care Cost Allocation* ... - 39 -

B. *Billing* ... - 41 -

C. *Lost Revenue Mechanism* ... - 41 -

D. *Clarification Accounts 908/910 Advertising* ... - 42 -

VI. UPDATES ... - 42 -

VII. CONCLUSION ... - 44 -

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 05-E-1222 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corporation for Electric Service

BRIEF OPPOSING EXCEPTIONS OF THE DEPARTMENT OF PUBLIC SERVICE STAFF

I. INTRODUCTION

On June 29, 2006, Briefs on Exceptions (BOE) to the Recommended Decision (RD) issued in this proceeding were filed by Department of Public Service staff (Staff), the Consumer Protection Board (CPB), the Public Utility Law Project (PULP), Multiple Intervenors (MI), Nucor Steel Auburn, Inc. (Nucor), Constellation NewEnergy, Inc. (Constellation), the Small Customer Marketer Coalition and Retail Energy Supply Association (collectively known as SCMC-RESA), Direct Energy Services, LLC (Direct), Energetic, Inc. (Energetix) and New York State Electric and Gas Corporation (NYSEG or the Company).

The Company raises 25 exceptions to the RD. These exceptions range from the RD's recommended rate of return to its proposals regarding the fixed price option (FPO). Staff opposes a majority of the Company's exceptions. Various parties also raise exceptions to the RD. Those exceptions have a tendency to overlap the Company's, and as such, shall be addressed concomitantly with our response to the Company.

As we noted in our Brief on Exceptions, NYSEG's ongoing campaign to discredit the RD and its threats about service curtailments suggest that the Commission should consider appropriate oversight and penalty provisions in its rate order. These threats are unusual and suggest that the Company should be held accountable for operation and maintenance programs, capital programs and expenditures which are funded in rates.

We cannot recall any rate case where a company has filed for a rate increase when it had overearned by such a large amount for so long. There was simply no basis for NYSEG to have asked for a distribution rate increase. The only logical explanation is that this case was filed in order to provide a bargaining chip which the Company could trade for it to be allowed to continue to profit from an FPO.

II. REVENUE REQUIREMENT

A. *Sales and Revenue Adjustments*

NYSEG objects to the RD's acceptance of Staff's sales forecast. The Company claims that the RD ignores record evidence supporting a projected growth rate of 0.4% in electric sales. Further, the Company argues that a projected growth rate of 0.4% is consistent with "the slowing growth trend in the number of customers in NYSEG's service" (NYSEG-BOE, p. 17). The record evidence shows otherwise.

NYSEG's projected growth rate for customers over the next two years does not materially deviate from the historical average and, as matter of fact, is slightly trending up from the previous two years (Exhibit (Exh.) 3, SRP-5). The Company also revised upward its projection for the number of customers when filing its update in January 2006 (Exh. 103, AL-2). With respect to electric sales, the Company's projected sales growth rate for the next two years is only one quarter of the historical average. NYSEG's projection of such a dramatic slowing of sales growth is not at all consistent with its projected customer growth rate.

The RD is correct that the NYISO's forecast can be used to confirm Staff's forecast. The Company criticizes the RD's use of NYISO forecasts because these forecasts are for energy requirements, not billed sales. However, the difference between the two is only unbilled sales and line losses. Unbilled sales and line losses account for a small portion of energy requirement and should not vary significantly year by year. As such, NYISO's forecasted growth rate is comparable to the growth rates in electric billed sales for NYSEG. The Company's futile effort to make a distinction between the two concepts does not impair the use of NYISO's forecast to support Staff's forecast.

NYSEG attempts to demonstrate that Staff's sales forecast is overstated by comparing our sales forecast with recent actual sales for a six-month period ending May 2006. This attempt fails in all aspects. First, the six month period chosen by NYSEG is a period with a mild winter season. As of May 2006, the weather is warmer than normal by 8.5% (608 heating degree days, NOAA, National Climatic Data Center). Weather is normalized in Staff's forecast. Further, the record shows that the Company's methodology for weather normalization is flawed and cannot be used for the purpose of comparing a forecast to actual sales (Tr. 2867-2869).

The Company's forecast is below actual sales, when weather normalized, by 99,404 MWh for a five-month period ending November 2005 and by 235,717 MWh for a four-month period when the anomalous November is excluded (Exh. 103, AL-2, Schedule 2, p. 2).[1] On an "annualized" basis, NYSEG's sales forecast is below the actual sales by 238,570 MWh and 707,151 MWh, respectively, with and without the anomalous November 2005.

NYSEG disagrees with the RD's conclusion on the proper modeling of the anomalous November 2005 data. NYSEG claims that the RD reached its conclusion by relying solely on a Staff line graph. It argues that the "persuasive" evidence it submitted on the anomaly prior to and beyond November 2005 was not considered. This is not true. Staff presented compelling evidence for the November 2005 anomaly by both graphic analysis and residual analysis (Exh. 103, AL-2, Schedule 3; Tr. 2855-2856). As explained in Staff's Reply Brief (SRB), the latter is the key determinant of a data anomaly. Staff employs a dummy variable for November 2005 because a large percentage of the residuals for that month (11% to 16%) cannot be explained by NYSEG's regression model (Tr. 2856-2858). For the data prior to November 2005, the evidence shows that sales for October 2005 conform to a normal growth trend (Exh. 103, AL-2, Schedule

---

1 Sales are for the five largest customer classes modeled.

3, p.1) and the residuals fall within the boundaries of the average errors (SRB, pp.17-18). Staff's analysis includes actual sales data through November 2005. NYSEG did not show that sales for December 2005 deviated from the historical trend, nor did it perform a residual analysis to see if the model's unexplained error exceeds the boundaries of the average errors. NYSEG's reliance on the statistical significance of arbitrarily added dummy variables, which might be done for any other month, is not "sound" econometric modeling practice; it is an incomplete analysis that fails the econometric standard. The RD's conclusion that NYSEG has not presented any persuasive evidence showing the nature of the three-month anomaly is correct.

NYSEG also objects to the RD's recommendation that the Commission should direct that in any future proceeding it provide good reasons for excluding available data and show what the results would be with the use of any such data. NYSEG claims to have excluded some sample data to make statistical diagnostic gains, but Staff shows that adding back the excluded data does not enhance the statistical diagnostics of the data (Staff Initial Brief (SIB), p.46). Thus, NYSEG's argument that it has used "at least 20 years of sample data" does not provide a compelling reason for excluding data from the sample. The RD's recommendation on this regard should be adopted.

B. *Asset Sale Gain Account*

For the first time in its BOE, NYSEG calls for using the entire amount of the Asset Sale Gain Account (ASGA) balance for refunds because, it alleges, to not do so would violate its current Electric Rate Plan. MI continues its call for using "substantial" amounts of the ASGA balance for refunds (MI-BOE, pp. 3-10). CPB too would like to see refunds "sooner or later" (CPB-BOE, pp. 10-11). As the RD recommends, under the circumstances, the ASGA should be used to reduce rate base, for the time being.[2]

The Company accuses the ALJ's of "a thinly-veiled attempt to further reduce NYSEG's earnings [by] using the ASGA balance to lower the Company's investment base upon which rates are set" (NYSEG-BOE, p.16). NYSEG then proceeds to state that the ALJ's use of ASGA to reduce rate base violates the "the clear language and intent of the Electric Rate Plan". This novel position was not advanced in either NYSEG's testimony or briefs and is clearly inconsistent with its previous position that the ASGA should be used to reduce rate base, albeit by a lesser amount ($30.1 million; see, NYSEG Initial Brief (NIB), Appendix 1, Schedule K-3, p. 6 of 7).

There is no basis for NYSEG's accusation that the ALJ's were motivated to reduce NYSEG's earnings, or more importantly, that the use of ASGA as a rate base reduction would accomplish that end. NYSEG's rate base includes similar items as assets (e.g., $460 million of electric pension assets) that increase rate base (Tr. 2119-2120). In fact, the paper assets that increase rate base are much more substantial than the $87 million of ASGA. As Staff's unchallenged testimony states, the use of ASGA to mitigate the expected increase in paper rate base is a superior approach to any further rate moderation, either by additional reduction in rates or via a direct refund to customers. We agree with the ALJ's that it would be unwise to deplete the ASGA because there would be no pool of dollars available as a source of funding for future potential mandated economic development contracts, unforeseen events (such as, CPB suggests, changes in the NYPA hydropower allocation), and/or commodity losses resulting from the changes to NYSEG's commodity program. It would be unwise to subject customers to a potential future rate increase by a complete or even a substantial depletion of the ASGA.

---

2 NYSEG's introduction and statement of the case incorrectly states that NYSEG's rate base is reduced by the full amount of the ASGA. For 2006, the ASGA treatment should follow the current rate plan however ASGA activity not reflected in rates should accumulate in a separate sub-account and accrue interest. Starting in 2007, ASGA activity not reflected in rates should continue to accumulate in the same separate sub-account and accrue interest at the authorized pre-tax rate of return instead. Future ASGA activity could encompass: future earnings sharing, authorized adjustments (e.g., mandated contracts) and Staff audit adjustments. (SIB, p.142, footnote 62).

To support its argument that the use of ASGA to reduce rate base violates the terms of the Electric Rate Plan for the Company, NYSEG belatedly argues that Section VI.C.5 of the Electric Rate Plan requires that "if an ASGA balance remains at the end of the [Electric] Rate Plan, it will be returned to customers in a manner to be determined by the Commission" (NYSEG –BOE, p. 16). The language cited by NYSEG is silent as to the timing of such return of ASGA monies; it simply does not mandate an <u>immediate</u> return of <u>all</u> monies. The Commission is free to determine the manner and timing in which the money is returned. A credit to rate base reduces rates currently and is an option that the parties contemplated in the Joint Proposal and one that the Commission contemplated in approving the terms of the existing rate plan (as would be offsetting known cost increases). In fact, NYSEG's new position on exceptions is undermined by its original proposal to only refund $30 million of ASGA funds to ratepayers and reduce rate base for the balance.[3]

The proposal to refund any amount of the ASGA is fraught with difficulties. First, and foremost, refunds are not a "free lunch" as NYSEG's rate base would increase. If the entire ASGA were refunded, the delivery revenue requirement would increase by $9 million annually. Second, since the final amount of the ASGA is yet to be determined, there are significant tax issues which are unresolved and compliance filings remain to be made (SIB, pp. 143-144). These compliance filings will have to be audited by Staff before a final ASGA balance can be determined.

Even if the Commission were to consider a modest ASGA refund, there are numerous and contentious equity and computational issues to be resolved. However, because the Company's proposal that all ASGA monies be refunded was raised only in its BOE, there is little, if any evidence in the record to determine who the recipients of such refunds should be and in

---

3 The final accounting for the Electric Rate Plan (which is expected to identify the tentative final ASGA balance) will not be made until March 2007, over six months <u>after</u> the Commission's decision in this rate case. Also, the compliance filings supporting the ASGA have not been audited.

what amounts. As MI has pointed out, there are issues of: identifying the sources of the ASGA funds (e.g., how much is from generation gains, commodity profits, other credits, etc.); allocating the ASGA (who should receive the refunds, in what proportion and for what purpose); and how and when the refunds should be distributed (lump sum or multiple checks or bill credits). There is also no evidence in the record to determine who should bear the costs of the refunding the ASGA or how potential reductions in NYSEG's uncollectibles should be handled if refunds or bill credits are applied to arrearages. The RD's adoption of Staff's balanced rate base reduction approach should be adopted by the Commission as it combines the benefit of a smaller immediate rate reduction to customers with the assurance that these funds would make it unlikely that electric delivery rates would increase in the immediate future.

C. *Incentive Compensation*

NYSEG's claim that it justified $4.5 million of executive incentive Compensation allocated from its affiliated company Energy East Management Corporation (EEMC) is not supported by the evidence. The Commission should reject rate recovery of all incentive compensation (including management as well as executive incentive compensation) as contrary to its long-standing policy which requires such compensation to be self-funded. Staff has attempted to ascertain throughout this proceeding, the specific criteria, goals and achievements for these sizeable incentive payments. The explanation NYSEG offered to support its incentive payments were vague and nebulous. They used criteria such as: "met expectations", "potential future contributions" and "incentives that are targeted at or near market levels."[4] NYSEG would have the ALJs and the Commission believe that the goal of its incentive compensation programs is to provide sufficient compensation to attract and retain employees. However, the Company was unable to justify these large payments as it could not point to any criteria it employed, any accomplishment it achieved, or goal it surpassed to support the sizeable incentive payments.

---

4 Exh. 87, (DPS-318).

The $4.5 million in executive incentive payments represents 191% of the base wages ($2.3 million) allocated to NYSEG from EEMC, an out-of-state holding company.[5] Throughout this proceeding, Staff has attempted to audit the Company's consultants' "cash compensation studies" that purported to justify its generous incentive payments to executives and management. The Company's disingenuous offer to Staff, allowing it to "view" compensation data is insufficient, because "view only access" would not enable Staff to reproduce, analyze and compare the data, and the information would be outside the record. Staff correctly concluded that a review of the studies would be fruitless, because viewing the data claimed by NYSEG to be confidential has little if any utility unless Staff and the other parties can analyze and test it. The offer was merely a cosmetic effort to deflect criticism of the Company's failure to provide "confidential" documents related to the incentive compensation studies and its failure to meet its burden of proof regarding the propriety of its incentive compensation expense.

In the past, the Commission has rightly determined that incentive compensation should be self supporting (e.g., offset by the efficiencies associated with the incentives) and not an expense that should be borne by ratepayers (Tr. 2348; SIB, p. 66; SRB, pp. 21-22). The Company forecasted over $7 million of incentive payments in the Rate Year. The Commission should reject the Company's exception for $4.5 million and also reject the ALJ's erroneous incentive compensation allowance for the remaining $2.5 million.

D. *Apprenticeship Program*

The Company objects to the RD's removal of one-third of its projected increased hiring associated with its Apprenticeship Program. We believe, however, that the ALJs should have removed all these costs as they are not incremental expenses. NYSEG's objection is in stark contrast with the facts. The apprenticeship program is not a new program (Tr. 2335). The Company's workforce has remained constant since the beginning of the Historic Test Year (July 2004) even though the apprenticeship program was in place during this period (Tr. 2336).

[5] Exh. 87, (DPS-188, Attachment 3); 87.04% allocated to NYSEG Electric Department.

Apprentices hired are replacements for workers who retire (Tr. 2335). Moreover, the projected large apprentice class to be filled (hired) in November 2005 never occurred (RD, p. 16). More recently, NYSEG has revealed that instead of hiring additional employees, it will reduce its workforce (Staff - BOE, p. 21). In light of the overwhelming facts, NYSEG's exception should be denied and the ALJ's proposed allowance for the remaining two-thirds of the program costs should be eliminated by the Commission. Alternatively, if the Commission allows the expense, it should also ensure that the Company accounts for the expenditure since NYSEG has a history of delaying or not undertaking programs funded by ratepayers.

E. *Health Care Benefits – Inflation*

NYSEG objects to the RD's use of an overall inflation factor for Health Care Benefits. In its critique of the RD, the Company claims that the Commission policy from 1984 is outdated and would deny NYSEG's Constitutional right to recover health care benefits expenses (NYSEG-BOE, p. 22). NYSEG has not justified removing medical cost from the inflation pool, nor does the Commission's policy deny the Company an opportunity to recover its operating expenses.

It is the Commission's long standing policy to apply the GDP deflator to forecast all costs, including medical costs (Tr. 2340, lines 9-19). The policy recognizes that within a pool of dollars, some cost elements will exceed the rate of inflation, while other costs will fall below that rate. The Company will recover its historic year level of O&M expenses (including health care benefits) and the GDP deflator is then used to forecast the inflation factor for all such expenses. NYSEG has provided no basis for the Commission to abandon its policy. Under the Company's proposal, it would apply a high medical escalation rate of 27.1% to increase medical expenses and a lower medical escalation rate of 9.2% to remove medical inflation from the general inflation rate (Tr. 2339; Exh. 89).

NYSEG boldly claims that if the Commission does not adopt its proposal regarding inflating of medical benefits and other O&M expenses, the Company's Constitutional right to recover its prudently incurred expenses will be violated. However, instead of adjusting the general inflation rate to exclude medical escalation (which it claimed to have done during the case), the Company now employs both a high inflation factor for Health Care costs and an overall GDP inflation rate (unadjusted for a medical cost component) to inflate other Operation and Maintenance expenses. The Company has not presented any compelling reason to alter long-standing Commission precedent. Indeed, acceptance of NYSEG's flawed and highly biased method would result in exactly the kind of cherry picking of inflation rates the Commission wanted to avoid by using a general GDP deflator. Therefore, the Company's exception should be denied.

F. *Site Investigation and Remediation Expense and Rate Base Correction*

NYSEG excepts to the RD's elimination of $3.5 million of additional funding for Site Investigation and Remediation (SIR) costs and its rejection of pre-approved deferral accounting (NYSEG-BOE, p. 23). In addition, NYSEG offers a "correction" to rate base to provide for purported "forecast rate year expenditures" (NYESG-BOE, Appendix 1, Schedule B, p. 4). NYSEG's exceptions and "correction" should be rejected.

First, regarding the level of SIR expenses, the RD correctly found that a more than adequate dedicated environmental clean up reserve is available to fund the environmental remediation of property (RD, pp. 22-23). Second, since the Commission will be setting rates for one year, deferral accounting should not be allowed by the Commission as deferral accounting treatment is available only in multi-year rate plans (Staff-BOE, p.5).

There is more than adequate funding available in the reserve for expected environmental remediation expenses in the rate year. Although NYSEG claims that it will be forced to stop environmental remediation work should funding be depleted, it purposefully ignores the fact that in such an event the Company could file a petition for Commission approval to use deferral accounting subject to the general requirements that the expenses be unforeseen, material, and NYSEG not be in an over-earnings position. The funding already provided and the regulatory process already in place assure that the Company does not have to fund these costs on the backs of shareholders. NYSEG's threats to discontinue clean up projects are irresponsible, and may be a violation of applicable law and/or consent orders with governmental agencies (NYSEG-BOE, p. 24). The Commission should take a dim view of this threat and caution the Company as to taking such course of action.

Finally, NYSEG ignores the fact that the RD rejected its belated and unsupported $24 million rate year forecast for SIR expense which it first raised in rebuttal (RD, p. 23). NYSEG's BOE neither discusses, nor excepts to that point, but instead now brazenly claims that this unsupported level of expenditures is a "correction" (NYSEG-BOE, Appendix 1, schedule B, p. 4). NYSEG's purported correction also misrepresents the record because Staff's direct testimony adjustment to rate base for SIR specifically included $5.58 million of historical spending to forecast rate year SIR expenditures (Exh. 91). NYSEG's "correction" totally ignores the fact that the RD found that Staff's SIR forecast to be more representative of the rate year level of spending. The proper adjustment to the RD's revenue requirement is a reduction to rate base of $4.711 million as discussed in our Brief on Exceptions (Staff-BOE, p.11).

G. *Transportation Fuel*

NYSEG objects to the RD's cost of transportation fuel. NYSEG now discloses select portions of its fuel hedging contract prices, which it previously claimed as trade secret. In a vain effort to support its grossly inflated Rate Year transportation fuel costs, NYSEG cherry picks the information it will allow in the record by revealing only the portion of the trade secret information that bolsters its position (the trade secret portions of the fuel contracts are not in the record). Staff objects to the inclusion of these amounts because they are not on the record, nor was the new information provided to Staff for verification. Furthermore, the Company continues to compare its gasoline price to Staff's lower forecast price of gasoline, but ignores the impact of Staff's higher forecast of diesel fuel, which makes up a large portion of the Company's transportation fuel costs and gallons.

The alleged recent hedged fuel prices (January to May 2007) contained in the Company's BOE are not part of the record, nor were Staff and the other parties afforded the opportunity to test this information in information requests (IRs) or by cross-examining witnesses at the evidentiary hearing (NYSEG-BOE, p. 25). Also, the unredacted amounts were never made public and NYSEG continues to claim trade secret for the rest of the information in the contracts (NYSEG-BOE, p. 25, footnote 39). NYSEG has made public the price of the fuel, but not many of the pertinent hedging contract clauses that can affect the price of these contracts; i.e.; quantity of fuel delivered, delivery dates, pricing periods, trade dates, commodity reference price, tax rates, settlement information, etc. If this information is not revealed, the full impact of these provisions on the contract prices cannot be ascertained by the Commission.

If the Commission allows NYSEG to bolster its case after the record is closed in this proceeding, the record will be unfairly skewed by the Company manipulation of the information.[6] Therefore, the information contained in NYSEG's BOE should not be utilized by the Commission in determining transportation fuel costs.

The ALJ's correctly found that "NYSEG has sought to increase the fuel allocation to its electric department" (RD, p. 26). NYSEG disagrees. However, in support of its Rate Year Fuel expense, NYSEG's response to a Staff information request (Exh. 87, DPS-617), reveals that the transportation fuel allocation percentage (Gas/Electric Departments) attributed to the NYSEG's Electric Department increases from 57% to 67.5% without any explanation or rationale.

Based upon the lack of record evidence, questionable allocation procedures, unverifiable amounts and unclear updating methodology, the Company's request for a last minute update should be rejected by the Commission. Staff has provided a reasonable and verifiable amount of transportation fuel expense. The Company's exception should be denied.

---

[6] NYSEG agrees that the record is closed in this proceeding (NYSEG-BOE, p. 38).

H. *Productivity Adjustment*

Despite the fact that the ALJ's found to the contrary, NYSEG continues to erroneously cling to its claim that it "demonstrated that there would be at least $40.5 million of net merger savings for the 2007 rate year and that all of these savings will flow to customers" (NYSEG-BOE, p. 28, footnote omitted).[7] NYSEG objects to the ALJ's use of a conservative 2% productivity adjustment in lieu of the more substantial and specific levels of merger efficiency savings both Staff and CPB recommended. NYSEG again uses hyperbole to dramatically overstate the impact of the ALJ's decision in stating that the RD "effectively directs NYSEG to cut its labor by 3%". According to the Company, there is no PSC precedent for mandated employee reductions and requiring a 3% reduction could "devastate" NYSEG (NYSEG-BOE, p. 28). These claims are absurd.

First, the ALJ's did not mandate that NYSEG reduce its workforce by 3%. They merely imputed an additional 2% productivity adjustment as a proxy for specified productivity adjustments made by CPB and Staff. More importantly, the ALJs found that further merger related productivity improvements are both imminent and were not captured in NYSEG's rate filing. It is important to note that the expense allowance recommended by the ALJs represents a 12.4% or $33.5 million (nearly a 5% annual growth rate) increase over NYSEG's historic expenses, not a cutback as NYSEG suggests.[8]

Specifically, the ALJs found "that it is reasonable to expect the Company to achieve more cost savings and greater efficiencies than were reflected in....the rate filing" (RD, p. 39). These cost savings were not entirely related to employee reductions. In fact, NYSEG projected that over $10 million of efficiency savings will accrue from "capital project savings, material inventories and supply purchases" (NIB, p. 109) which have nothing to do with employee

---

7 Staff disagrees with NYSEG's $40.5 million computation of net merger savings in its filing. At most, NYSEG has reflected $9 million (Tr. 2154).

8 It is also interesting to note that the ALJ's expense allowance is within 0.9% of the expense forecast in NYSEG's direct filing. (See RD, Appendix B, Schedule A and Exh. 5).

reductions. Efficiencies can be generated without layoffs. For example, NYSEG can generate efficiencies through use of less overtime, more efficient use of contractors, more efficient purchasing methods, etc.

The Company's attempt to create an employee cutback issue by blaming the ALJs is ironic. NYSEG itself boasts that it cut its workforce by 22% and that this "reduction...has not caused any customer service problems or caused system reliability to deteriorate" (RD, p. 38). No matter how NYSEG spins this issue, it will achieve additional productivity gains in the rate year. Ignoring these imminent efficiency gains would benefit NYSEG's bottom line to the detriment of customers.

The RD's productivity adjustment is exceedingly conservative. Contrary to NYSEG's claims that it included $40 million in productivity and the 'standard' 1% forward looking productivity adjustment, NYSEG's rate filing does not in fact reflect any additional productivity. NYSEG's filing did not result in a net reduction to historic base payroll expense to reflect productivity, rather it increased base payroll by $2.6 million (about 2.6%). NYSEG achieves this increase in historic base payroll by adding payroll for: CCS ($1.73 million), the apprenticeship program ($1.18 million), and the meter read and TDIRP programs ($0.79 million), less a $1.1 million productivity adjustment (using 1% of labor productivity (see, Exh. 5, RRP-3, Schedule D, p. 1)).

Further, NYSEG failed to disclose that while it achieved virtually no employee reductions during the historic base year (July 2004-June 2005). Total employment between NYSEG, EEMC and USSC increased by over 34 employees during the same time frame.[9] Because NYSEG receives the greatest share of EEMC/USSC cost allocations, NYSEG's expenses reflect the cost increases associated with the additional employees.

---

[9] Exh. 1, NYSEG responses ERPE-0143-0145 to DPS-118-120.

If anything, NYSEG should be required to show additional efficiencies to offset the above cost increases. The ALJ's conservative 2% of payroll doesn't even eliminate the increases in base and service company payroll sought by NYSEG (discussed above), much less require that NYSEG "slash" its workforce. In a round about way, the RD contemplates that in its Summary and Multi Year Implications section by concluding: "there is testimony on this record regarding future potential efficiencies, such as the ability of the Company to use a new computer system throughout its operations... [so] the delivery and commodity rates and terms recommended here could very well remain in place for some time to come" (RD, p. 167). Given the fact that there is no productivity reflected in the NYSEG forecasts, adoption of Staff's conservative adjustment is required to capture even a conservative amount of expected efficiency savings.

Finally, in its related discussion on incentive compensation, NYSEG for the first time alleges that the RD double counted merger savings[10] because the RD allegedly excludes:

> ...$4.5 million of incentive compensation and then fails to consider that when it imputes an additional 2% labor productivity. Because merger savings are net of EEMC and USS costs, by eliminating the incentive compensation paid to EEMC, the RD artificially increases the merger savings in this case, all of which are flowed back to customers by reducing the revenue requirement. Therefore, the exclusion of any incentive compensation increases merger savings by that amount and should result in a reduction of imputed productivity savings on a dollar-for-dollar basis (NYSEG-BOE, p. 21).

This alleged "error" is concocted and lacks a record basis. Not only did the ALJs not accept NYSEG's flawed computation of the $40 million in alleged net merger savings, they found that not all potential merger savings were incorporated in the revenue requirement. More importantly, they did not use or rely upon NYSEG's quantification of merger savings in any way to produce their revenue requirement. Since NYSEG's computation of net merger savings had no impact on the ALJ's revenue requirement, any required correction would not change the revenue

---

[10] The incentive compensation paid to executives can be earned through cost savings, increases in stock price, fixed price option profits, and other activities (Tr. 2351-2352). The Commission requires these types of compensation plans to be self funding. As a result, it is conceivable that all incentive compensation can be generated by and funded without any productivity (e.g., through fixed price option profits). There is no double count.

requirement. The ALJs used the same logic as Staff used in its filing. However, NYSEG never raised the issue at the evidentiary hearing or in its pre-RD briefs. The belated need for this "correction" is another desperate attempt by NYSEG to rehabilitate its weak case and as such, it should be rejected.

I. *Trusts*

NYSEG states:

> The RD errs in adopting Staff's proposal to remove from NYSEG's capitalization $18.9 million of trust assets that are used to support benefits to certain employees and directors (RD, p. 58). The trusts were established nearly 12 years ago, and have been included in capitalization in NYSEG's last three rate proceedings. Moreover, the RD fails to include in the revenue requirement the pay-as-you-go benefit costs of $1.15 million that would be incurred if the trusts did not exist...Thus, if the trusts are not included in rate base, expenses must be increased by $715,000 (NYSEG-BOE, pp. 30-31).

NYSEG's exception must be rejected as it is based on faulty logic and incorrect assumptions. First, these trusts were never included in NYSEG's capitalization in this or NYSEG's last three rate proceedings (Tr. 467-469). For the last decade, NYSEG's rates have, for the most part, been based on 'black box' settlements in which no specific rate base was identified (Tr. 284). Even if one could credibly argue that those trusts were in rate base, those previous settlements create no binding precedent for ratemaking here.

Second, the funding of a benefit has no bearing on the expenses incurred by NYSEG. The benefits are expensed when earned, not when funded. Therefore, it is illogical for the Commission to allow a pay as you go expense for these benefits, as they have been reflected in expenses when the benefits were earned, not when they are paid (SIB, pp. 161-162).

J. *Depreciation*

NYSEG contends that the RD fails to consider all factors, known and measurable, that will affect depreciation rates for each of the property groups (NYSEG-BOE, p. 28). There is also an assertion by NYSEG that it has provided information related to the Infrastructure Program's impact on future service lives (NYSEG-BOE, footnote 45). For five distribution accounts NYSEG does not forecast a significant increase in expenditures for replacements relative to past retirements (SIB, p. 111). Therefore, it is very doubtful that the expected replacements will significantly change the current mortality of these accounts.

In addition, NYSEG's claim that a correction appears to be needed to the RD depreciation expense should be rejected. NYSEG, for the first time, alleges in its BOE that Staff's depreciation adjustment may be overstated by $1.43 million if Staff included the CCS project in the depreciable base to compute its adjustment. Staff specifically excluded all software including the CCS project in computing its depreciable base. Staff's depreciable base has never been in dispute. Furthermore, NYSEG never claimed that Staff had made any kind of double count in adjusting depreciation expense. NYSEG's claims are nothing more than a post record fishing expedition and should be rejected.

K. *Software Amortization*

NYSEG's exception to the RD's elimination of IBO and WMS software costs from rate base purportedly relies on the language in its current Electric Rate Plan (RD, pp. 29-30). The Company's citation of this language ("maybe capitalized") from the Electric Rate Plan is taken out of context and even if it meant what NYSEG implies, NYSEG incorrectly applied the associated Electric Rate Plan accounting requirements.

First, the rate plan was clarified by the Commission.[11] On page 15, the Commission states that "[t]he latter provision, as well as Appendix A to the Joint Proposal, suggests that the parties intended that all merger costs would be recovered in rates during the rate plan," Those merger costs referred to by the Commission included the costs for software as demonstrated by Exh. 81.

Second, even if the Commission did not require these costs to be amortized by the end of the Electric Rate Plan (2006), NYSEG's interpretation to amortize these costs beyond 2006 would be correct only if it had obtained prior authority to specifically defer or capitalize these costs as

---

[11] Cases 01-E-0359 and 01-M-0404, NYSEG Electric Rates and Merger, Order Adopting Provisions of Joint Proposal with Modifications (issued February 27, 2002).

resulting from a change in accounting for software and had established a pre-determined amortization period. If NYSEG wished to make a change in its accounting for internal software it should have requested a change, just as it requested a change in the depreciable lives of other property in this proceeding.

The Company now attempts to overcome the Commission's requirements regarding changes in accounting by a vague work paper reference suggesting that IBO and WMS costs were" ...within the type of merger costs that were identified in the merger proceeding by Mr. Flaherty (Exh.81)." More on point, Exh. 86 discusses the basis for IT system capital synergy savings: "Projected capital expenditures associated with the development of duplicative systems and future application development have been converted to fixed charge rates assuming a <u>5 year depreciable life</u> converting to a 28% annual fixed charge rate (emphasis added)." As a result, these costs were already recovered as a deduction from the synergy savings used to set rates and calculate the net synergy savings of the merger.

A vague reference in a company work paper is simply not an adequate substitute for a proper request to the Commission to change accounting methodology for internal software and the RD properly found that NYSEG has never received Commission approval to amortize these costs over a ten year period (RD, p. 45).

L. *Construction Contingency*

NYSEG's exception to the RD's elimination of $6 million from rate base related to contingencies in NYSEG's construction forecast should be denied (NYESG-BOE, p. 30). NYSEG's exception is based upon its claim that Staff has not shown that NYSEG has consistently under spent the rate allowances for construction activity. NYSEG next claims that it has spent $350.5 million over the first four years of the $355 million presumed for the five year term of its current rate plan.

The burden is on the Company to show a need for a contingency and it has failed to meet its burden. Staff also showed that NYSEG vastly overstated its construction forecast for the current rate plan in calendar years 2002 – 2004 (SIB, p.136). As noted in the RD, not only did Staff demonstrate that NYSEG has not exceeded its construction estimates but that NYSEG can be expected to complete some of its major projects well within the amounts it has budgeted (RD, p. 49). For example, the CCS project is in service at an approximate cost of $75 million, far less than the $86 million projected by the Company (SIB, p. 137).

NYSEG's reliance on the construction forecast of $355 million, which was negotiated in its current rate plan, is misplaced. The negotiated five year forecast of $355 million was substantially reduced from that proposed by NYSEG in its litigated case and, therefore, can not be compared or be relied upon to support its litigated construction forecast in this proceeding. In addition, NYSEG's claim that it achieved $350.5 million of actual construction expenditures is overstated because that amount includes over $60 million of costs related to its internal software, which was not considered in the $355 million forecast (SIB, p. 125). The Company was obviously not meeting the $355 million target and used accounting subterfuge to avoid the penalty that would result from substantially missing the forecast. For all of the above reasons, NYSEG's exception should be denied.

M. *Ithaca Project*

Concerning the Ithaca Project, NYSEG states:

> if the PSC were to adopt the RD's proposal, NYSEG should be authorized to defer any associated carrying costs (exclusive of AFUDC) that NYSEG incurs prior to the next rate case if the Ithaca Project goes into service before being reflected in rates (NYSEG-BOE, pp. 31-32).

Staff urges the Commission to reject NYSEG's belated, open-ended, and ill-defined, proposal to defer carrying costs on the Ithaca Project. Given NYSEG's poor track record of achieving targeted capital spending, there is no reason for the Commission to single out this project for deferral.

However, if the Commission were to consider this proposal, and if NYSEG spends these dollars and if the project is placed in service during 2007, the Commission should compare the entire amount of capital expenditures made by NYSEG during the 2007 rate year to the capital budget. The Commission could consider allowing deferral of the carrying charges on the Ithaca Project but only if NYSEG's actual spending exceeds the capital budget in total, and just for any months that the project is not accruing AFUDC. Such special treatment should also end by December 2007, the end of the rate year.

N. *Increased Interest Rates*

NYSEG's exception number eight notes that interest rates have increased and that the RD proposed a 5.75% discount rate for calculating pension and Other Post Employment Benefits (OPEB) expenses (NYSEG-BOE, p. 23). For the first time, NYSEG suggests the Commission update its variable rate debt by $1.27 million if the Commission adopts the 5.75% discount rate. It is reasonable to update NYSEG's short-term debt rate with the latest available figures. The Company should provide the Commission with the latest update to its short term interest rate at the time of the Commission decision, along with relevant documents and information to support its update.

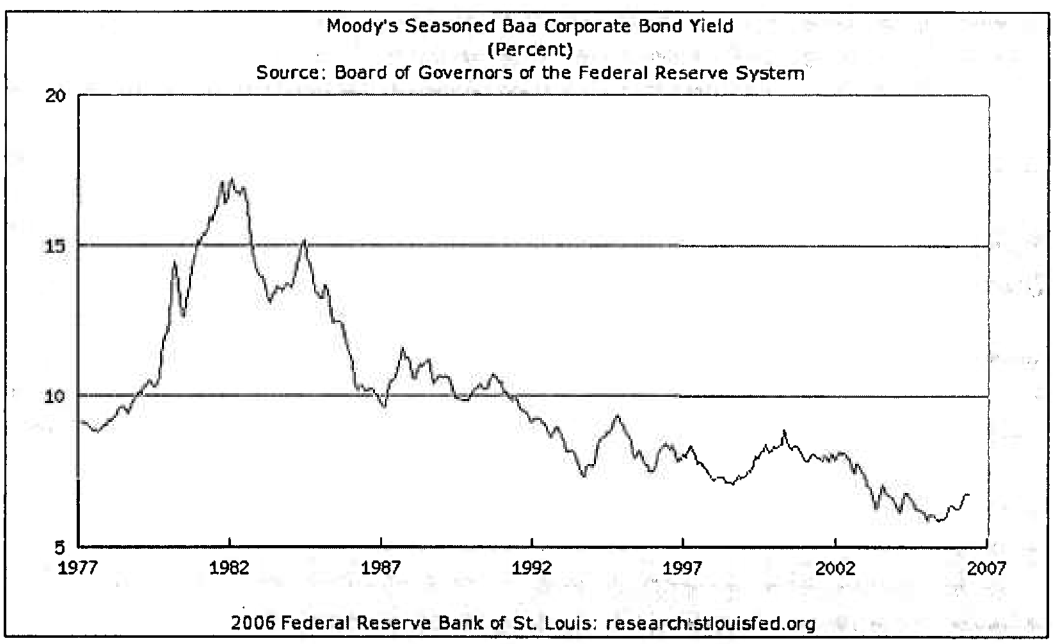
However, NYSEG's attempt to link the placeholder 5.75% discount rate used in the RD for pension and OPEB expense is an inaccurate one-sided misrepresentation of the issue (RD, p. 20). Although NYSEG reports in its BOE (Appendix 2) on Moody's A and Baa Bond yields - showing rates close to 6.5%, it does not suggest an update to the 5.75% discount rate used in the RD but instead now, for the first time, demands an update to its variable debt rates.

The 5.75% pension and OPEB expense discount rate placeholder used in the RD is clearly conservative and outdated. Staff's reply brief noted that the Moody's Aa long term index at April 27, 2006 was 6.13% as compared to the 5.41% rate (rounded up to the nearest .25% to arrive at 5.5%) at the time of Staff's pre-filed testimony (SRB, p. 28). Using the latest Moody's Aa long term index of June 23, 2006 of 6.27% (rounded to 6.25%) results in updated decreases of $633,000 and $4,606,000 to OPEB and pension expenses, respectively. As recommended in the

RD, Staff's unopposed pension and OPEB expense update should be adopted be the Commission (RD, p. 20).

III. ESTIMATE OF THE COST OF EQUITY

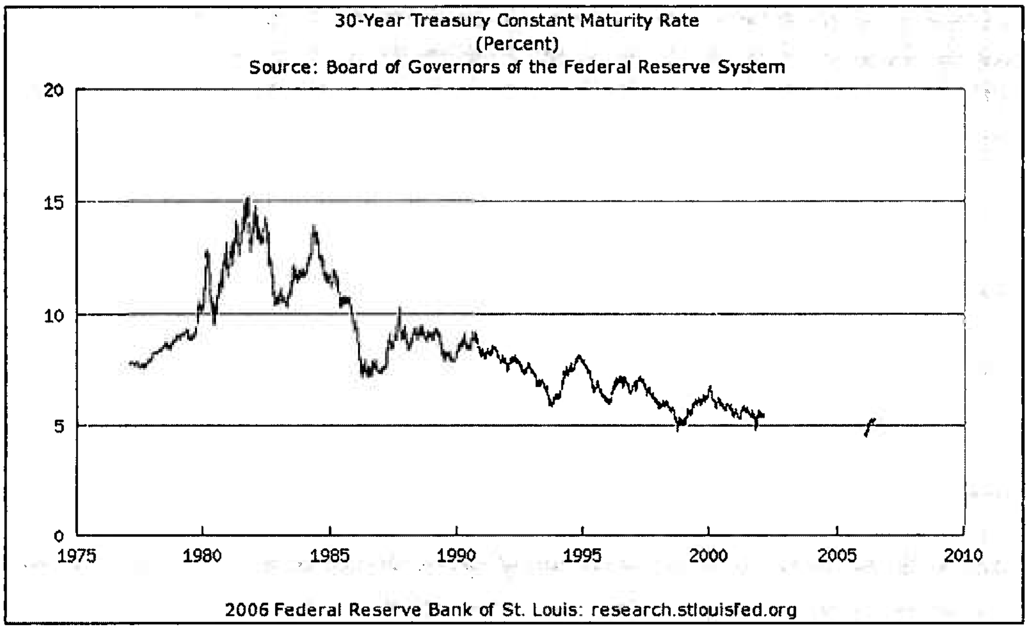
Staff believes that the methodology used by the ALJs to estimate the cost of equity is reasonable. The Company's criticisms of the RD's cost of equity determination are without merit. While we address each of these criticisms below, it is imperative that the Commission recognize the context for its return on equity (ROE) decision in this case. NYSEG's brief is replete with vague statements and innuendo implying that RD's cost of equity determination is out of touch with conditions in the financial markets. The tables below obtained from the Board of Governors of the Federal Reserve System (available at research.stlouisfed.org) show changes in long term Baa bond yields and long term treasury yields from February 1977 to June 1, 2006.



Latest Observations:

Date 2006-06-01

Value 6.78



Latest Observations:

Date 2006-07-06

Value 5.23

These charts show that long term rates today are at very low levels relative to the study period (the actual data contained in charts is contained in Attachment A).[12] The results not only call for the Commission to set a return on equity lower than what it has typically set ROEs at in the last 25-30 years, it also shows that NYSEG's concern that the 9.3% return would be the lowest return in "modern history" is irrelevant. The Commission should set the ROE to reflect that interest rates are at or near their lowest levels in the last 25-30 years.[13]

---

[12] The gap in 30 year treasury yields reflects the time period for which no new 30 bonds were issued.

[13] NYSEG's suggestion that interest rates are higher today than when Staff filed its case (NYSEG-BOE, p. 4) ignores the fact that interest rates are still historically low relative to the last 30 years.

A. *Legal Standard Regarding Confiscation*

The Company's takes exception to the RD's 9.3% cost of equity because it is "confiscatory". It also argues that the Hope[14] and Bluefield[15] set standards for a fair rate of return which are not met by the ALJs' recommendation. To support this desperate claim, the Company presents data allegedly showing that recent allowed returns on equity in other jurisdictions have been about 10.5% and that the average allowed return for the proxy group employed by Staff was either 11.1%, as reported by AUS, or 10.7% based on returns granted to the subsidiaries of Staff's proxy group companies in 2004-2005. Finally, NYSEG notes that the RD's 9.3% return on equity, if adopted, represents the "lowest ROE for a major electric utility in modern times" (NYSEG-BOE, p. 3).

NYSEG's comments regarding the confiscatory nature of the RD's cost of equity determination fail to recognize several pertinent facts. First, the Company's claim is particularly dubious in light of the 9.6% return on equity agreed to in a recent multi-year Joint Proposal in the Central Hudson rate case (Cases 05-E-0934 and 05-G-0935). Considering that such joint proposals for multi-year rate plans contain stay-out premiums in returns, the Judge's 9.3% determination is well within a reasonable range of outcomes and shows that the ROE recommended in the RD is not confiscatory, but just and reasonable. Second, NYSEG's position also ignores record evidence that since the beginning of 2005, there were 24 cost of equity recommendations made by state regulatory commission staffs for gas and electric utilities below 10% and seven cost of equity decisions by commissions which were below 10% (Tr. 3403-3405). While the Company would like to make the ALJs' and Staff's recommendations appear as outliers, the record evidence does not support such a perspective.

---

[14] Federal Power Commission v. Hope Natural Gas Co. 320 U.S. 591 (1944).

[15] Bluefield Waterworks & Improvement Company v. Public Service Commission of West Virginia, 262 U.S. 679 (1923).

Furthermore, NYSEG's reliance on allowed returns in other jurisdictions is not only a circular exercise, it represents cherry-picking of the highest order. The use of returns allowed by other commissions to estimate the cost of equity is a circular process which creates the potential for a mass of stale cost of equity determinations that cannot possibly reflect the pertinent risks of a company or the latest market conditions.[16] Moreover, NYSEG's argument that New York should defer to the judgments of other commissions on cost of equity represents nothing more than the continuance of the classic cherry picking approach that the Company has followed throughout this proceeding. Indeed, if the determinations of other commissions were as relevant as NYSEG implies, why would not NYSEG also argue that the New York Commission should set operation and maintenance expense levels at national levels or set rates on a historic test year rather than a fully forecasted rate year? Obviously, NYSEG is picking and choosing methodologies at its whim in an attempt to achieve the results it wants.

NYSEG fails to make any showing that the returns allowed in other jurisdictions are in any way comparable to the one year cost of equity proposed in the RD. The Company does not provide the most basic information, such as whether the returns were the product of litigated proceedings or settlements, and whether the returns were for a single or multi-year year rate case. Moreover, NYSEG has not shown that the regulatory approach which produced these allowed returns is similar to that of New York (i.e., the use of a fully projected rate year versus a historic test period, the use of earnings caps and sharing mechanisms, and the presence of risk reducing mechanisms such as adjustment clauses, deferrals and true-ups). Also, the Company neglects to mention the risk reducing effect of the RD's proposal to move greater amounts of fixed costs from volumetric charges to the monthly fixed charge (i.e., increasing the monthly customer charge). Finally, NYSEG does not indicate whether the proxy group companies are "low risk pipes and wires" companies as Energy East proclaims itself and its subsidiaries to be to Energy East's

16 If every State Commission relied on what the last State Commission decision was, the allowed return on equity would never change.

investors (Exh. 128, p. 15). In short, while there may be a difference between allowed returns in other jurisdictions and those allowed in New York, the differences are logical when their context, which NYSEG conveniently omits, is considered. Looking at these returns in the proper context affords the Commission a rational basis to adopt the RD's ROE since it is commensurate with the returns on investments in other enterprises having corresponding risks.

NYSEG's makes claims regarding the confiscatory nature of the RD's cost of equity but does not even attempt to precisely define the level at which an allowed return becomes confiscatory. NYSEG presents average allowed returns and strongly implies that returns below the average are per se confiscatory. Thus, if one accepts NYSEG's logic, any return below the average does not meet the test that the return "should be commensurate with the returns on investments in other enterprises having corresponding risks" (NYSEG-BOE, p. 3). The Company's simplistic and unrealistic logic, however, is fatally flawed since it implies that half of the returns approved are confiscatory. When NYSEG's logic is taken to its ultimate conclusion, if each of the allowed returns below the average is eliminated from the average, eventually all the allowed returns in the group will equal the highest allowed return. The ALJs' market based approach relies on rigorous DCF and CAPM analyses which use market based data to assure that the cost of equity was estimated to provide a return commensurate with the risk on the enterprise.

B. *Tests of Reasonableness*

The Company takes exception to the recommended return on equity because it believes it fails several tests of reasonableness. NYSEG notes that rate cases do not occur in a vacuum and recycles comments it presented in its testimony from various credit agencies and financial publications (Tr. 3179-3183). In its BOE, NYSEG summarizes the reaction of the financial community to Staff's rate case filing and states that the ROE recommended in the RD will have "serious negative consequences" for the Company and its ratepayers. Though not stated in its BOE, the Company implies that the ALJs' recommendation will result in a downgrade of the Company's bond rating if the Commission adopts the ROE recommendation. NYSEG's approach to this particular topic should be of significant concern to the Commission. The Company has not only ignored one of the Commission's primary means of evaluating the reasonableness of a return on equity determination, but also invented a new and spurious test of reasonableness based upon a fabricated context.

NYSEG's direct case placed great emphasis on its bond rating as an important element of its rate filing. The most obvious way for the Commission to test the reasonableness of an allowed return is to consider its effect on the utility's financial parameters. NYSEG, however, has provided no information in its BOE concerning the likely effect of the RD's recommendation on its financial parameters or those of its parent, Energy East. The Company, in fact, failed to provide any forecasts of its financial parameters for the rate year under its requested rate of return. The only forecasts of financial parameters on the record are those provided by Staff based on our recommended cost of equity and 40% equity ratio (SIB, pp. 197-198). These projections, which we include as Attachment B, show that NYSEG's financial parameters under our recommendations are consistent with an "A" bond rating (Tr. 3388-3391).[17] NYSEG's position in this proceeding conveniently ignores this information.

We urge the Commission to carefully consider the context for NYSEG's statement about "serious negative consequences". The following chart, from the Five Year Book published on the Commission's website, shows that NYSEG has realized more than a robust earned return on its book equity since 2000, relative to other New York combination utilities.[18]

---

[17] We note that NYSEG claimed that these results were overstated because Staff did not reduce the Company's cash flow for expenses that the RD disallowed, but the Company would actually incur. Such claims should be rejected since they amount to nothing more than rate case disagreements about the prudent level of expenses for the rate year.

[18] http://www.dps.state.ny.us/5yrbook/roesum2004.pdf

Return on Common Equity
(In Percent)
Combination Electric and Gas Companies

	2004	**2003**	**2002**	**2001**	**2000**
Central Hudson	13.8	14.1	11.5	11.2	11.1
Consolidated Edison	8.9	11.4	12.7	14.2	12.9
New York State E & G	**23.1**	**23.2**	**14.8**	**26.2**	**34.9**
Niagara Mohawk	6.1	14.2	3.3	(0.1)	(2.1)
Orange & Rockland	13.3	15.0	16.5	16.0	11.8
Rochester G & E	-0.1	12.8	6.0	9.3	12.2
New York State Composite	**9.0**	**13.5**	**13.3**	**11.0**	**10.0**

Financial results such as these raise the threshold question of why NYSEG would even file a rate case. The answer to this question is most likely that the Company's rate filing was driven by its desire to preserve earnings from its very profitable FPO. By making such a filing, NYSEG attempted to create unrealistic expectations that it has a reasonable chance of realizing at least some of its requested increase. Staff's analysis, however, exposed the Company's contrived strategy and the RD largely confirms Staff's findings. As a result, NYSEG must either admit its strategic error, by recognizing that its earnings must necessarily be lower in the future, or attempt to continue its current charade by seeking to shift blame for necessarily lower earnings from itself to Staff and now the ALJs.

NYSEG appears to pin its case on the fact that the Commission will be influenced greater by statements from the financial community than the record adduced in this proceeding and time honored precedents used by the Commission to set just and reasonable rates. We submit that this proceeding should be decided by the Commission on the facts adduced in the record and adhering to Commission precedent.

NYSEG's complete silence on Staff's suggestions that Energy East needs to increase its equity ratio in order to improve its bond ratings suggests that Energy East and NYSEG do not intend to pursue the most obvious way of improving its S&P bond ratings. NYSEG and Energy East would rather assign the responsibility for their financial challenges to regulators, and ultimately, ratepayers.

Turning to the Company's comments regarding recent increases in interest rates, the interest rate increases have no bearing on the reasonableness of the RD or Staff's methods, because both are subject to update. Staff has already updated its ROE once in this case and the ROE should be further updated at the time of the Commission's decision.

C. *Absence of a Record Basis for the RD's ROE*

The Company contends that there is no record basis for the RD's recommended return on equity of 9.3%. The Company claims that both Staff in its Initial Brief and the ALJs in the RD have supplied no work papers or calculations to support their conclusion on return on equity. It is ironic that NYSEG uses this argument because in its briefs, the Company provided no update of its methodologies at all, preferring a simplistic interest rate adjustment to a recalculation of its testified positions. Contrary to the Company's assertions, there is a complete record in this case to allow the ALJs to update Staff's and CPB's cost of equity methodologies. The Staff and CPB methodologies were described in direct testimony. Updates of the relevant inputs in the DCF and CAPM equations are readily available to the ALJs and the Commission. The Company's exception should be denied.

D. *GFC Methodology*

The Company takes exception to the Recommended Decision's reliance on the Generic Financing Case's (GFC) return on equity methodology. It criticizes the reliance in three ways: (1) there is no final decision from the Commission in the GFC; (2) the Commission has not always relied on the GFC; and, (3) the methodology used in the RD departed from the GFC in several important ways. The three criticisms are both contradictory and misguided. How can the ALJs slavishly rely on the GFC return on equity methodology yet be criticized for deviating from it? The Commission may not have approved the GFC, but NYSEG was a signatory to the Return on Equity Consensus Document and the Financial Integrity Consensus Document in that case. The Commission may make appropriate adjustments to the GFC return on equity methodology; however, the Commission has consistently rejected most of the return on equity methodologies put forth by the Company. NYSEG, it would appear, will only apply the GFC methodology if it produces a result it likes (e.g., since the method is responsive to interest rate changes, NYSEG would support the method in high interest rate periods as well as periods in which interest rates were rising).

The Company's exception also reiterates complaints that the short term dividend stream in Staff's DCF methodology is inconsistent with the GFC (NIB, p. 223). In this instance, the Company ironically insists on a slavish adherence to the GFC methodology. We think that NYSEG is too rigid on this issue. The ALJ's methodology provides a more accurate cost of equity result since it uses the latest Value Line information rather than relying on estimates that could be as much as six months old. Thus, the Company's exception in this regard should be denied.

The Company also took exception to the RD's CAPM calculation by criticizing the market risk premium and the risk free rate. The ALJs used an estimate from Merrill Lynch to derive the market risk premium and used the average of 10 and 20 year U.S. Treasury instruments to develop a risk-free rate. The Commission has used each of these estimates recently and should continue to do so.[19] The Company used historical Ibbotson data and assumed that risk premiums are constant over time. However, Company witness Rosenberg acknowledged that empirical evidence does not support this assumption (Tr. 3106). NYSEG's claims are further undermined by Ibbotson's forward-looking market risk premium estimate of 3.41% (in contrast to Company witness Rosenberg's assertion of a 7% premium).

The Company's risk-free rate estimate is flawed as it contains instruments other than pure Treasury instruments. The RD's risk-free rate has been used in other cases before the

---

[19] Case 95-G-1034, Central Hudson Gas & Electric Corporation - Rates, Opinion No. 96-28 (issued October 3, 1996), p. 14; Case 02-E-0198, et al., Rochester Gas & Electric Corporation - Rates, Order Adopting Recommended Decision with Modifications (issued March 7, 2003), p. 71.

Commission. It's modification from the original GFC methodology reflect current realities (i.e., there is not enough experience yet with the new 30-Year Treasury bond to merit its inclusion in the CAPM calculation). The RD presents a very reasonable assessment of what the risk-free rate should be in the CAPM equation. The Company's exception here should be denied.

1. The DCF Approach

The Company argues that the long-term growth rates produced by the ALJs' DCF model are too low. Instead, NYSEG believes its higher growth rate estimates should be used in the DCF model. We reiterate the critical flaws in the Company's overstated long-term growth estimates. The use of nominal GDP growth rate itself is flawed because conservation measures and increased efficiencies in production make it unlikely that a macroeconomic measure of economic output is applicable to the electric industry given the incentives that businesses have to minimize electric consumption per unit of output (Tr. 3307-3308). Likewise, NYSEG's use of growth in the electric industry as a long-term growth rate in utility dividends is undermined by its failure to consider the unique circumstances facing each company in the proxy group (i.e., the dividend payout policies of the proxy companies (Tr. 3307)). Finally, the Company's cherry picking of its sustainable growth DCF methodology overstates the long-term sustainable growth recommendation (SIB, pp. 213-214). Thus, the infirmities which NYSEG supposedly sees in the RD's growth estimates pale in comparison to the problems in each of NYSEG's growth rate estimates. As a result, the Commission has no reasonable choice other than adopting the growth rates produced by the ALJs' DCF model because they are consistent with the financial parameters for each company in the proxy group, including the short-term growth rate. NYSEG's exceptions should be denied.

2. The CAPM Analysis

NYSEG criticizes the Recommended Decision's CAPM methodology because it relies solely upon Merrill Lynch's estimate for the expected market risk premium. NYSEG suggests that the Merrill Lynch cost of the market number is flawed because it is out of synch with the cost of equity allowed by other state commissions.[20] It suggests that the Commission should use the higher market risk premiums it advocates (Ibbotson's historical calculation of a market premium and the market premium derived from a DCF analysis on the Standard & Poor's 500).

When investors look for a measure of the market, Staff submits that investors look to a reputable source like Merrill Lynch for the data. It is hard to imagine that investors will look at the returns granted in Nevada, Arkansas or any state for that matter as a means of developing a cost of equity for the market. The Commission should follow its precedent and continue to use a CAPM that incorporates Merrill Lynch's cost of the market. Additionally, as noted above, the historical Ibbotson data was misused by the Company witness. If Ibbotson data is to be employed in a CAPM by the Commission, a forward-looking estimate delivers a much more accurate cost of equity result. The Company's exception concerning the use of Ibbotson data should be denied.

3. NYSEG's flawed CAPM and DCF

NYSEG's CAPM based upon a market premium derived from a DCF analysis on the Standard & Poor's 500 is flawed by its assumption of an overstated market return (SIB, pp. 219-220). This DCF used a growth rate from FirstCall, a consensus of a group of financial analysts. NYSEG's Brief on Exceptions makes note that it is the consensus of many analysts and that this makes it superior to the Merrill Lynch estimate. However, the consensus of the analysts is a five year growth rate in earnings, not a long-term growth rate, and is entirely unsuitable for a single stage DCF. The Company's use of a single stage model and the 11.5% dividend growth estimate distorts the intent of the analysts. Furthermore, the use of this growth rate in a single stage model is inconsistent with NYSEG's basic DCF approach and it produces an overstated estimate of the cost of the market and the market risk premium. This 11.5% dividend growth rate far exceeds the growth rate (2.1% above inflation) of S&P 500 dividends for the period 1946-1999 (Siegel, The Shrinking Equity Premium, p.14; Tr. 3310-3311; SIB, pp. 219-220). The prospect of 11.5%

[20] NYSEG's argument fails to consider the fact that there were a number of returns allowed in other states below 10% since the beginning of 2005.

dividend growth for the S&P 500 in perpetuity, prima facie, fails any reasonable measure of credibility. Therefore, like the Ibbotson analysis, the Company's exception based on the DCF estimated return on the Standard & Poor's 500 should be denied.

Staff believes the Company's exceptions regarding the ROE should be rejected in totality. The returns on equity methodologies employed by in the RD are reasonable and are time honored traditions of the Commission. Staff urges the Commission to adopt the ALJ's recommendations on this issue.

IV. RATE DESIGN AND REVENUE ALLOCATION

A. *Revenue Allocation*

According to MI, it has demonstrated that the Company's embedded cost of service (ECOS) study overstates the cost responsibility of the S.C. 7 subclasses because the ECOS calculates separate non-coincident peak demands for the high-load factor customers (MI-BOE, p. 21). MI indicates that the only way the Company's ECOS study would not overstate each S.C. 7 subclass' non-coincident peak demand would be if the I/HLF and non-I/HLF customers peaked at the same hour during the year (MI-BOE, p. 22). MI has not, however, shown the impact of its alleged miscalculation of non-coincident peak demands for the S.C. 7 subclasses and admits that the alleged miscalculation cannot be quantified (MI-BOE, p. 22). Therefore, Staff recommends that the Commission take no action to "correct" the alleged overstatement of the cost responsibility for the S.C. 7 subclasses.

B. *Energy Charges*

Staff supports the RD's proposal to eliminate the energy charges for the S.C. 7 classes (RD, p. 76; Staff-BOE, p. 19) to the extent possible, without unacceptable rate impacts, under the revenue requirement approved by the Commission. It appears that under the RD's revenue requirement, the energy charges can be reduced, but not eliminated. Should the Commission determine a revenue requirement reduction greater that that proposed by the RD, Staff continues to support the elimination of these energy charges to the extent possible.

C. *Consolidation of HLF and Non HLF Classes*

Giving all the HLF classes the average rate decrease is far too gradual a move toward composite rates, therefore, we oppose the exceptions of MI and Nucor on this issue. Our proposal provides some rate decreases for the S.C. 7 HLF subclasses while moving toward a composite rate. As Nucor notes, the 7-4 HLF class is the only HLF class with an above average rate of return (Nucor-BOE, p. 9). The 7-4 HLF class consists of two customers that just happen to be non coincident with the system peak. However, there is no cost basis for these two customers to be grouped together and separated from the rest of the class. Additionally, NYSEG has economic development rates that are costs based. Economic development is not a cost based reason for the HLF rates to be significantly lower than the composite rates because they are well below marginal costs. Staff's proposal does not result in a rate increase for S.C. 7-4 HLF customers.

V. COMMODITY OPTIONS

A. *Retail Conversion Factor*

NYSEG argues that the 17.5% plus 3 mills mark-up for the FPO recommended in the RD fails to provide adequate compensation to NYSEG and would erect barriers to entry. NYSEG holds up its Exhibit CP-7 (Exh. 61) as "the only record evidence regarding the cost of providing a fixed commodity price," which it argues "demonstrates that the winning bid in the New Jersey Basic Generation Service auction to provide fixed price service was priced at a 131% factor, when adjusted for comparability."[21] Unfortunately, NYSEG's analysis is fatally flawed, and ignores several critical factors that distinguish the New Jersey Basic Generation Service (BGS) auction from its FPO.

---

[21] NYSEG-BOE, p. 11.

An important distinguishing factor is that none of the winning bidders in the BGS auction were incumbent utilities (Tr. 1608). Any resulting mark-up over forecasted market prices resulting from the auction go to ESCOs, thus providing an incentive for ESCOs in New Jersey to bid to provide BGS supply, furthering the state's goal of increasing competition in electricity markets, rather than an incentive for the incumbent utilities to retain customers and frustrate that goal.

BGS bidders bid to serve load for a term of three years (from June 2006 through May 2009. See, Exh. 62; Tr. 1606), as opposed to the two-year term of the current NYSEG program, and the one year term recommended in the RD. As NYSEG has repeatedly pointed out, a longer term significantly increases the risk of supplying energy at a fixed price. The three-year term of the BGS auction means its results cannot be directly compared to the one-year program outlined in the RD.

Furthermore, customers taking service under the BGS are not "locked in" and may switch to a competitive supplier at any time. Both NYSEG's current program and the FPO program outlined in the RD provide switching customers a market-based supply adjustment, meaning that customers continue to pay NYSEG the mark-up even after they have switched. Therefore, BGS auction winners face a significant switching risk not faced by NYSEG. These factors alone make the mark-up factor derived from the BGS auction utterly inapplicable to NYSEG – except to note that NYSEG's mark-up, given the conditions of its FPO offering, should be considerably lower.

Even if the conditions of the New Jersey BGS and NYSEG FPO programs were similar, NYSEG's calculation of the BGS mark-up is drastically flawed, in ways that at best describe a wide margin of error, and at worst badly distort the results in favor of a higher mark-up. NYSEG's calculation compares the BGS winning bids to forecasted market prices for the three year period during which winning bidders will serve customers. As discussed below, the calculation suffers from multiple flaws.

Perhaps the most serious distortion is that NYSEG's analysis grosses up the winning BGS auction bids to adjust for line losses (Exh. 61, CP-7). This is an error because the winning bids represent what residential customers actually pay under BGS rates; therefore, bidders must factor potential line losses into their bids.[22] Removing this distortion alone reduces the mark-up in NYSEG's analysis from 130.5% to 123.6%.

NYSEG's analysis further compares the winning bids to inconsistent and questionable forecasts of market prices. Day-ahead prices for PJM West during 2005 were aggregated into monthly average prices. The monthly prices were then used as a basis to calculate factors that were applied to NYMEX daily peak and off-peak forward prices for 2006, the first year under the BGS contract. Thus, the basis of NYSEG's BGS/FPO comparison is fundamentally inconsistent: the markup for BGS is calculated from daily prices, while NYSEG's FPO mark-up is calculated entirely from monthly, quarterly or annual forward contracts. NYSEG would have the Commission set the mark-up based upon an apples to oranges comparison.

Furthermore, NYMEX daily and monthly quotes were available only through February of 2007. Applying its monthly factors to annual quotes, NYSEG set monthly quotes for the balance of 2007 and all of 2008 that were shaped to be consistent with 2006 quotes. For 2009, no NYMEX quotes were available. NYSEG consequently derived 2009 prices using 2008 quotes, but adjusted the 2008 data for relative changes in Henry Hub gas prices from 2008 to 2009. Given the numerous estimations, proxies and assumptions, NYSEG's analysis is at best a highly speculative exercise, and would be regarded as extremely unreliable, even if it had been prepared by disinterested experts. Since NYSEG's analysis contains a number of gross and identifiable errors - all in NYSEG's favor - the analysis offers no probative value.

---

[22] Although the market prices against which NYSEG compares the BGS winning bids are not adjusted for line losses, line losses are among the costs that NYSEG covers with its mark-up. In calculating the magnitude of the mark-up, it is therefore appropriate to exclude a line loss adjustment from the market price.

Finally, it is remarkable that NYSEG chose to perform its analysis with 2006 auction results, requiring the gross estimations described above to derive future prices against which to compare them. NYSEG could easily have performed the analysis with 2002, 2003 or 2004 BGS auction results, and compared them against actual prices for the periods covered. Perhaps the reason NYSEG chose 2006 is that "[w]inning prices were substantially higher in this year's auction, as compared to previous years."[23]

The Company also objects to the 17.5% plus 3 mills mark-up on the basis that the costs for providing the FPO are over 50% of the 135% mark-up currently applied to the FPO (NYSEG-BOE, p. 11). However, according to NYSEG's own data (response ERPE-0370 to DPS-252[24]), the average actual costs were 17.61%, or according to its own expert's testimony, about half of the 35% mark-up (Tr. 1804). NYSEG now claims that they were "over 50%" of the conversion factor (NYSEG-BOE, p. 11). NYSEG is technically correct, by 0.11%, or about 0.056 <u>mills</u> per kWh. However, when viewing these claims, it is important to note two facts. First, the portion of the mark-up representing "costs" went down from the first commodity period (18.2% for 2003/2004) to the second (16.9% for 2005/2006). Second, the GRT element representing 0.25% of costs was eliminated in 2005 (NYS Tax Law Article 186(a)). Therefore, use of the 17.5% is a reasonable, if not generous, representation of costs for providing the FPO, and as such, it should be adopted by the Commission.

NYSEG rejects use of 3 mills as an appropriate adder, but admits (NYSEG-BOE, p. 11) that it agreed to a 3 mill adder in Case 01-E-0359, but argues that such an adder constituted a 129% mark-up at that time. This statement is correct, however, it ignores two important facts. The GRT rate at that time was 4% and the term under discussion in that case was for seven years.

---

23 CRA International, <u>Post-Auction Report on the New Jersey Utilities' Basic Generation Service Auction Processes: February 2006</u>, Prepared For the New Jersey Board of Public Utilities, Docket EO05040317.

24 Although not in the record, this information response is provided as Attachment C, not to add facts to the record, but to demonstrate the Company's overblown statement that 17.5% is not representative of the costs for the FPO.

If a 3 mill adder is sufficient risk protection for the Company for a seven-year term, it begs logic why such an adder is not adequate when the term is for only one year. Logic is further defied when one realizes that the Company now argues that it needs 135% (or at least 131%) mark-up for a one-year term.

Additionally, NYSEG provides information regarding the mark-ups of other energy service companies (ESCO) offering fixed price service in New York. This last ditch attempt to justify its bloated mark-up based upon a comparison with other ESCO mark-ups is highly suspect given the numerous flaws in the Company's BGS analysis. Further, NYSEG's analysis of ESCO mark-ups (NYSEG-BOE, p. 12), without any underlying workpapers or opportunity for review, should be completely disregarded.

Energetix argues that the mark-up should be 140% based on the need to create sufficient head room for ESCOs to compete against NYSEG's FPO (Energetix-BOE, pp. 3-7). This proceeding no doubt presents the Commission with the task of balancing the Public Service Law's requirement that rates be just and reasonable with its competitive agenda. Energetix may be correct that a mark-up of 17.5% and 3 mills provides insufficient headroom for ESCOs to compete. However, faced with the overwhelming evidence, the mark-up at 135% let alone 140% cannot be viewed as a just and reasonable rate.

Energetix justifies the need for a higher mark-up on the fact that the ESCOs do not have the buying power to purchase the requisite hedges to provide a competitively priced fixed price service (Energetix-BOE, p. 5). ESCOs will never achieve this "buying power" if NYSEG remains the dominant provider of commodity services generally and fixed price service specifically. Consequently, we recommend that NYSEG be allowed by the Commission to only offer a variable rate service.

B. *Variable Price Option – Default Service*

The Company objects to the variable price option (VPO) being the default service for those customer not affirmatively electing a commodity option (NYSEG-BOE, pp. 13-14).

According to the Company, it is this type of non-participatory customer that must be protected with an FPO default. PULP also objects to the VPO being the default service.[25]

Both NYSEG and PULP fail to make compelling arguments for the Commission to alter the RD's proposal that the VPO be the default service option. NYSEG's "concern" about customers being unable to have fixed price service if they fail to choose the FPO and PULP's assertion that the VPO default service "limits access" to the FPO, ignores the fact that such customers are free at any time to procure such service from an ESCO. Concerns regarding the VPO as the default service can be tempered with the ability of customers to procure fixed price service from ESCOs, the limited duration (one year) of the commodity period, and the portfolio approach recommended by Staff for the VPO (Staff-BOE, pp. 21-22). The Commission should decline to modify the RD's recommended default service.

C. *Sharing Mechanism*

NYSEG rejects the 80/20 (ratepayer/shareholder) costs/benefits sharing mechanism and associated $5 million deadband proposed in the RD (NYSEG-BOE, pp. 14-15). According to NYSEG, this mechanism fails to adequately compensate the Company for its FPO associated risks. The Company offers a 25/75 (ratepayer/shareholder) sharing of costs and a 50/50 sharing of benefits as a more appropriate sharing mechanism. As we have discussed throughout this case, if one maintains the 135% mark-up for the FPO, the Company's offer to incur 75% of losses on the FPO is nothing more than an empty offer because the bloated mark-up overcompensates the Company for its associated risks (SIB, pp. 230-233). Further, offering to equally share profits related to the FPO from the first dollar does not erase the fact that the mark-up, as proposed by the Company, is excessive and unreasonable.

---

25 PULP also accepts to the RD's dismissal of its complaints with regard to the ESCO Referral Program. PULP raises no arguments that were not already addressed by the RD; therefore, Staff provides no comment on this issue.

If the Commission elects to have NYSEG offer an FPO, then it should adopt the 90/10 sharing mechanism and associated $5 million deadband as recommended by Staff (Staff-BOE, p. 20).

D. *One-Year Term*

PULP excepts to the one-year commodity options term called for in the RD (PULP-BOE, pp. 8-11). This exception should be rejected. The electric delivery rates in this proceeding are being established for one year. Therefore, if there is a change to delivery rates in the second year of PULP's proposed two-year commodity options program, then customers on the FPO would have their rates changed in the second year of the program. Such a change totally defeats the purpose of having "fixed" price service.

VI. COST OF SERVICE STUDY

A. *Call Center and Other Customer Care Cost Allocation*

NYSEG's proposal to use its special study or, in the alternative, use Staff's SGEN allocator to allocate Call Center and other customer care costs should be rejected (NYSEG-BOE, pp. 34-35). The RD's adoption of Staff revenues-based allocator for call center and other customer care costs among competitive and non-competitive functions should be accepted by the Commission.

NYSEG introduces no new arguments to the analysis performed by the ALJs in arriving at their recommended decision. It instead resorts to a statement that "the RD's apparent strict reliance on prior Commission guidance is misplaced" (NYSEG-BOE, p. 34). NYSEG apparently does not criticize the ALJs for relying on prior Commission guidance, but rather that the Commission's prior guidance was "preliminary" in nature and that the RD incorrectly concludes that NYSEG did not adequately distinguish the Company's proposal here from that prior guidance (Id.). However, NYSEG's discussion in its BOE does not in any way illustrate either point. It makes no showing that the Commission's prior guidance on NYSEG's call center and customer care costs are either further refined by subsequent information or Commission rulings or that they are in some way distinguishable from the consideration of those costs in this proceeding. Therefore, the Company's argument that the RD "erred" in accepting Staff's position which reflects the Commission's guidance should be afforded no weight.

NYSEG also states that the RD "inexplicably reasons that [NYSEG's special] study must be suspect simply because it resulted in "only 9.29%" of calls being placed in the supply-related category and that the Company did not provide sufficient support for this figure (RD, p. 125). Simply because a number appears small does not make it incorrect" (Id.). NYSEG misses the point. The ALJs did not reject the Company's position because the utility's special study produced only a 9.29% allocation. They rejected it because the situation in this case closely resembled the situation under which the Commission provided its initial guidance on these costs for NYSEG. The ALJs used this evaluation as a check to note that the percentage allocated by NYSEG's special study was so low as to reasonably be compared to the situation that led to the Commission's earlier reasoning that revenues are an appropriate allocator for these costs.

NYSEG's fallback position is equally unsupported. NYSEG proposes that if the Commission does not accept the results of the special study for the allocation of these costs that it should instead use Staff's SGEN allocator, a position totally unsupported by any party in the record of this case (NYSEG-BOE, p. 35). NYSEG's sole reason for this fallback position is "to avoid inappropriately skewing costs to competitive functions..." (Id.). NYSEG does not explain why this allocation is more appropriate, it doesn't explain why this allocator better reflects cost causation, and it doesn't demonstrate the resulting difference between this allocation and either the one adopted by the Commission previously (and the ALJs in this proceeding) or the one it prefers. While the SGEN allocator is appropriate for the allocation of certain types of costs, ones that are demonstrably related to the broader nature of this allocator, we do not concur with the Company that the record contains any evidence that this allocator is appropriate for this application.

Finally, NYSEG objects to the application of a revenue-based allocator to other customer care costs as well as the call center (Id.). However, NYSEG does not address the fact that the Commission guidance, which it seeks to ignore here, applied equally to customer care and call center costs. NYSEG produced no new information in its BOE that should cause the Commission to deviate from its prior resolution of this issue.

For all of the above reasons, the Commission should adopt the RD's proposal to use revenues to allocate call center and other customer care costs among competitive and non-competitive functions, and reject all of NYSEG's arguments to the contrary.

B. *Billing*

NYSEG excepts to the ALJ's assignment of one-twelfth of CCS costs to billing. Instead, based on a data request response that is not on the record[26], NYSEG now improperly alleges that a mere 2% of CCS costs should be assigned to billing. Not only should the Commission deny NYSEG's improper exception, it must overturn the ALJ's overly conservative allocation of CCS costs. Furthermore, as requested by Staff (Tr. 2146-2147), the Commission should use this opportunity to open a full investigation of the seemingly excessive costs of NYSEG's CCS.

Staff testified that one-sixth of the CCS costs be used for billing based on the functionality of the CCS (Tr. 2654). Staff further testified that the actual CCS costs related to billing could be determined during a review of the entire project (Tr. 2146-2147).

C. *Lost Revenue Mechanism*

NYSEG requests that the Commission "recognize that all unavoidable costs, such as those included in Accounts 908, 910, 912 and 916 as well as the A&G Accounts 920, 921, 923, 928, 930.1 and 930.2, that are functionalized to the competitive services should be included as reconcilable items in the LRM" (NYSEG-BOE, p. 36). NYSEG notes that Staff agrees. Staff

---

26 Appendix 4 to NYSEG's BOE is absurd on its face and appears to be based on an extremely narrow quantification of costs (NYSEG alleges that only 2% of an $86 million customer service system relates to billing). The Commission should not consider Appendix 4 in its decision as it constitutes improper bolstering of its case. Furthermore, Appendix 4 should be counted as one page of the 100 pages allowed for exceptions.

does agree that unavoidable costs should be reconciled in the LRM. However, Staff noted that avoidable costs, such as commodity working capital and uncollectibles should not be reconciled. Staff also found that there are components of A&G costs, advertising, and regulatory costs that would be avoidable as well based on commodity profits (Staff-BOE, pp. 24-25). In theory, those avoidable costs should not be reconciled as well. However, for purposes of this case, Staff would accept NYSEG's LRM, if it does not create a binding precedent for future cases.

D. *Clarification Accounts 908/910 Advertising*

NYSEG sought clarification that "if the Commission adopts the RD's recommendation, only the Voice Your Choice costs contained in Accounts 908 and 910 should be allocated by application of Staff's SGEN" (NYSEG-BOE, p. 37). Staff agrees with this clarification.

VI. UPDATES

Under the guise of "updates and corrections for mathematical errors and inconsistencies," NYSEG purports that the ALJ's $37.2 million revenue requirement decrease is dramatically understated by $12.0 million or 32% (see NYSEG-BOE, Appendix 1, Schedule A). Many of NYSEG's updates and corrections are unsupported by the record and serve as nothing more than an attempt to back fill its vastly overstated rate filing. In fact, if the ALJ's revenue requirement were updated properly, as explained below, a further rate reduction of $2.5 million to $39.7 million would be required (Attachment D). Staff's revenue requirement, after incorporating updates and corrections, is now -$77.3 (Attachment E). As explained below, most of these proposed 'corrections' are improper and in some cases are themselves not correct. With limited exceptions, as explained below, these adjustments must be rejected.

For an update to be permitted in the Brief on Exceptions, the Statement of Policy on Test Periods requires:

> revisions for known changes in cost rates...to the extent they are material, may be made as late as the company's initial brief on exceptions...if...they are relatively easy for our staff to verify, and our staff...will have an opportunity to note any disagreement in their replies to exceptions (Statement of Policy on Test Periods, p. 8).

The following NYSEG proposed adjustments identified on Appendix 1, Schedule A (amounting to $9.5 million) must be rejected because they do not fit the requirements and conditions of the Policy Statement and/or are not supported by the record:

Table-Unsupported, Inconsistent, and Improper Adjustments

Description	#	$000s	Comment
Capital structure	1	1,365	Provision for updating and data are not on the record and the source of the data is unknown
Depreciation	13	1,432	See Response to Exception No. 13
Merger efficiencies	5	4,578	Does not represent a double count, see Response to Exception No. 12
Interest expense reduction	"Co. Audit"	270	Difference is unsupported and unexplained by NYSEG[27]
Rate base SIR Reserve	9	525	See Response to Exception No. 9 [28]
Trust benefit costs	16	715	Does not represent a correction (see Response to Exception No. 16)
Inflation rate	7	636	Update would be proper, however NYSEG's computation is inconsistent with its position on medical escalation (below)

As noted, Staff urges the Commission to update pension ($4.6 million) and OPEB ($0.636 million) discount rates (infra, Section II.N). Similarly, Staff does not oppose NYSEG's $1.27 million adjustment for interest on variable rate debt. This adjustment should be updated and incorporated in the Commission's decision. The Commission should also adopt the -$4.7 million adjustment to rate base for SIR inadvertently omitted from the RD (Staff-BOE, p. 11).

---

[27] The RD relied upon NYSEG's actual December 31, 2005 equity ratio contained in Exh. 120 (CSP-2, pp. 1 and 7). However, Exh.120 does not contain any information on NYSEG's December 31, 2005 debt cost.

[28] Contrary to NYSEG, in Staff's Brief on Exceptions (p. 11), we noted that our -$4.7 million on the record correcting adjustment for SIR reserve rate base was omitted from the RD. That adjustment incorporated expected draw downs of SIR reserve funds based on historical patterns. NYSEG seems to agree because it captured the essence of this adjustment on Appendix 1, Schedule B, p. 4, but then overrode that on the record adjustment with $5.1 million of new adjustments that were not on the record and are double counted. Since the ALJ adopted Staff's position on SIR costs, this adjustment must be adopted by the Commission.

The $0.636 million update for inflation proposed by NYESG should be adopted, but only if the Commission adopts our position on medical cost escalation (infra, Section II.E).

Finally, in its Exception No. 18, NYSEG raises three tax issues. Staff previously acknowledged that we accepted NYSEG's proposed tax changes as reflected in Exh. 83 (SRB, p. 42) and believed they were incorporated in our revenue requirements. However, when the ALJs incorporated the tax adjustments found in Exh. 83 tracking Staff's depreciation changes[29], it was not clear that some of these adjustments were netted with other adjustments. This caused an inadvertent double counting of some of the tax adjustments. As a result, in order to conform to the ALJ's revenue requirement, taxes would need to be increased by $1.228 million as suggested by NYSEG.

VII. CONCLUSION

Staff's exceptions to the Recommended Decision and our opposition to NYSEG's and the parties' exceptions should, for the reasons stated herein and in the other briefs, be adopted by the Commission in their entirety.

Respectfully submitted,

Kimberly A. Harriman

Kimberly A. Harriman
Steven J. Kramer

[29] One of the NY state tax adjustments is to normalize (or defer rather than flow through) the book/tax depreciation differences.

ATTACHMENT A

Attachment A

Title: 30-Year Treasury Constant Maturity Rate
Series ID: GS30
Source: Board of Governors of the Federal Reserve System
Release: H.15 Selected Interest Rates
Seasonal Adjustment: Not Applicable
Frequency: Monthly
Units: Percent
Date Range: 1977-02-01 to 2006-06-01
Last Updated: 2006-07-05 11:12 AM CT
Notes: Yields on actively traded non-inflation-indexed issues adjusted to constant maturities. The 30-year Treasury constant maturity series was discontinued on February 18, 2002, and reintroduced on February 9, 2006

DATE	VALUE	DATE	VALUE	DATE	VALUE	DATE	VALUE	DATE	VALUE
2/1/1977	7.75	1/1/1980	10.6	1/1/1983	10.63	1/1/1986	9.4	1/1/1989	8.93
3/1/1977	7.8	2/1/1980	12.13	2/1/1983	10.88	2/1/1986	8.93	2/1/1989	9.01
4/1/1977	7.73	3/1/1980	12.34	3/1/1983	10.63	3/1/1986	7.96	3/1/1989	9.17
5/1/1977	7.8	4/1/1980	11.4	4/1/1983	10.48	4/1/1986	7.39	4/1/1989	9.03
6/1/1977	7.64	5/1/1980	10.36	5/1/1983	10.53	5/1/1986	7.52	5/1/1989	8.83
7/1/1977	7.64	6/1/1980	9.81	6/1/1983	10.93	6/1/1986	7.57	6/1/1989	8.27
8/1/1977	7.68	7/1/1980	10.24	7/1/1983	11.4	7/1/1986	7.27	7/1/1989	8.08
9/1/1977	7.64	8/1/1980	11	8/1/1983	11.82	8/1/1986	7.33	8/1/1989	8.12
10/1/1977	7.77	9/1/1980	11.34	9/1/1983	11.63	9/1/1986	7.62	9/1/1989	8.15
11/1/1977	7.85	10/1/1980	11.59	10/1/1983	11.58	10/1/1986	7.7	10/1/1989	8
12/1/1977	7.94	11/1/1980	12.37	11/1/1983	11.75	11/1/1986	7.52	11/1/1989	7.9
1/1/1978	8.18	12/1/1980	12.4	12/1/1983	11.88	12/1/1986	7.37	12/1/1989	7.9
2/1/1978	8.25	1/1/1981	12.14	1/1/1984	11.75	1/1/1987	7.39	1/1/1990	8.26
3/1/1978	8.23	2/1/1981	12.8	2/1/1984	11.95	2/1/1987	7.54	2/1/1990	8.5
4/1/1978	8.34	3/1/1981	12.69	3/1/1984	12.38	3/1/1987	7.55	3/1/1990	8.56
5/1/1978	8.43	4/1/1981	13.2	4/1/1984	12.65	4/1/1987	8.25	4/1/1990	8.76
6/1/1978	8.5	5/1/1981	13.6	5/1/1984	13.43	5/1/1987	8.78	5/1/1990	8.73
7/1/1978	8.65	6/1/1981	12.96	6/1/1984	13.44	6/1/1987	8.57	6/1/1990	8.46
8/1/1978	8.47	7/1/1981	13.59	7/1/1984	13.21	7/1/1987	8.64	7/1/1990	8.5
9/1/1978	8.47	8/1/1981	14.17	8/1/1984	12.54	8/1/1987	8.97	8/1/1990	8.86
10/1/1978	8.67	9/1/1981	14.67	9/1/1984	12.29	9/1/1987	9.59	9/1/1990	9.03
11/1/1978	8.75	10/1/1981	14.68	10/1/1984	11.98	10/1/1987	9.61	10/1/1990	8.86
12/1/1978	8.88	11/1/1981	13.35	11/1/1984	11.56	11/1/1987	8.95	11/1/1990	8.54
1/1/1979	8.94	12/1/1981	13.45	12/1/1984	11.52	12/1/1987	9.12	12/1/1990	8.24
2/1/1979	9	1/1/1982	14.22	1/1/1985	11.45	1/1/1988	8.83	1/1/1991	8.27
3/1/1979	9.03	2/1/1982	14.22	2/1/1985	11.47	2/1/1988	8.43	2/1/1991	8.03
4/1/1979	9.08	3/1/1982	13.53	3/1/1985	11.81	3/1/1988	8.63	3/1/1991	8.29
5/1/1979	9.19	4/1/1982	13.37	4/1/1985	11.47	4/1/1988	8.95	4/1/1991	8.21
6/1/1979	8.92	5/1/1982	13.24	5/1/1985	11.05	5/1/1988	9.23	5/1/1991	8.27
7/1/1979	8.93	6/1/1982	13.92	6/1/1985	10.45	6/1/1988	9	6/1/1991	8.47
8/1/1979	8.98	7/1/1982	13.55	7/1/1985	10.5	7/1/1988	9.14	7/1/1991	8.45
9/1/1979	9.17	8/1/1982	12.77	8/1/1985	10.56	8/1/1988	9.32	8/1/1991	8.14
10/1/1979	9.85	9/1/1982	12.07	9/1/1985	10.61	9/1/1988	9.06	9/1/1991	7.95
11/1/1979	10.3	10/1/1982	11.17	10/1/1985	10.5	10/1/1988	8.89	10/1/1991	7.93
12/1/1979	10.12	11/1/1982	10.54	11/1/1985	10.06	11/1/1988	9.02	11/1/1991	7.92
		12/1/1982	10.54	12/1/1985	9.54	12/1/1988	9.01	12/1/1991	7.7

Title: 30-Year Treasury Constant Maturity Rate
Series ID: GS30
Source: Board of Governors of the Federal Reserve System
Release: H.15 Selected Interest Rates
Seasonal Adjustment: Not Applicable
Frequency: Monthly
Units: Percent
Date Range: 1977-02-01 to 2006-06-01
Last Updated: 2006-07-05 11:12 AM CT
Notes: Yields on actively traded non-inflation-indexed issues adjusted to constant maturities. The 30-year Treasury constant maturity series was discontinued on February 18, 2002, and reintroduced on February 9, 2006

DATE	VALUE	DATE	VALUE	DATE	VALUE	DATE	VALUE	DATE	VALUE
1/1/1992	7.58	1/1/1995	7.85	1/1/1998	5.81	1/1/2001	5.54	1/1/2004	.
2/1/1992	7.85	2/1/1995	7.61	2/1/1998	5.89	2/1/2001	5.45	2/1/2004	.
3/1/1992	7.97	3/1/1995	7.45	3/1/1998	5.95	3/1/2001	5.34	3/1/2004	.
4/1/1992	7.96	4/1/1995	7.36	4/1/1998	5.92	4/1/2001	5.65	4/1/2004	.
5/1/1992	7.89	5/1/1995	6.95	5/1/1998	5.93	5/1/2001	5.78	5/1/2004	.
6/1/1992	7.84	6/1/1995	6.57	6/1/1998	5.7	6/1/2001	5.67	6/1/2004	.
7/1/1992	7.6	7/1/1995	6.72	7/1/1998	5.68	7/1/2001	5.61	7/1/2004	.
8/1/1992	7.39	8/1/1995	6.86	8/1/1998	5.54	8/1/2001	5.48	8/1/2004	.
9/1/1992	7.34	9/1/1995	6.55	9/1/1998	5.2	9/1/2001	5.48	9/1/2004	.
10/1/1992	7.53	10/1/1995	6.37	10/1/1998	5.01	10/1/2001	5.32	10/1/2004	.
11/1/1992	7.61	11/1/1995	6.26	11/1/1998	5.25	11/1/2001	5.12	11/1/2004	.
12/1/1992	7.44	12/1/1995	6.06	12/1/1998	5.06	12/1/2001	5.48	12/1/2004	.
1/1/1993	7.34	1/1/1996	6.05	1/1/1999	5.16	1/1/2002	5.45	1/1/2005	.
2/1/1993	7.09	2/1/1996	6.24	2/1/1999	5.37	2/1/2002	5.4	2/1/2005	.
3/1/1993	6.82	3/1/1996	6.6	3/1/1999	5.58	3/1/2002	.	3/1/2005	.
4/1/1993	6.85	4/1/1996	6.79	4/1/1999	5.55	4/1/2002	.	4/1/2005	.
5/1/1993	6.92	5/1/1996	6.93	5/1/1999	5.81	5/1/2002	.	5/1/2005	.
6/1/1993	6.81	6/1/1996	7.06	6/1/1999	6.04	6/1/2002	.	6/1/2005	.
7/1/1993	6.63	7/1/1996	7.03	7/1/1999	5.98	7/1/2002	.	7/1/2005	.
8/1/1993	6.32	8/1/1996	6.84	8/1/1999	6.07	8/1/2002	.	8/1/2005	.
9/1/1993	6	9/1/1996	7.03	9/1/1999	6.07	9/1/2002	.	9/1/2005	.
10/1/1993	5.94	10/1/1996	6.81	10/1/1999	6.26	10/1/2002	.	10/1/2005	.
11/1/1993	6.21	11/1/1996	6.48	11/1/1999	6.15	11/1/2002	.	11/1/2005	.
12/1/1993	6.25	12/1/1996	6.55	12/1/1999	6.35	12/1/2002	.	12/1/2005	.
1/1/1994	6.29	1/1/1997	6.83	1/1/2000	6.63	1/1/2003	.	1/1/2006	.
2/1/1994	6.49	2/1/1997	6.69	2/1/2000	6.23	2/1/2003	.	2/1/2006	4.54
3/1/1994	6.91	3/1/1997	6.93	3/1/2000	6.05	3/1/2003	.	3/1/2006	4.73
4/1/1994	7.27	4/1/1997	7.09	4/1/2000	5.85	4/1/2003	.	4/1/2006	5.06
5/1/1994	7.41	5/1/1997	6.94	5/1/2000	6.15	5/1/2003	.	5/1/2006	5.2
6/1/1994	7.4	6/1/1997	6.77	6/1/2000	5.93	6/1/2003	.	6/1/2006	5.15
7/1/1994	7.58	7/1/1997	6.51	7/1/2000	5.85	7/1/2003	.		
8/1/1994	7.49	8/1/1997	6.58	8/1/2000	5.72	8/1/2003	.		
9/1/1994	7.71	9/1/1997	6.5	9/1/2000	5.83	9/1/2003	.		
10/1/1994	7.94	10/1/1997	6.33	10/1/2000	5.8	10/1/2003	.		
11/1/1994	8.08	11/1/1997	6.11	11/1/2000	5.78	11/1/2003	.		
12/1/1994	7.87	12/1/1997	5.99	12/1/2000	5.49	12/1/2003	.		

Title: Moody's Seasoned Baa Corporate Bond Yield
Series ID: BAA
Source: Board of Governors of the Federal Reserve System
Release: H.15 Selected Interest Rates
Seasonal Adjustment: Not Applicable
Frequency: Monthly
Units: Percent
Date Range: 1919-01-01 to 2006-06-01
Last Updated: 2006-07-06 10:35 AM CT
Notes: Averages of daily data. Reprinted with permission from Moody's Investors Services. Copyright.

DATE	VALUE	DATE	VALUE	DATE	VALUE	DATE	VALUE	DATE	VALUE
2/1/1977	9.12	1/1/1980	12.42	1/1/1983	13.94	1/1/1986	11.44	1/1/1989	10.65
3/1/1977	9.12	2/1/1980	13.57	2/1/1983	13.95	2/1/1986	11.11	2/1/1989	10.61
4/1/1977	9.07	3/1/1980	14.45	3/1/1983	13.61	3/1/1986	10.5	3/1/1989	10.67
5/1/1977	9.01	4/1/1980	14.19	4/1/1983	13.29	4/1/1986	10.19	4/1/1989	10.61
6/1/1977	8.91	5/1/1980	13.17	5/1/1983	13.09	5/1/1986	10.29	5/1/1989	10.46
7/1/1977	8.87	6/1/1980	12.71	6/1/1983	13.37	6/1/1986	10.34	6/1/1989	10.03
8/1/1977	8.82	7/1/1980	12.65	7/1/1983	13.39	7/1/1986	10.16	7/1/1989	9.87
9/1/1977	8.8	8/1/1980	13.15	8/1/1983	13.64	8/1/1986	10.18	8/1/1989	9.88
10/1/1977	8.89	9/1/1980	13.7	9/1/1983	13.55	9/1/1986	10.2	9/1/1989	9.91
11/1/1977	8.95	10/1/1980	14.23	10/1/1983	13.46	10/1/1986	10.24	10/1/1989	9.81
12/1/1977	8.99	11/1/1980	14.64	11/1/1983	13.61	11/1/1986	10.07	11/1/1989	9.81
1/1/1978	9.17	12/1/1980	15.14	12/1/1983	13.75	12/1/1986	9.97	12/1/1989	9.82
2/1/1978	9.2	1/1/1981	15.03	1/1/1984	13.65	1/1/1987	9.72	1/1/1990	9.94
3/1/1978	9.22	2/1/1981	15.37	2/1/1984	13.59	2/1/1987	9.65	2/1/1990	10.14
4/1/1978	9.32	3/1/1981	15.34	3/1/1984	13.99	3/1/1987	9.61	3/1/1990	10.21
5/1/1978	9.49	4/1/1981	15.56	4/1/1984	14.31	4/1/1987	10.04	4/1/1990	10.3
6/1/1978	9.6	5/1/1981	15.95	5/1/1984	14.74	5/1/1987	10.51	5/1/1990	10.41
7/1/1978	9.6	6/1/1981	15.8	6/1/1984	15.05	6/1/1987	10.52	6/1/1990	10.22
8/1/1978	9.48	7/1/1981	16.17	7/1/1984	15.15	7/1/1987	10.61	7/1/1990	10.2
9/1/1978	9.42	8/1/1981	16.34	8/1/1984	14.63	8/1/1987	10.8	8/1/1990	10.41
10/1/1978	9.59	9/1/1981	16.92	9/1/1984	14.35	9/1/1987	11.31	9/1/1990	10.64
11/1/1978	9.83	10/1/1981	17.11	10/1/1984	13.94	10/1/1987	11.62	10/1/1990	10.74
12/1/1978	9.94	11/1/1981	16.39	11/1/1984	13.48	11/1/1987	11.23	11/1/1990	10.62
1/1/1979	10.13	12/1/1981	16.55	12/1/1984	13.4	12/1/1987	11.29	12/1/1990	10.43
2/1/1979	10.08	1/1/1982	17.1	1/1/1985	13.26	1/1/1988	11.07	1/1/1991	10.45
3/1/1979	10.26	2/1/1982	17.18	2/1/1985	13.23	2/1/1988	10.62	2/1/1991	10.07
4/1/1979	10.33	3/1/1982	16.82	3/1/1985	13.69	3/1/1988	10.57	3/1/1991	10.09
5/1/1979	10.47	4/1/1982	16.78	4/1/1985	13.51	4/1/1988	10.9	4/1/1991	9.94
6/1/1979	10.38	5/1/1982	16.64	5/1/1985	13.15	5/1/1988	11.04	5/1/1991	9.86
7/1/1979	10.29	6/1/1982	16.92	6/1/1985	12.4	6/1/1988	11	6/1/1991	9.96
8/1/1979	10.35	7/1/1982	16.8	7/1/1985	12.43	7/1/1988	11.11	7/1/1991	9.89
9/1/1979	10.54	8/1/1982	16.32	8/1/1985	12.5	8/1/1988	11.21	8/1/1991	9.65
10/1/1979	11.4	9/1/1982	15.63	9/1/1985	12.48	9/1/1988	10.9	9/1/1991	9.51
11/1/1979	11.99	10/1/1982	14.73	10/1/1985	12.36	10/1/1988	10.41	10/1/1991	9.49
12/1/1979	12.06	11/1/1982	14.3	11/1/1985	11.99	11/1/1988	10.48	11/1/1991	9.45
		12/1/1982	14.14	12/1/1985	11.58	12/1/1988	10.65	12/1/1991	9.26

Attachment A

Title: Moody's Seasoned Baa Corporate Bond Yield
Series ID: BAA
Source: Board of Governors of the Federal Reserve System
Release: H.15 Selected Interest Rates
Seasonal Adjustment: Not Applicable
Frequency: Monthly
Units: Percent
Date Range: 1919-01-01 to 2006-06-01
Last Updated: 2006-07-06 10:35 AM CT
Notes: Averages of daily data. Reprinted with permission from Moody's Investors Services. Copyright.

DATE	VALUE	DATE	VALUE	DATE	VALUE	DATE	VALUE	DATE	VALUE
1/1/1992	9.13	1/1/1995	9.08	1/1/1998	7.19	1/1/2001	7.93	1/1/2004	6.44
2/1/1992	9.23	2/1/1995	8.85	2/1/1998	7.25	2/1/2001	7.87	2/1/2004	6.27
3/1/1992	9.25	3/1/1995	8.7	3/1/1998	7.32	3/1/2001	7.84	3/1/2004	6.11
4/1/1992	9.21	4/1/1995	8.6	4/1/1998	7.33	4/1/2001	8.07	4/1/2004	6.46
5/1/1992	9.13	5/1/1995	8.2	5/1/1998	7.3	5/1/2001	8.07	5/1/2004	6.75
6/1/1992	9.05	6/1/1995	7.9	6/1/1998	7.13	6/1/2001	7.97	6/1/2004	6.78
7/1/1992	8.84	7/1/1995	8.04	7/1/1998	7.15	7/1/2001	7.97	7/1/2004	6.62
8/1/1992	8.65	8/1/1995	8.19	8/1/1998	7.14	8/1/2001	7.85	8/1/2004	6.46
9/1/1992	8.62	9/1/1995	7.93	9/1/1998	7.09	9/1/2001	8.03	9/1/2004	6.27
10/1/1992	8.84	10/1/1995	7.75	10/1/1998	7.18	10/1/2001	7.91	10/1/2004	6.21
11/1/1992	8.96	11/1/1995	7.68	11/1/1998	7.34	11/1/2001	7.81	11/1/2004	6.2
12/1/1992	8.81	12/1/1995	7.49	12/1/1998	7.23	12/1/2001	8.05	12/1/2004	6.15
1/1/1993	8.67	1/1/1996	7.47	1/1/1999	7.29	1/1/2002	7.87	1/1/2005	6.02
2/1/1993	8.39	2/1/1996	7.63	2/1/1999	7.39	2/1/2002	7.89	2/1/2005	5.82
3/1/1993	8.15	3/1/1996	8.03	3/1/1999	7.53	3/1/2002	8.11	3/1/2005	6.06
4/1/1993	8.14	4/1/1996	8.19	4/1/1999	7.48	4/1/2002	8.03	4/1/2005	6.05
5/1/1993	8.21	5/1/1996	8.3	5/1/1999	7.72	5/1/2002	8.09	5/1/2005	6.01
6/1/1993	8.07	6/1/1996	8.4	6/1/1999	8.02	6/1/2002	7.95	6/1/2005	5.86
7/1/1993	7.93	7/1/1996	8.35	7/1/1999	7.95	7/1/2002	7.9	7/1/2005	5.95
8/1/1993	7.6	8/1/1996	8.18	8/1/1999	8.15	8/1/2002	7.58	8/1/2005	5.96
9/1/1993	7.34	9/1/1996	8.35	9/1/1999	8.2	9/1/2002	7.4	9/1/2005	6.03
10/1/1993	7.31	10/1/1996	8.07	10/1/1999	8.38	10/1/2002	7.73	10/1/2005	6.3
11/1/1993	7.66	11/1/1996	7.79	11/1/1999	8.15	11/1/2002	7.62	11/1/2005	6.39
12/1/1993	7.69	12/1/1996	7.89	12/1/1999	8.19	12/1/2002	7.45	12/1/2005	6.32
1/1/1994	7.65	1/1/1997	8.09	1/1/2000	8.33	1/1/2003	7.35	1/1/2006	6.24
2/1/1994	7.76	2/1/1997	7.94	2/1/2000	8.29	2/1/2003	7.06	2/1/2006	6.27
3/1/1994	8.13	3/1/1997	8.18	3/1/2000	8.37	3/1/2003	6.95	3/1/2006	6.41
4/1/1994	8.52	4/1/1997	8.34	4/1/2000	8.4	4/1/2003	6.85	4/1/2006	6.68
5/1/1994	8.62	5/1/1997	8.2	5/1/2000	8.9	5/1/2003	6.38	5/1/2006	6.75
6/1/1994	8.65	6/1/1997	8.02	6/1/2000	8.48	6/1/2003	6.19	6/1/2006	6.78
7/1/1994	8.8	7/1/1997	7.75	7/1/2000	8.35	7/1/2003	6.62		
8/1/1994	8.74	8/1/1997	7.82	8/1/2000	8.26	8/1/2003	7.01		
9/1/1994	8.98	9/1/1997	7.7	9/1/2000	8.35	9/1/2003	6.79		
10/1/1994	9.2	10/1/1997	7.57	10/1/2000	8.34	10/1/2003	6.73		
11/1/1994	9.32	11/1/1997	7.42	11/1/2000	8.28	11/1/2003	6.66		
12/1/1994	9.1	12/1/1997	7.32	12/1/2000	8.02	12/1/2003	6.6		

ATTACHMENT B

Electric Credit Quality Ratio Comparison Based on NYSEG IR Response ERPE-0912

	(1) NYSEG Est. for Staff	(2) Staff Adjustments	(3) Staff Filing Electric	(4) NYSEG ROE and 50% ER	(5) Staff Est. for NYSEG
Net Income	$46.9	$5.4 (a)	$52.3	$30.3 (c)	$82.6
Non Cash Operating Items:					
Depreciation	80		80		80
Pension Income	-16.6		-16.6		-16.6
SFAS-106 OPEB Accrual	14		14		14
Environmental Accrual	0		0		0
Amortization Debt Dis. And Exp.	2.7		2.7		2.7
Deferred Taxes	3		3		3
Disallowed O&M	-34.3	34.3 (b)	0		0
Cash Flow From Operations	$95.7		$135.4		$165.7
Interest Expense	47.0		47.0	-8.0 (d)	39.0
Debt Outstanding	882.1		882.1	-131.1 (e)	751
FFO/Interest	3.0X		3.9X		5.3X
FFO/Debt	10.8%		15.3%		22.1%

(1) NYSEG's forecast of Cash Flow and Credit Metrics produced by Staff's Electric Rate Case Position. The figures are copied from Column 1 (Electric Staff Filing) of the Attachment that NYSEG provided in response to ERPE0912.

(2) Staff adjustments to NYSEG forecast to more accurate depict the Credit Metrics produced by Staff's recommendation.

ADJUSTMENT (a): Net income is computed by applying the weighted equity return to staff's rate base (TR 3256) while the interest charges reflected in this table are computed by applying a 72.3% allocator to the $1.22 billion of staff debt (TR 3255). Both amounts should be calculated consistently. Adjustment (a) computes net income in the same manner as interest by first applying a 72.3% allocation factor to staff's equity and then multiplying by staff's 8.7% return on equity. (831.2*.723*.087)-46.0=5.4

ADJUSTMENT (b): NYSEG eliminates $34.3 million of staff rate case adjustments. The company believes that they will actually incur these expenses. (TR 3257) Staff disagrees and continues to believe its adjustments reduce NYSEG's expenses to a reasonable rate year level. Thus, Staff does not believe that there is any negative cash flow effect from its adjustments. Staff, therefore, restores this $34.3 million of cash flow to NYSEG. Ultimately, the prudent level of rate year expenses set by the Commission in rates will have no cash flow effect, and therefore, no effect on these ratios.

(3) Staff's adjusted cash flow estimate for NYSEG's electric operations and the likely FFO/INT and FFO/DEBT ratios produced by staff's recommendation.

(4) Staff desires to illustrate the rate year effects of the Commission adopting NYSEG's cost of equity and 50% equity ratio requests. The adjustments in this column reflect the effects of these items on net income, interest and total debt.

ADJUSTMENT (c): This reflects the increase in net income by applying NYSEG's requested 11% cost of equity to common equity of $751million. This common equity amount is computed by multiplying the .723 electric allocator times staff's total capital of of $2,078 million and then multiplying the total electric capitalization by 50%. (2078*.723*.5*.11)-52.3=30.3.

ADJUSTMENT (d): This reflects the reduced interest expense, at NYSEG's 5.19% embedded cost of debt, associated with the reduction in NYSEG's debt ratio produced by adopting the company's 50% request. The reduction in outstanding debt is computed in ADJUSTMENT (e).

ADJUSTMENT (e): This reflects the reduced debt balance that occurs when one changes NYSEG's capital structure from one with a 40% equity ratio to one with a 50% equity ratio. This adjustment assumes an equity amount of electric as equity. Staff capital of $2078 million is multiplied by the .723 electric allocator and then a 50% debt ratio to produce $751 million of electric debt.

ATTACHMENT C

New York State Electric & Gas Corporation
2005 Electric Rate Plan Extension Filing
PSC Case No. 05-E-1222

Information Request

Requesting Party and No.: (DPS-252) D'Ambrosia

NYSEG Response No.: 0370

Request Date: November 30, 2005

Information Requested of: Commodity Options

Reply Date: December 7, 2005

Responsible Witness: Commodity Options

QUESTION:
On pages 7-8, Mr. Segal states "Over one-half of the retail conversion factor covers retail supply costs that are not contained in the base wholesale number. The balance of the retail conversion factor is meant to absorb the risks of offering a fixed price retail commodity option."

Response 0029 to DPS-7 indicates that:

"For 2003/2004 for the Bundled Rate Option the components were approximately:

Item	Cost ($/MWH)
Wholesale Energy	32.25
Wholesale Capacity	3.12
Line Losses, company use and unaccounted for energy	2.30
Capacity Reserves	0.55
Load shaping	3.30
Gross Receipts Tax	0.30"

Based upon latest available information through October 2005, provide NYSEG's actual: line losses, company use and unaccounted for energy, capacity reserves, load shaping, and gross receipts tax costs for 2005. If actual information is not available, provide an estimate of such latest known costs for 2005.

RESPONSE:

The following is the Company's estimate for the second commodity period.

Item	Cost ($/MWh)
Wholesale Energy	49.23
Wholesale Capacity	2.11
Losses, Company use and unaccounted for	3.30
Capacity Reserves	0.38
Load Shaping	4.79
GRT	0.25

ATTACHMENT D

NYSEG Electric Rates
2007 Changes to ALJ Revenue Requirement
$ Millions

			Income	Rate Base	Revenue Requirement
ALJ REVENUE REQUIREMENT					$ (37.2)
Staff Updates/Corrections		**Ref.***			
1	Pension update	8	$ (4.7)	$ 1.4	$ (4.5)
2	OPEB update	8	$ (0.6)	$ 0.2	$ (0.6)
3	Interest rate update	8	$ 1.2	$ -	$ 1.2
4	Income taxes	A1	$ 1.3	$ -	$ 1.3
5	Site remediation	9	$ -	$ (4.7)	$ (0.6)
6	Inflation	7/A1	$ 0.6	$ -	$ 0.6
	Total Staff Adjustments				**$ (2.5)**
ALJ Revenue Requirement as Adjusted					**$ (39.7)**

* Reference to Exception No. or Appendix in NYSEG's Brief on Exceptions

ATTACHMENT E

Attachment E

NYSEG Electric Rates
2007 Changes to Staff Revenue Requirement
$ Millions

			Income	Rate Base	Revenue Requirement
STAFF REVENUE REQUIREMENT					$ (73.5)
Staff Updates/Corrections		**Ref.***			
1	RD position & Pension update	8	$ (7.3)	$ 1.4	$ (7.1)
2	RD position & OPEB update	8	$ (0.9)	$ 0.2	$ (0.9)
3	Interest rate update	8	$ 1.2	$ -	$ 1.2
4	Income taxes	A1	$ 1.3	$ -	$ 1.3
5	Inflation	7/A1	$ 0.6	$ -	$ 0.6
6	Staff Imputed interest update 6.6		$ 0.4	$ -	$ 0.4
7	IRS Refund to other Proceeding		$ 0.8	$ 2.0	$ 1.0
8	Property tax per ALJ		$ 0.4	$ -	$ 0.4
9	Tree Timming & System Benefit		$ 1.7	$ -	$ 1.7
10	AFUDC and other		$ 0.2	$ -	$ 0.2
11	CPB adjustments adopted by ALJ		$ (2.6)	$ -	$ (2.6)
	Total Staff Adjustments				**$ (3.8)**
Staff Revenue Requirement as Adjusted					**$ (77.3)**

* Reference to Exception No. or Appendix in NYSEG's Brief on Exceptions