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STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

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Case 01-M-0075 - Joint Petition of Niagara Mohawk  
Power Holdings, Inc., Niagara Mohawk Power  
Corporation, National Grid Group plc, and National  
Grid USA for Approval of Merger and Stock  
Acquisition.  
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Evidentiary Hearing  
3rd Floor Hearing Room  
Public Service Commission  
Agency Building Three  
Albany, New York

Tuesday, October 3, 2006  
10:30 a.m.

PRESIDING:

JEFFREY E. STOCKHOLM,  
Administrative Law Judge

ORIGINAL

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APPEARANCES:

For NYS Public Service Commission:

Jane C. Assaf, Esq.  
NYS Department of Public Service  
Three Empire State Plaza  
Albany, New York 12223

For the company:

Carlos A. Gavilondo, Esq.  
National Grid  
300 Erie Boulevard West.  
Syracuse, New York 13202-4250

Kenneth G. Jaffe, Esq.  
Alston & Bird LLP  
The Atlantic Building  
950 F Street, N.W.  
Washington, D.C. 20004-1404

For Multiple Intervenors:

Michael Mager, Esq.  
Couch White  
540 Broadway  
Albany, New York 12201

1 JUDGE STOCKHOLM: Let's go on the record. I  
2 call case 01-M-0075, Joint Petition of Niagara Mohawk  
3 Holdings, Inc., Niagara Mohawk Power Corporation,  
4 National Grid Group, PLC, and National Grid USA for  
5 approval of merger and stock acquisition.

6 Could we begin this morning with appearance  
7 of counsel.

8 MS. ASSAF: For the Department of Public  
9 Service, Jane C. Assaf.

10 MR. GAVILONDO: Your Honor, for Niagara  
11 Mohawk Power Corporation, Carlos A. Gavilondo and  
12 with me at counsel table is Kenneth G. Jaffe.

13 MR. MAGER: For Multiple Intervenors, the  
14 law firm of Couch White by Michael Mager.

15 JUDGE STOCKHOLM: Other appearances? Okay.  
16 Thank you.

17 I would like to start this morning by  
18 dealing a little bit with the requests for  
19 confidentiality, some of which I think are  
20 straightforward, and some of which I think may well  
21 be contested, and it may solve some of the problems  
22 in going through as we come across them. So, let me  
23 start there.

24 Is there anything we need to deal with

1 first? Okay. What I would like to do is start with  
2 the September 26th filing of the company because,  
3 frankly, I think this is a fairly easy one.

4 Confidentiality was requested in a letter dated  
5 September 26th with regard to the confidential  
6 information contained in volume 3 of the company's  
7 filing of that date, consisting of exhibits.

8 And the exhibits--the reason for the  
9 confidentiality that was requested was personal  
10 information. The exhibits all contain names of  
11 employees and/or positions of employees and similar  
12 information, and it seems to me that this record does  
13 not require those specific names for us to go to the  
14 Commission.

15 Does anybody disagree with that at least  
16 preliminary conclusion? Okay. I am going to grant  
17 confidentiality that the company asked for, and also  
18 I am going to direct that this information not be  
19 included in the record.

20 To the extent that staff has information on  
21 individuals' names, that should be returned to the  
22 company and I will return myself my copies of the  
23 unredacted materials to the company with regard to  
24 that letter and that information.

1           The second general category of confidential  
2 information concerns a request made on September 1st  
3 with regard to two--confidential information with  
4 regard to two different panels or witnesses. I guess  
5 witnesses is appropriate. I take that back. There  
6 is a panel or two here as well.

7           And there is two categories in my mind, at  
8 least here as well, and the parties should correct me  
9 if they think I am not stating this accurately. With  
10 regard to the first set of information that basically  
11 comes from Mr. Sauvage's testimony, the request is  
12 that non-public forward looking, among other things,  
13 that non-public forward looking financial projections  
14 for the company should be kept confidential.

15           The third category, skipping over that for  
16 the moment, is non-public retiree medical benefits  
17 data. This is basically comparison data that  
18 Mr. Abrams presented from Tower Perrins. Again, in  
19 looking at this data it seems to me that this is  
20 legitimately trade secret because of the method that  
21 was set forth in the testimony of the witness for  
22 compiling this information across the industry.

23           Without more verbiage than that, is there  
24 anyone who disagrees with that view of this

1 information? That information will be considered  
2 trade secret, and when we get to that testimony I  
3 want to ask both the staff, well, all the parties,  
4 not just the staff and the company, if they believe  
5 that the information must be in the record under  
6 seal, or whether the information does not need to be  
7 in the record at all.

8 In any event, however, the information, the  
9 requested trade secret from Mr. Abrams' testimony is  
10 granted. The final category I have a question about,  
11 and we can deal with this when we get to the  
12 testimony of Mr. Sauvage and the panel testimony of I  
13 believe it's Molloy and Richer, I don't understand  
14 why this information should be trade secret or, put  
15 another way, I don't understand why the public, who  
16 has to pay the rates that will come out of these  
17 discussions, should not have this information  
18 available to them so that they would understand what  
19 those rates are being based on.

20 In particular, the analogy that comes to my  
21 mind most closely, and I may be wrong about this--by  
22 the way, only indicating my preliminary view of this,  
23 I will consider arguments by the parties to the  
24 contrary, but the closest analogy in my mind is to an

1 expert witness hired from the outside who would come  
2 into a rate case and testify as to the company's  
3 required return on capital for a future period.

4 I have never seen that testimony held  
5 confidential, and I don't understand why this is  
6 different. All of that is for the company, because  
7 it's their burden on this question. I give you that  
8 to let you know what I am thinking about so that when  
9 we come to this issue on the record you will be  
10 prepared to address at least what my concerns are.

11 Other than the company, and specifically the  
12 staff, although I don't know if MI might have an  
13 opinion on this, does staff have an opinion as to  
14 whether or not the information in Mr. Sauvage's  
15 testimony should be considered trade secret?

16 MS. ASSAF: Your Honor, are you talking  
17 about this last piece which--you are not talking  
18 about--the the first piece you said was trade secret?

19 JUDGE STOCKHOLM: Not Mr. Sauvage's, no.

20 MS. ASSAF: The public forward looking.

21 JUDGE STOCKHOLM: No. No. I was raising a  
22 question about that. I was merely trying to state  
23 that was a category. I saw three categories of  
24 information. It ran through the testimony, whether

1 it was in the first filing or the second filing  
2 doesn't matter, and it's in staff's filing. Staff  
3 has kept a redacted copy, keeping confidential what  
4 the company has requested in this area.

5 Staff, in a letter earlier to me this month,  
6 said that it didn't necessarily agree that everything  
7 should be kept confidential. I guess my question is:  
8 Do you have a position with regard to the information  
9 that Mr. Sauvage brings to the record?

10 MS. ASSAF: Your Honor, when you say that,  
11 there is certain information that we think, for  
12 example, there are certain numbers that are  
13 historical numbers that they suggested are  
14 confidential and we don't really believe historical  
15 numbers should be considered confidential.

16 As to some of the other information in  
17 there, perhaps it is. To be honest with you, we did  
18 not go point by point to determine it.

19 JUDGE STOCKHOLM: Point by point, okay. We  
20 may have to go point by point. I don't know. In any  
21 event, I raise that for what it's worth. My  
22 understanding from the company is that Mr. Sauvage's  
23 appearance will not be today in any event as he had  
24 problems getting out of Chicago; is that right,



1 counselor?

2 MR. GAVILONDO: That is correct, Your Honor.

3 JUDGE STOCKHOLM: We'll see if we can--have  
4 you had a chance to talk to the parties about  
5 rescheduling that witness?

6 MR. GAVILONDO: No. In fact, I called just  
7 before the commencement of the hearing to Mr.  
8 Sauvage's associate colleague and was unable to  
9 contact them to find out what his availability is  
10 going to be.

11 JUDGE STOCKHOLM: Okay. We will deal with  
12 it later. Okay. Are there any questions on the  
13 rulings that I have made today?

14 MS. ASSAF: Your Honor, as you indicated,  
15 there is certain information that staff too has  
16 identified, has kept confidential, mainly because of  
17 the company's claims and the fact that we didn't  
18 argue with it.

19 We do have at least one number, might be two  
20 numbers, but one number in our testimony which is a  
21 number that we put together that we believe needs to  
22 be in the record but kept confidential.

23 JUDGE STOCKHOLM: I think I am familiar with  
24 that number, and we will have to take a look at that

1 testimony as we go through. I am afraid that's the  
2 only way we can deal with that.

3 As I ruled, the Abrams' information and the  
4 employee information, those motions were both  
5 granted. Anything else before we start with the  
6 witnesses?

7 Mr. Gavilondo.

8 MR. GAVILONDO: Yes, Your Honor. I am  
9 just--in terms of the opportunity for the parties to  
10 present their case, one of the things we did not  
11 discuss was the opportunity for the company to  
12 present rebuttal testimony in the event that when  
13 staff presents its case something that has not been  
14 presented in the prefiled portion of staff's case  
15 comes up, company would like to have an opportunity  
16 to put a witness on the stand.

17 I think what's typically known as surrebutal  
18 testimony. That's one thing we didn't discuss. I  
19 just wanted to clarify that up front.

20 JUDGE STOCKHOLM: I certainly would not rule  
21 that out. It would depend on the facts and  
22 circumstances.

23 MR. GAVILONDO: In terms of other  
24 preliminaries, there are three witnesses who filed

1 prefiled testimony, Mr. Abrams, Mr. Clem Nadeau and  
2 Mr. Bill Dowd. The latter two appear as a panel.  
3 Staff has indicated that they have no cross  
4 examination for that panel. Multiple Intervenors, I  
5 believe, has also indicated they have no  
6 cross-examination for that panel.

7 The witnesses have prepared affidavits for  
8 purposes of entering their testimony into the record.  
9 I am not sure if you would like to proceed with that  
10 now or do you want to wait?

11 JUDGE STOCKHOLM: No. That's fine. We can  
12 proceed with that now. And the one outstanding issue  
13 is whether or not I had questions of those witnesses,  
14 and they will be happy to know I don't.

15 MR. GAVILONDO: Very good. May I approach,  
16 Your Honor?

17 JUDGE STOCKHOLM: Yes.

18 MR. GAVILONDO: I have copies for the court  
19 reporter. For your Honor I have the originals--or  
20 should I give the originals to the reporter?

21 JUDGE STOCKHOLM: Originals to the reporter,  
22 please.

23 MR. GAVILONDO: And also copies for all the  
24 parties and staff. So, the originals of the

1 affidavit of Mr. William F. Dowd.

2 JUDGE STOCKHOLM: Before you hand those to  
3 the reporter, have you given any thought to numbering  
4 for witness--or for exhibits?

5 MR. GAVILONDO: We have given some thought  
6 to it, but I think all the discussion has been within  
7 the folks that reside at 300 Erie Boulevard.

8 JUDGE STOCKHOLM: This is my concern. If  
9 you have figured out a way that you want to put these  
10 in numerical order and this is going to screw up the  
11 order, I won't mark these yet, but I mean if we can  
12 make this Exhibit 1 and you don't have other plans,  
13 that's fine. You start there. Nothing in  
14 particular, okay. Let's make the two affidavits  
15 Exhibit 1. Three affidavits, I am sorry, three  
16 affidavits Exhibit 1.

17 (Exhibit 1 marked for identification.)

18 MR. GAVILONDO: That would be the affidavits  
19 of Mr. William F. Dowd, Mr. Alan Abrams, and  
20 Mr. Clement E. Nadeau. And copies--for the record,  
21 as well, Mr. Nadeau, there is a response to  
22 information request attached to Mr. Nadeau's  
23 affidavit at the request of staff, who staff  
24 accommodated the company by indicating that it didn't

1 want to call Mr. Nadeau here just to admit his IR  
2 response, and we appreciate that on the part of  
3 staff.

4 In terms of preliminaries, I believe that is  
5 it.

6 JUDGE STOCKHOLM: Have you given a copy of  
7 the testimony to the reporter?

8 MR. GAVILONDO: I have not yet.

9 JUDGE STOCKHOLM: Do you have one for the  
10 reporter?

11 MR. GAVILONDO: I do. Your Honor, we did  
12 not separate them into the individual testimony and  
13 exhibits of each witness. What we have are the  
14 filings that were made September 1st and  
15 September 26th in the booklet forms in which they  
16 were filed.

17 JUDGE STOCKHOLM: Okay. Let's go off the  
18 record for a second.

19 (Discussion held off the record.)

20 JUDGE STOCKHOLM: While the company is  
21 pulling that together, so to speak, I think we will  
22 take just a short break. We will be back in about  
23 ten minutes.

24 (Recess taken.)

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JUDGE STOCKHOLM: Back on the record.

Mr. Gavilondo, we had some exhibits marked while we were off the record. Would you describe those, please.

MR. GAVILONDO: Yes, Your Honor. Entered into the record as if given here today orally were the prefiled testimony of Alan Abrams dated September 1st. Exhibit number 2, Mr. Abrams' exhibit marked AA-2.

MS. ASSAF: I am sorry. It's the testimony and the exhibit?

MR. GAVILONDO: No. The testimony was provided as if given today on the record.

(The following is the prefiled testimony of Alan Abrams:)

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ALAN ABRAMS

1 I. Witness Qualifications

2 Q: Please state your name and business address.

3 A: My name is Alan Abrams. My business address is Towers Perrin, 111

4 Huntington Avenue, Boston, Massachusetts 02199.

5

6 Q: By whom are you employed and in what capacity?

7 A: I am a Principal of Towers Perrin.

8

9 Q: Please describe your education and professional background.

10 A: I received a Bachelors degree in Mathematics and Economics from the

11 University of Pennsylvania in 1985. I am a Fellow of the Society of

12 Actuaries and a Member of the American Academy of Actuaries. I am

13 responsible for the management of the Boston Health and Welfare Unit

14 within Towers Perrin.

15

16 Q: Please describe Towers Perrin.

17 A: Towers Perrin is one of the nation's leading benefits and compensation

18 consulting firms. Our clients include three-quarters of the world's 500

19 largest companies and three-quarters of the *Fortune* 1000 U.S.

20 companies One of those companies is National Grid and its operating

21 subsidiaries.

22

Case 01-M-0075

ALAN ABRAMS

1 Q: Have you testified previously before this or another utility regulatory  
2 commission?

3 A: Yes. I have testified before state utility regulatory agencies in  
4 Connecticut.

5

6 **II. Introductory Matters**

7 Q: What is the purpose of your testimony?

8 A: The purpose of my testimony is to present and explain some of the  
9 benchmarking analysis that Niagara Mohawk relied upon as it  
10 negotiated changes to its retiree health benefits as part of the  
11 Company's 2004 labor negotiations. Specifically, I will describe how  
12 the value of Niagara Mohawk's union retiree medical benefits  
13 compared to those of a peer group of 12 other investor-owned utilities  
14 both before and after changes agreed to as part of Niagara Mohawk's  
15 2004 Union contract. Company witness William Dowd, National  
16 Grid's Vice President responsible for human resources matters, will  
17 discuss further the Company's use of the analysis we performed.

18

19 Q: Are you sponsoring any exhibits in support of your testimony?

20 A: Yes. I am sponsoring Exhibits \_\_ (AA-1) and \_\_ (AA-2).

21



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ALAN ABRAMS

1 Q: Were Exhibits \_\_\_ (AA-1) and \_\_\_ (AA-2) and prepared by you or  
2 under your supervision and direction?

3 A: Yes.

4

5 Q: Please describe Exhibit \_\_\_ (AA-1).

6 A: Exhibit \_\_\_ (AA-1) consists of a schedule showing: (1) the value of  
7 Niagara Mohawk's union retiree medical benefits before and after the  
8 2004 Union contract and (2) the value of the Company's cost  
9 responsibility for those benefits, relative to those of other utilities.

10

11 Q: Please describe Exhibit \_\_\_ (AA-2).

12 A: Exhibit \_\_\_ (AA-2) shows graphically a projection of the percentage of  
13 medical plan premiums paid by the Company and the retiree had  
14 Niagara Mohawk not eliminated the benefits cap that was assumed to  
15 take effect in 2009. This projection is for post-65 retirees who are  
16 Medicare-eligible.

17

18 **III. Union Medical Benefits Analysis**

19 Q: Please describe how Towers Perrin compiled the data that underlie  
20 Exhibit \_\_\_ (AA-1).

21 A: Towers Perrin gathers benefit plan provisions from clients that can be  
22 used to benchmark the value of benefits provided. We offer all

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ALAN ABRAMS

1 organizations that choose to provide this data the opportunity to access  
2 that information with the following caveat. In exchange for  
3 responding to a detailed survey of medical benefits provided, Towers  
4 Perrin will share with the participating company, for use by its  
5 executives and human resource departments only, information  
6 gathered, including, for example, an analysis showing how the  
7 participant's benefits compare against those provided by a peer group  
8 of 12 to 15 companies. In other words, we induce companies to  
9 participate with the commitment that their results will be shared only  
10 with those in other participating companies, and each company agrees  
11 to maintain this data as confidential.

12

13 Q: What is your commitment to survey participants with respect to  
14 disclosure of their identities?

15 A: We are committed to maintaining the data provided for companies as  
16 confidential. Each survey participant can see its relative position in the  
17 analysis, but we do not identify the position of other participants. We  
18 can describe the characteristics of the group included in the analysis,  
19 but we adhere to our commitment to confidentiality by using letters to  
20 denote individual companies.

21

22 Q: How do you value future retiree medical benefits?

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ALAN ABRAMS

1 A: To value future retiree medical benefits, we analyze the plan  
2 provisions in question. In the case of Niagara Mohawk, for example,  
3 our analysis of pre-2004 contract terms reflected the assumption that  
4 the Company's share of medical benefits would be fixed forever at the  
5 dollar level they reached in 2009. We also make assumptions about  
6 the future escalation of health care costs, average age at retirement,  
7 retiree life expectancy, and other items.

8 Q: What assumptions about future medical cost inflation underlie your  
9 analysis for Niagara Mohawk?

10 A: We assumed that medical inflation would be 10% annually in 2004 and  
11 would decline from that level one percentage point per year until  
12 reaching 5%, after which we assumed it would continue indefinitely at  
13 that level.

14  
15 Q: How would you describe the peer group used for purposes of analyzing  
16 Niagara Mohawk's Union retiree medical benefits?

17 A: 15 companies with a unionized workforce based in the Mid-Atlantic,  
18 New England, or Great Lakes region were used. All but one company  
19 had revenues in excess of \$1 billion, and 12 of the 15 were investor-  
20 owned utilities.

21

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ALAN ABRAMS

1 Q: Are these the companies for which data is shown on Exhibit \_\_\_ (AA-  
2 1)?

3 A: Yes, except that we have excluded from the Exhibit data for the three  
4 companies that were not investor-owned utilities.

5

6 Q: Please explain what is portrayed in Exhibit \_\_\_ (AA-1).

7 A: Exhibit \_\_\_ (AA-1) shows two bars for each company labeled on the  
8 bottom axis as A through O (Note companies F, I, and N were  
9 excluded, as mentioned above). The first light-colored bar shows the  
10 total value of that company's union retiree medical benefits relative to  
11 the average value of those provided by the peer group excluding  
12 Niagara Mohawk (coded at NGNY-U and NGNY-U Rev). The second  
13 dark-colored bar shows the value of the employer's expected share of  
14 the cost, again expressed relative to the average total benefit offered by  
15 the peer group excluding Niagara Mohawk. The bars are sorted left to  
16 right on employer value, most generous to least generous.

17

18 Q: Does your analysis reflect regional variations in medical costs?

19 A: No. The level of medical benefit values are calibrated to reflect  
20 average national claims levels, determined by Towers Perrin's annual  
21 Health Care Cost Survey. Because of the plan's coordination with

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ALAN ABRAMS

1 Medicare when a retiree attains age 65, regional differences in health  
2 care costs are less pronounced than for a non-Medicare population.

3

4 Q: Are any medical costs excluded from your analysis?

5 A: The total value does not include member out-of-pocket expenses such  
6 as copays. The level of member cost sharing required before payments  
7 are made under the plan is captured in the total value (i.e., the bar for a  
8 plan with a \$100 deductible would be higher than a plan with a \$1,000  
9 deductible, everything else being equal).

10 Q: What is the relationship of the two bars shown for each company?

11 A: For a company with noncontributory retiree medical coverage, the bars  
12 would be the same height. The bar showing the company share is  
13 lower to the extent retirees are responsible for making larger  
14 contributions to purchase coverage.

15

16 Q: How does Niagara Mohawk stand relative to the peer companies as a  
17 result of the 2004 Union contract?

18 A: Our analysis shows that Niagara Mohawk is providing competitive  
19 benefits relative to the defined peer group of investor-owned utilities  
20 in both the value of its medical benefits for union retirees and the value  
21 of the employer's cost contribution to those benefits. More  
22 specifically, Niagara Mohawk ranks [REDACTED] out of 13 in both

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ALAN ABRAMS

1 categories. The company that ranks highest is rated [REDACTED] on the value  
2 of the employer's support, while Niagara Mohawk's rating is [REDACTED], or  
3 approximately [REDACTED]% less than the top-ranked rating. Niagara Mohawk  
4 occupies a similar position relative to the peer group on total medical  
5 plan value. Niagara Mohawk's rating is [REDACTED], while the highest-  
6 ranked employer is rated [REDACTED].

7

8 Q: How did Niagara Mohawk compare to the same peer group before the  
9 2004 Union contract was implemented?

10 A: The value of Niagara Mohawk's medical plan rated only slightly lower  
11 than it did post-contract: [REDACTED], as opposed to [REDACTED]. However the  
12 relative value of Niagara Mohawk's employer contribution was far, far  
13 less: [REDACTED], as opposed to [REDACTED]. In other words, as a result of the 2004  
14 Union contract, the value of Niagara Mohawk's employer contribution  
15 to medical benefits for union retirees went from [REDACTED]% of the total plan  
16 value to [REDACTED]% of the total plan value.

17

18 Q: Can you explain this striking result?

19 A: Yes. This change is attributable largely to the decision in the 2004  
20 Union contract to eliminate the "cap" assumption for medical benefits  
21 that was to become effective in 2009 and replace it with the  
22 assumption that medical benefit costs for union retirees instead would

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ALAN ABRAMS

1 be shared by the Company and beneficiaries following the plan's  
2 defined cost-sharing features (for example, co-insurance).

3

4 Q: Have you calculated what Niagara Mohawk's share of medical benefit  
5 costs would have been in the future if the cap had not been replaced  
6 with a different approach?

7 A: Yes. As shown in Exhibit \_\_\_ (AA-2), I have calculated that by 2019,  
8 10 years after the cap was to be implemented, Niagara Mohawk's share  
9 of the medical benefit costs for its union retirees would have decreased  
10 from 75% to 50%. The beneficiary would be responsible for the  
11 remaining 50% of plan cost. In 2024, five years later, the company  
12 and beneficiary shares of medical benefit costs would be 39% and  
13 61%, respectively. Since the cap was a fixed dollar amount, the  
14 Company's percent cost share would continue to shrink over time  
15 while the retiree cost share would continue to grow over time.

16

17 **IV. Conclusion**

18 Q: Thank you. I have no further questions at this time.

1 MS. ASSAF: Okay.

2 MR. GAVILONDO: The exhibit number 2 for the  
3 hearing is Mr. Abrams' exhibit AA-2.

4 MS. ASSAF: Thank you.

5 MR. GAVILONDO: Also given today or provided  
6 today as if given on the record is the September 1st  
7 testimony of Clement E. Nadeau and William F. Dowd.  
8 Also, Exhibit 3 is the exhibit to their testimony  
9 which had been marked as ND-1.

10 (The following is the prefiled testimony of  
11 Clement E. Nadeau and William F. Dowd:)

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Case 01-M-0075

CLEMENT E. NADEAU and WILLIAM F. DOWD

1           **RESPONSIVE TESTIMONY OF CLEMENT E. NADEAU AND**  
2   **WILLIAM F. DOWD**  
3

4   **I.    Introduction**

5   Q:    Please state your name and business address.

6   A:    (Mr. Nadeau) My name is Clement E. Nadeau. My business address is  
7           300 Erie Boulevard West, Syracuse, New York 13202.

8           (Mr. Dowd) My name is William F. Dowd. My business address is 25  
9           Research Drive, Westborough, Massachusetts 01582.

10

11   Q:    By whom are you employed and in what capacity?

12   A:    (Mr. Nadeau) I am employed by Niagara Mohawk Power Corporation  
13           as Senior Vice President - Customer Operations.

14           (Mr. Dowd) I am employed by National Grid USA Service Co. as  
15           Vice President – Human Resources Operations.

16

17   Q:    Please describe your education and professional experience.

18   A:    (Mr. Nadeau) I received my Bachelor of Science degree in Electrical  
19           Engineering from Union College and <sup>attended LeMoyne College in pursuit of</sup> a Masters of Business  
20           Administration degree ~~from LeMoyne College~~. I joined Niagara  
21           Mohawk in 1974. Prior to assuming my current position I held  
22           positions of increasing responsibility, including Manager - System  
23           Power Control, Vice President - Electric Delivery, Vice President -

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CLEMENT E. NADEAU and WILLIAM F. DOWD

1 Marketing and Planning, and Vice President, Power Transactions and  
2 Planning.

3 (Mr. Dowd) I received my Bachelor of Science degree from  
4 Bridgewater State College. I also have a Masters Degree in Public  
5 Administration from Suffolk University in Boston. Over the course of  
6 the more than twenty years I have held positions of increasing  
7 responsibility in the human resources field with National Grid USA  
8 and its predecessor, New England Electric System. In my current  
9 position I am responsible, among other things, for managing National  
10 Grid's relationship with three labor unions representing over 6,000  
11 employees, and I serve as National Grid's Chief Labor Negotiator in  
12 New England.

13

14 Q: Have you testified previously before this or any other utility regulatory  
15 commission?

16 A: (Mr. Nadeau) I have testified before the Commission in Case Nos. 94-  
17 E-0098 (the "PowerChoice" proceeding), in this proceeding in support  
18 of the merger of Niagara Mohawk and National Grid, and in several  
19 other Commission proceedings. I also have testified before the Federal  
20 Energy Regulatory Commission.

1 (Mr. Dowd) I have testified in proceedings before the Massachusetts  
2 Department of Telecommunications and Energy and the Rhode Island  
3 Public Utilities Commission.

4

5 Q: What is the purpose of your testimony?

6 A: The purpose of our testimony is to respond to proposals by the Staff  
7 Panel ("Staff") to "offset," or reduce, Niagara Mohawk's pension and  
8 OPEB deferrals based on three separate and independent theories  
9 advanced by Staff. Specifically, Staff would reduce pension and  
10 OPEB deferrals "[t]o reflect offsets for the non-pension & OPEB  
11 employee benefit reductions negotiated as part of the October 2004  
12 union contract" (adjustment 21.a); "[t]o reflect offsets for the  
13 operational savings in the approved union contract" (adjustment 21.b);  
14 and "[t]o treat increases in pension and OPEB costs given to  
15 management employees as "costs to achieve" (adjustment 21.c). (Exh.  
16 \_\_\_ (SP-1), Sched. 2, p. 3.)

17

18 Q: Are you sponsoring an exhibit in support of your testimony?

19 A: Yes. We are sponsoring Exhibit \_\_\_ (ND-1).

20

21 Q: Was this exhibit prepared by you or under your supervision and  
22 direction?

1 A: Yes.

2

3 Q: Please describe Exhibit \_\_\_ (ND-1).

4 A: Exhibit \_\_\_ (ND-1), which consists of a single page, is an analysis of  
5 the policies of Niagara Mohawk and several "benchmark" employers  
6 with respect to cost responsibility for post-retirement health benefits.  
7 We will describe Exhibit \_\_\_ (ND-1) in more detail later in our  
8 testimony.

9

10 **II. Staff's Proposed "Offset" Adjustments (Staff Panel, pp. 110-125)**

11 Q: Please describe Staff's proposed "offset" adjustments to pension and  
12 OPEB deferrals (Line 21).

13 A: Staff proposes to "offset" pension and OPEB deferrals in three separate  
14 ways. First, Staff recommends that Niagara Mohawk's pension and  
15 OPEB deferrals be reduced to capture 100% of benefit savings  
16 negotiated as part of the 2004 Union contract, reduced by 50% of  
17 increased costs for benefits of part-time employees. (SP at pp. 115-  
18 117.) Staff proposes to reduce pension and OPEB deferrals by an  
19 aggregate of \$775,000 through June 2005 and by an aggregate of  
20 \$4,650,500 through December 2007. (Exh. \_\_\_ (SP-1), Sched. 2, p. 3  
21 of 3, at 21.a.)

22

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1 Q: What is Staff's second offset proposal?

2 A: Staff recommends that Niagara Mohawk's pension and OPEB deferrals  
3 also be reduced to capture 100% of operational savings achieved in the  
4 2004 Union contract. Staff proposes to reduce pension and OPEB  
5 deferrals by an aggregate of \$2,943,250 through June 2005 and by an  
6 aggregate of \$12,755,720 through June 2007. (SP at p. 119; Exh. \_\_\_\_  
7 (SP-1), Sched.2, p. 3 of 3, at 21.b.)

8

9 Q: What is Staff's third and final offset proposal?

10 A: Staff recommends that Niagara Mohawk's pension and OPEB deferrals  
11 be further reduced by 100% of the cost of pension and OPEB plan  
12 changes implemented for management employees after the effective  
13 date of the Merger Rate Plan based on the notion that such cost  
14 impacts already are covered by Niagara Mohawk's share of the "costs  
15 to achieve" savings under the Merger Rate Plan. Staff's third  
16 adjustment is an aggregate reduction of \$10,136,750 through June  
17 2005 and an aggregate reduction of \$19,174,250 through June 2007.

18

19 Q: Does Staff propose that its three "offset" adjustments extend beyond  
20 June 2007?

21 A: Yes. Staff proposes that its first offset adjustment be applied through  
22 March 31, 2008, which is the end of the 2004 Union contract. (SP at p.

1           118, lines 4-6.) Staff proposes that its second and third adjustments be  
2           applied through December 31, 2011, the end of the Merger Rate Plan.  
3           (SP at p. 120, lines 8-15, and p. 123, lines 8-12.) Staff has not offered  
4           an estimate of its post-June 2007 offset reductions.

5

6   Q.    Are any of these adjustments authorized by the Merger Rate Plan?

7   A.    No, and Staff cites no provision that supports their adjustments. Staff  
8           ignores the fundamental structure of the Merger Rate Plan. Under the  
9           Merger Rate Plan, the parties agreed on an estimated level of synergy  
10          savings and costs to achieve that was reflected in Attachment 18. The  
11          Merger Rate Plan credited 50 percent of these factors to customers up  
12          front in the revenue requirements used to set rates. See Attachment 1  
13          to the Merger Rate Plan, page 2, lines 10-11. The Company then had  
14          the obligation to manage the business, including its labor relations and  
15          personnel policies to realize the savings or face the financial  
16          consequences of failing to meet its agreed upon projections of savings.  
17          As provided in Section 1.5 of the Merger Rate Plan, the Joint Proposal,  
18          “The reduction in stranded cost recovery, the limitations on  
19          transmission and distribution charges, and the reduction in the overall  
20          level of Electricity Delivery Rates during the Rate Plan Period are  
21          designed to resolve: . . . all issues associated with the estimation,  
22          allocation, and sharing of Efficiency Gains, Synergy Savings, and

1 Costs to Achieve, including the ratemaking treatment of those  
2 Efficiency Gains, Synergy Savings, and Costs to Achieve during the  
3 Rate Plan Period.” Staff’s adjustments disturb this balance in a  
4 fundamental way; its adjustments to capture a second share of synergy  
5 savings and efficiency savings are inconsistent with both the language  
6 and the intent of the Merger Rate Plan.

7

8 **First Adjustment - Benefits Changes Under Union Contract.**

9 Q: What is the rationale for Staff’s first recommendation, namely, that  
10 cost savings to the Company from certain benefit changes in the 2004  
11 Union contract be allocated to ratepayers?

12 A: Staff cites two grounds for reducing pension and OPEB deferrals by  
13 the amount of estimated savings in other fringe benefits programs as a  
14 result of the Union Contract. The first is that “it has been for the most  
15 part the Commission’s policy to reflect in rates both the cost increases  
16 as well as the cost decreases associated with negotiated union contract  
17 changes.” Second, according to Staff “it appears the Company was  
18 more than willing to concede on benefit areas of which the incremental  
19 costs would be borne by ratepayers, in exchange for achieving material  
20 savings for the exclusive benefit of shareholders.” (SP at p. 116, line  
21 21 – p. 117, line 7.)

22

1 Q: Please respond to Staff's first point.

2 A: Staff seeks to treat this filing as a new rate case. As explained above,  
3 it is not. Accordingly, the Staff may not selectively apply in this  
4 deferral proceeding a Commission policy that, at least in the case of  
5 Niagara Mohawk, has not been applied for many years. It is true that  
6 in Niagara Mohawk rate cases during the 1980s and early 1990s the  
7 cost impacts of union negotiations, both positive and negative,  
8 generally were reflected in second-stage filings. Second-stage filings,  
9 when allowed, were approved by the Commission as part of a rate  
10 order. In recent years the Company has not requested, and the  
11 Commission has not authorized, second-stage filings for the effect of  
12 future labor negotiations. The Merger Rate Plan, like the PowerChoice  
13 rate plan before it, contains no provision authorizing or requiring a  
14 second-stage filing to address all the impacts of future labor contracts.  
15 As explained above, the contrary is true. There accordingly is no basis  
16 for making Staff's proposed adjustment.

17

18 Q: Please respond to Staff's second point, namely, that the Company  
19 conceded pension and OPEB issues to the Union "in exchange for  
20 achieving material savings for the exclusive benefit of shareholders" --  
21 that is, in exchange for concessions by the Union on other benefits  
22 issues.



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1 A: We deny categorically that there was any "quid pro quo" with the  
2 Union on benefits issues. In the 2004 Union negotiations, Niagara  
3 Mohawk's goals with respect to benefits were driven by two business  
4 considerations. First, Niagara Mohawk sought to bring its benefits  
5 package closer in line with those offered by comparable companies,  
6 including Niagara Mohawk's New England affiliates. Second, Niagara  
7 Mohawk sought to control costs, including benefit costs, and improve  
8 service to customers. Sound business reasons underlay our positions  
9 and strategy in the negotiations.

10 Q: Are there other factors that would call Staff's explanation of events  
11 into doubt?

12 A: Yes. The 2004 Union negotiations were long, intense, and hard-  
13 fought. Despite the Company's best efforts the final contract departed  
14 in significant respects from the Company's position. The suggestion  
15 that the 2004 Union contract somehow was the product of a calculated  
16 plan to increase costs in benefit areas that could be passed through to  
17 ratepayers in return for other benefit cost savings on items that are not  
18 eligible for deferral is wholly unfounded.

19  
20 Q: What benefit change under the Union contract had the largest impact  
21 on pension and OPEB costs?

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1 A: The largest impact resulted from a change in the allocation between the  
2 Company and beneficiaries for the cost of retirees' post-retirement  
3 medical benefits, namely, the replacement of an assumed future dollar  
4 cap on benefits with a future percentage cost sharing formula between  
5 the Company and its retirees. By definition that change affects only  
6 OPEB costs.

7

8 Q: What is the background of this issue?

9 A: Under the previous Union contract, which had been negotiated in 2001,  
10 Niagara Mohawk's responsibility for the cost of post-retirement health  
11 care was to be capped in 2009 at then-current levels. In other words,  
12 retirees were assumed to be responsible for any increase in health care  
13 costs above a dollar amount to be fixed in 2009. The Union wanted to  
14 postpone or eliminate the cap, and similarly was resistant to any  
15 alternative mechanism under which the Company and retirees would  
16 share cost responsibility. Niagara Mohawk for its part believed that  
17 sharing of responsibility for health care costs between the Company  
18 and retirees was highly preferable to a cap approach.

19

20 Q: Please explain why Niagara Mohawk favored moving from a capped  
21 benefits approach to a sharing formula.

1 A: There were several reasons. First, by placing on retirees 100%  
2 responsibility for health care costs above a target amount to be fixed in  
3 the future, a cap structure caused great uncertainty for prospective  
4 retirees as to their future health care costs. Second, the cap structure  
5 threatened to produce significant and unpleasant financial volatility for  
6 the Company and retirees alike at such future time as the cap might be  
7 adjusted. Third, continued postponement of the effectiveness of the  
8 cap threatened to cause the Company's auditors to refuse to recognize  
9 the cap for financial reporting purposes.

10

11 Q: Can you further explain your third point?

12 A: In the long term, the assumption that a cap would be imposed in the  
13 future was not sustainable. The cap, when implemented, would have  
14 caused retirees to face increasingly and significantly diminished  
15 benefits as a result of inflation and increased medical costs. Indeed, in  
16 the 2001 labor contract negotiations, Niagara Mohawk had agreed to  
17 defer the effectiveness of the cap from 2002 until 2009. At the time  
18 the 2001 contract was concluded, Niagara Mohawk's auditors advised  
19 that continuing to postpone the effectiveness of the cap was not viable,  
20 and that they might be compelled to disregard the cap for financial  
21 reporting purposes if it was again postponed.

22

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1 Q: Did Niagara Mohawk take competitive considerations into account in  
2 deciding to move from a capped formula to a shared benefits formula?

3 A: Yes. The move from a cap to a percentage contribution approach  
4 brought Niagara Mohawk's post-retirement health care benefits more  
5 in line with those provided by other utilities.

6

7 Q: What is the basis for your conclusion?

8 A: (by Mr. Dowd) Our conclusion is based on knowledge of industry  
9 practices and trends. Moreover two relevant analyses confirm that  
10 eliminating the cap was appropriate based on competitive  
11 considerations. The first such analysis is that set forth in Exhibit \_\_\_\_  
12 (ND-1). Exhibit \_\_\_\_ (ND-1) portrays the results, as disclosed in  
13 response to IR No. 239 [PSC-184 (DAG-10), 1/10/06], of a telephone  
14 survey by the Company of benchmark utilities to ascertain their  
15 policies regarding cost responsibility for post-retirement health care.  
16 The second is an analysis of employer-sponsored medical benefits for  
17 union retirees provided by our benefits consultant, Towers Perrin.  
18 That analysis is presented in the Testimony of Alan Abrams. The  
19 same data were made available to Staff in somewhat different form in  
20 Niagara Mohawk's response to IR No. 239.

21

22 Q: What does Exhibit \_\_\_\_ (ND-1) show?

- 1 A: That Exhibit shows that the percentage contribution approach  
2 negotiated as part of the 2004 Union contract is fully consistent with  
3 industry benchmarks. Each of the three utilities for which information  
4 on retiree health care is shown – Central Hudson, Public Service  
5 Electric & Gas, and Orange and Rockland – has adopted a percentage  
6 contribution formula for its union employees. From the webpage of  
7 the State of New York, Niagara Mohawk ascertained that the State’s  
8 policy on cost responsibility likewise provides for sharing by the  
9 employer and the retiree. The New York State retiree data are shown  
10 on the bottom line of Exhibit \_\_\_ (ND-1). The designation “floating”  
11 means that the percentage sharing formula applies to total cost,  
12 whether it rises or falls, while “frozen” means the retiree’s share will  
13 be fixed at some level.  
14
- 15 Q: How does Niagara Mohawk’s retiree medical cost sharing policy stack  
16 up against those of the other entities surveyed?
- 17 A: For retirees under age 65, the percentage of cost responsibility  
18 allocated to retirees under Niagara Mohawk’s 2004 Union contract was  
19 exactly the same as that required by the State of New York and  
20 somewhat higher than that required by the responding utilities. For  
21 retirees 65 and older, the percentage of cost responsibility allocated to  
22 retirees under the 2004 Union contract is higher than the percentages

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1 for the other employers. In addition, Niagara Mohawk and New York  
2 State retirees both are subject to a floating percentage approach.

3

4 Q: How do the results of this survey compare with other information  
5 available to you?

6 A: (Mr. Dowd) It is clear from my reading and from discussions with  
7 other human resources professionals that the trend in the market is  
8 toward using a percentage sharing structure to determine company  
9 contributions for post-retirement medical benefits. In addition, as  
10 noted above, Niagara Mohawk relied on industry benchmarking  
11 performed by Towers Perrin.

12

13 Q: Did Towers Perrin advise the Company at the time of the 2004 Union  
14 negotiations?

15 A: Yes. We asked Towers Perrin to analyze our union retiree medical  
16 benefits relative to those of other companies, especially utilities, as part  
17 of our effort to formulate objectives for a new contract, and our  
18 thinking was informed by Towers Perrin's analysis.

19

20 Q: At the time of the 2004 Union negotiations, had the Company already  
21 taken steps to move away from a cap approach and toward a  
22 percentage sharing formula?

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1 A: Yes. As stated in response to I.R. \_\_\_239, at the time Niagara Mohawk  
2 began preparing for the 2004 Union negotiations it already had  
3 changed from the cap to the percentage sharing approach with respect  
4 to health care benefits for the Company's management retirees.

5

6 Q: Staff notes that the Company made two changes with respect to its  
7 pension plan that resulted in increased costs: a change in the level of  
8 covered earnings for certain employees, and supplemental  
9 contributions to the pension plans for certain more recently hired  
10 employees. Were these changes made, as Staff asserts, in exchange for  
11 union concessions on other benefit issues?

12 A: No, as with the change in allocation of cost responsibility for post-  
13 retirement health care, the two pension changes were made for sound  
14 business reasons.

15

16 Q: What are covered earnings?

17 A: As Staff notes, "covered earnings" are earnings equal to an employee's  
18 average social security tax base over the thirty-five years prior to the  
19 employee's retirement date. Pension plans may treat covered earnings  
20 differently than earnings in excess of this amount because employees  
21 receive social security benefits associated with their covered earnings.  
22 An increase in covered earnings reduces pension expense.

1

2 Q: Why did the Company seek a change in the level of covered earnings  
3 in the most recent labor contract?

4 A: In the early 1990s, Niagara Mohawk and the Union agreed to set  
5 covered earnings at a level of \$16,500. Niagara Mohawk, for its part,  
6 expected that it would negotiate a new amount based on future  
7 increases in the social security tax base each time it negotiated a new  
8 labor contract with the Union. Niagara Mohawk accordingly  
9 calculated its pension expense using the assumption that covered  
10 earnings would increase every three to four years. However, until  
11 2001 the covered earnings amount specified in the labor contract was  
12 not changed despite the fact that the Internal Revenue Service (IRS)-  
13 prescribed value for covered earnings had increased. Moreover, the  
14 Company's auditors were becoming increasingly uncomfortable with  
15 the assumption that covered earnings would be updated in subsequent  
16 labor contracts.

17

18 Q: What was the result of labor negotiations concerning covered  
19 earnings?

20 A: After protracted and difficult negotiations, the Company and the Union  
21 agreed to a contract that provides for the level of covered earnings to



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1 increase eight percent annually from 2008 until it matches the IRS-  
2 prescribed value, after which it will track the IRS-prescribed value.

3

4 Q: What were the likely consequences of not changing the labor contract  
5 provision governing covered earnings?

6 A: Had Niagara Mohawk not been successful in obtaining the Union's  
7 agreement to move toward the IRS-prescribed value for covered  
8 earnings, it is all but certain that Niagara Mohawk would have  
9 experienced an abrupt and very considerable increase in pension  
10 expense as the Company was required to recognize the impact of the  
11 prior labor contract's treatment of covered earnings.

12 Q: Are there other reasons why the agreed-upon treatment of covered  
13 earnings made sense?

14 A: Yes. The covered earnings change moves Niagara Mohawk closer to  
15 the market and is fair to Union employees. Sound business practice  
16 dictated a more gradual shift of the covered earnings amount in order  
17 to "catch up" with the IRS-prescribed figure.

18

19 Q: Please explain the reason why the Company agreed, in the most recent  
20 labor contract, to make a supplemental pension contribution for the  
21 benefit of certain more recently hired employees.

1 A: As part of the 2004 Union contract, the Company agreed to make  
2 supplemental contributions averaging \$4,000 to the cash balance  
3 pension plans of a defined group of more recently hired Union  
4 employees who were not protected by the merger transition plan. The  
5 Union had sought to re-define the transition period so as to open up the  
6 transition group to more employees. The Company, however, did not  
7 wish to open the transition group to additional employees. To resolve  
8 this issue, Niagara Mohawk agreed as a compromise to make  
9 supplemental contributions averaging \$4,000 apiece for the  
10 approximately 1,400 employees eligible for the cash balance pension  
11 plan.

12 Q: Did the Company agree to this contribution in order to secure union  
13 agreement on reducing other benefits?

14 A: No. As with the other pension and OPEB issues discussed in this  
15 section of my testimony, this compromise was made not as a  
16 concession to the Union in exchange for reducing the costs of certain  
17 benefits not eligible for deferral, but rather to resolve this issue on its  
18 merits. The Union stated publicly that it wanted far more employees  
19 than those already in the transition group than the number ultimately  
20 negotiated. Had Niagara Mohawk been in the business of making  
21 concessions in accordance with Staff's theory, this outcome almost  
22 certainly would have been different.

1

2 Q: Staff identifies medical, dental, sick pay, and disability as benefits for  
3 which costs are not subject to deferral and as to which the new labor  
4 contract resulted in lower costs to the Company. Can you please  
5 explain why the Company sought changes in these benefits?

6 A: The fundamental basis for seeking these changes was to make benefits  
7 more consistent between National Grid's New England and New York  
8 operating subsidiaries. Consistency in benefits is essential to achieve  
9 the efficiencies that are presumed to be available from increasing scale.  
10 Moreover National Grid believes that employees doing the same job in  
11 New York and New England should be eligible for similar, if not  
12 identical, benefits. National Grid had a long history of negotiating  
13 benefits with its union employees in New England. The benefits we  
14 provided in New England in 2004 were competitive with the market  
15 and were deemed fair and satisfactory by the union representing our  
16 New England employees. In the interest of cross-regional fairness and  
17 in support of reducing the administrative costs associated with running  
18 two, different and complex union benefit programs, we sought to bring  
19 the benefit plans for Local 97 into line with the benefits provided by  
20 the Company to its other union employees.

21

22 **Second Adjustment – Operational Savings From Union Contract.**

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1 Q: Staff's second "offset" adjustment would reduce Niagara Mohawk's  
2 pension and OPEB deferrals to the amount of operational savings  
3 achieved in the 2004 Union contract. What basis does Staff cite for  
4 this adjustment?

5 A: Staff states that this adjustment is justified "for the same reasons  
6 previously explained" in support of its first adjustment. (SP at 118,  
7 line 22.)

8  
9 Q: What is your response?

10 A: Our response is essentially the same as our response to Staff's first  
11 adjustment. First, unlike in the case of some rate orders from years  
12 ago, there is no basis under the Merger Rate Plan for reconciliation of  
13 the cost impacts of Union negotiations. Staff's proposal to revive the  
14 abandoned practice of truing up for the impact of all changes in labor  
15 contracts amounts to nothing less than a proposal to re-write the Joint  
16 Proposal and the Merger Rate Plan. Those agreements provide for the  
17 deferral of 100% of pension and OPEB expense, but include no  
18 provision requiring or authorizing the true-up of either benefits outside  
19 the Commission's Policy Statement or operational savings achieved in  
20 labor negotiations. It would be improper for the Commission at this  
21 late date to read into those agreements reconciliation mechanisms that  
22 are not there.

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1                   Second, Niagara Mohawk had sound business reasons for each  
2                   contract change it negotiated with the Union, no less in the area of  
3                   operational savings than in the area of benefits. There was no “quid  
4                   pro quo” with the Union based on the rate treatment of costs. Staff  
5                   tellingly cites no provision of any agreement or order in support of its  
6                   adjustment.

7

8                   **Third Adjustment – Eliminating Policy Statement Treatment for**  
9                   **Management.**

10

11    Q:    Please describe Staff’s third “offset” adjustment.

12    A:    Staff’s third “offset” adjustment would reduce pension and OPEB  
13           deferrals by the amount of any pension expense and OPEB expense for  
14           management employees that is attributable to pension or OPEB benefit  
15           changes since the merger of Niagara Mohawk and National Grid.

16

17    Q:    What are those changes?

18    A:    Those changes are (1) a phased-in increase in the covered earnings  
19           assumption used to determine pension expense, and (2) replacement of  
20           a benefit “cap” with a percentage sharing mechanism for health care  
21           costs, which affects OPEB expense.

22

23    Q:    Were these two changes the same ones you described earlier for Union  
24           employees?

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1 A: Yes, the changes are the same, although the dates of implementation  
2 are different. As we noted earlier, for management employees only the  
3 cap on health care benefits was replaced with a percentage sharing  
4 mechanism in 2002. The change in covered earnings related to  
5 pension benefits for management employees was announced in 2005.

6

7 Q: What does Staff cite as the grounds for “offsetting” Niagara Mohawk’s  
8 pension and OPEB deferrals?

9 A: Staff cites three basis for its position. First, Staff asserts that  
10 maintaining an equitable balance between New York and New  
11 England benefits “is not a valid reason to defer the costs . . . .” (SP at  
12 p. 123, line 16.) In Staff’s view, Niagara Mohawk already has been  
13 compensated for the two management benefit changes at issue through  
14 an allowance for “costs to achieve” the merger of Niagara Mohawk  
15 and National Grid. (SP at p.123, line 20 – p. 124, line 2.) Second,  
16 Staff asserts that Niagara Mohawk is “load[ing] up the costs associated  
17 with the pension and OPEBs benefit plans, and plac[ing] the financial  
18 responsibility with someone other than itself.” (SP at p. 124, lines 3-  
19 7.) Staff contends that Niagara Mohawk did not “get any explicit  
20 benefits” in return for changes to its management benefit plans. Third,  
21 Staff contends that attempting to ensure “an equitable balance”

1           between Union and management health and pension benefits is “not....  
2           appropriate. . . .” (SP at p. 124, lines 10-12.)

3

4   Q:    What is your response to Staff’s first argument?

5   A:    Staff’s contention that the costs of changing its pension and OPEB  
6           programs were intended to be counted as “costs to achieve” under the  
7           Joint Proposal is baseless. Section 1.2.5.2.7 of the Joint Proposal,  
8           entitled “Synergy Savings, Efficiency Gains, and Costs to Achieve,”  
9           says nothing that supports Staff’s position. Moreover, it is clear from  
10          the context that the term refers to one-time costs that must be incurred  
11          to achieve the other things in the caption of that section, namely,  
12          synergy savings and efficiency gains. Section 1.2.5.2.7 refers to  
13          Exhibit 18 to the Joint Proposal, which in turn sets out a schedule of  
14          the synergy savings, efficiency gains, and costs to achieve assumed for  
15          each year of the Merger Rate Plan. As shown in Exhibit 18, costs to  
16          achieve start at \$52.4 million in 2002, fall to \$20.9 million in 2003,  
17          decline further until they reach \$9.9 million in the current year (2006),  
18          and continue to fall thereafter, reaching \$3.1 million in 2011. Even if  
19          the absence of textual support in Section 1.2.5.2.7 for Staff’s position  
20          were not conclusive, the dramatic decline in annual costs to achieve  
21          over the life of the Merger Rate Plan demonstrates that the term cannot

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1 include ongoing costs like those resulting from applying benefits plan  
2 changes to management as well as Union employees.

3

4 Q: What is your response to Staff's second argument?

5 A: Staff second argument is that the Company did not receive any  
6 quantifiable "value" or "benefit" for changing management pension  
7 and OPEB benefits. Staff disregards entirely the benefits to Niagara  
8 Mohawk of providing benefits that are competitive based on external  
9 benchmarks and internally equitable. A company's ability to retain  
10 and attract qualified personnel depends on both. We have testified that  
11 Niagara Mohawk relied on external market benchmarks, acknowledged  
12 industry benefit trends, and National Grid's Union contract in New  
13 England to determine what changes in pension and OPEB benefits  
14 were appropriate to be implemented for Niagara Mohawk. Such real-  
15 world data is far better evidence of the reasonableness of Niagara  
16 Mohawk's benefit changes than would be an analysis that purported to  
17 show "quantifiable" benefits of making specific changes in  
18 management pension and OPEB benefits. Finally, we note again that  
19 the health care benefit for management employees whose cost Staff  
20 proposes to disallow is marginally less generous than that provided by  
21 comparable utilities and just slightly less generous than that provided  
22 by New York State to its employees, as shown in Exhibit \_\_\_\_ (ND-1).



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CLEMENT E. NADEAU and WILLIAM F. DOWD

1

2 Q: What is your response to Staff's third argument?

3 A: As we explained in response to IR DAG-10, changes to the  
4 management retiree medical plan were made in order to: "1) maintain  
5 an equitable balance between the non-union retiree medical plan in NY  
6 and the non-union retiree medical plan in New England, 2) resolve  
7 permanently the issue of the long term Company support for retiree  
8 medical benefits and 3) continue a competitive and motivational  
9 overall compensation and benefits program for our non-union staff."  
10 Greater parity between the medical plans of National Grid's New York  
11 and New England affiliates as well as between union and non-union  
12 staff maintains morale while preserving incentives for employee  
13 advancement. It is elementary that providing lesser benefits to  
14 management employees than to Union employees would hinder  
15 promotion of qualified union employees into management positions.  
16 Why would a Union employee forego the benefits and security of a  
17 Union position for a management position that did not even offer  
18 comparable benefits? Comparability of benefits between Union and  
19 management employees accords with good management principles and  
20 common sense.

21

1 Q: Are there any other Staff statements to which you would like to  
2 respond?

3 A: Yes. After enumerating its three stated grounds for disallowing the  
4 cost of implementing for management employees the same pension  
5 and OPEB benefit changes implemented for Union employees, Staff  
6 concludes: “[m]oreover, the quid pro quo for the union increases were  
7 operating practice changes that reduced the Company’s overall costs.”

8

9 Q: What is your response to this statement?

10 A: Staff manifestly is animated by the belief that Niagara Mohawk made a  
11 nefarious deal with Local 97 to shift costs to areas that were subject to  
12 true-up and away from areas that were not. As we already have  
13 explained, Niagara Mohawk’s positions in the 2004 labor negotiations  
14 were based on sound business considerations, and we categorically  
15 deny trying to “game” the Merger Rate Plan.

16

17 Q: Do you have any concluding comments about the Policy Statement?

18 A: Yes. The Policy Statement requires pension expense and OPEB  
19 expense to be fully reconciled. Nothing in the Policy Statement can be  
20 read to support the adjustments Staff is proposing. To the contrary, it  
21 is Staff’s proposed adjustment that is inconsistent with the Policy  
22 Statement. Had the parties to the Joint Proposal (or the Commission)

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CLEMENT E. NADEAU and WILLIAM F. DOWD

1           wished to create an exception to the Policy Statement to address the  
2           issue raised by Staff's "offset" adjustments, they could have done so.  
3           (Indeed, exceptions not relevant here were agreed to by the parties and  
4           approved by the Commission.) Staff's attempt to re-write the Joint  
5           Proposal and the Merger Rate Plan should be rejected.

6

7   **III. Conclusion**

8   Q:   Thank you. I have no further questions at this time.

1  
2  
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**REBUTTAL TESTIMONY OF  
CLEMENT E. NADEAU and WILLIAM F. DOWD**

4 **I. Introduction**

5 Q: Please state your names and business addresses.

6 A: Clement E. Nadeau. My business address and credentials were set forth in  
7 my responsive testimony, filed in this proceeding on September 1, 2006.

8 A: William F. Dowd. My business address and credentials were likewise set  
9 forth in my responsive testimony, filed in this proceeding on September 1,  
10 2006.

11

12 Q: What is the purpose of your testimony here?

13 A: We are replying to a point raised in the responsive testimony of Staff  
14 witnesses Denise A. Gerbsch and Robert A. Visalli (Staff Panel) regarding  
15 pensions and OPEBs. We note that, due to the limited time available, and  
16 because we fully described the basis for our position in our earlier  
17 testimony, we are not responding to every point made in the Staff Panel  
18 testimony, and our silence should not be construed as agreement with the  
19 arguments presented by the Staff Panel that are not addressed.

20

21 Q: In its responsive testimony, the Staff Panel "expand[s] upon the Company  
22 panel testimony [i.e., Nadeau and Dowd] concerning the covered earnings

1 change associated with the pension plan . . . .” (page 44, lines 6-9) More  
2 particularly, the Staff Panel points out that under the 2004 Union contract  
3 the covered earnings level used to calculate pension benefits will not reach  
4 the IRS-prescribed level for 20 years (page 47, lines 3-6). Why did  
5 National Grid agree to this phase-in period?

6 A: To avoid a strike by our represented employees in New York. We pushed  
7 hard in negotiations to implement quickly the IRS-prescribed covered  
8 earnings limit in lieu of the much lower limit we were using to determine  
9 pension benefits. However, the Union, perhaps not surprisingly, resisted.  
10 In our opinion based on many months spent in negotiations, including a  
11 late stage when both sides began to prepare for a strike, the covered  
12 earnings compromise embodied in the final Union contract reflects the  
13 best achievable outcome on that issue. To have pushed for more would  
14 have likely resulted in a strike, an outcome that National Grid believes  
15 would not have been in the best interest of our customers, our employees  
16 (represented and non-represented alike), or our shareholders.

17

18 **II. Conclusion**

19 Q: Thank you. I have no further questions at this time.

1 MR. GAVILONDO: And then I have also  
2 previously given to the court reporter a copy of  
3 Mr. Lawrence J. Reilly's testimony dated September  
4 1st, and Mr. Reilly's rebuttal testimony dated  
5 September 26th, and those have been treated as if  
6 given on the record.

7 Exhibit 4, marked for identification, is  
8 Mr. Reilly's exhibit to his testimony LJR-1.

9 JUDGE STOCKHOLM: Okay. Just for the  
10 record, the documents described by counsel should  
11 be marked for identification as exhibits 2, 3 and  
12 4.

13 (Exhibits 2, 3 and 4 marked for  
14 identification.)

15 JUDGE STOCKHOLM: With regard to the Abrams'  
16 testimony, the reporter has been provided a copy of  
17 that testimony without confidential information in  
18 it; is that correct?

19 MR. GAVILONDO: That is correct.

20 JUDGE STOCKHOLM: With regard to the  
21 Nadeau--let me stick with Abrams for a second. Did  
22 Mr. Abrams have rebuttal testimony or only direct?

23 MR. GAVILONDO: Only direct testimony.

24 JUDGE STOCKHOLM: Same question with regard

1 to Nadeau-Dowd.

2 MR. GAVILONDO: Nadeau-Dowd do have rebuttal  
3 testimony.

4 JUDGE STOCKHOLM: That was provided as well  
5 to be copied into the record?

6 MR. GAVILONDO: Yes.

7 JUDGE STOCKHOLM: Is there any confidential  
8 information in the Nadeau-Dowd testimony or exhibits?

9 MR. GAVILONDO: No, Your Honor.

10 JUDGE STOCKHOLM: Finally, with regard to  
11 Mr. Reilly, is there confidential information in Mr.  
12 Reilly's testimony or rebuttal testimony?

13 MR. GAVILONDO: No, sir.

14 JUDGE STOCKHOLM: Okay. Then Mr. Reilly is  
15 up, I assume.

16 MR. GAVILONDO: Yes. I would like to call  
17 Mr. Lawrence J. Reilly.

18 Mr. Reilly, would you state and spell your  
19 name for the record.

20 THE WITNESS: My full is name is Lawrence J.  
21 Reilly, R-e-i-l-l-y.

22 LAWRENCE J. REILLY, after first having been  
23 duly sworn, was examined and testified as follows:

24

1 MR. GAVILONDO: Your Honor, begging the  
2 indulgence of the Tribunal, can we go off the  
3 record just for a moment.

4 JUDGE STOCKHOLM: Certainly. Off the  
5 record.

6 (Discussion held off the record.)

7 JUDGE STOCKHOLM: Back on the record.

8 DIRECT EXAMINATION

9 BY MR. GAVILONDO:

10 Q. Good morning, Mr. Reilly.

11 A. Good morning.

12 Q. Mr. Reilly, before you is a document that  
13 consists of 26 pages dated September 1, 2006, and I  
14 would ask that you identify that for the  
15 record.

16 A. That document is my responsive testimony that  
17 was submitted to the Commission in this docket.

18 Q. Was that testimony prepared by you or under  
19 your supervision?

20 A. Yes, it was.

21 Q. Do have any changes or corrections to that  
22 testimony today?

23 A. Yes, I do. I have four very minor corrections  
24 I would like to note in that testimony.



1 JUDGE STOCKHOLM: Please proceed.

2 THE WITNESS: On page six.

3 JUDGE STOCKHOLM: Which testimony?

4 THE WITNESS: This is my September 1st  
5 testimony.

6 JUDGE STOCKHOLM: Thank you.

7 THE WITNESS: On page six of that, in line  
8 13, there is a reference to the merger rate plan  
9 having been submitted to the Commission on October  
10 11, 2001. I would like to amend that sentence to  
11 also reflect that a revised merger rate plan was also  
12 submitted to the Commission on October 16th. That's  
13 the first correction.

14 The second correction is on the next page.

15 MR. MAGER: Could you just maybe clarify  
16 exactly what words are being used so we all have the  
17 same understanding.

18 THE WITNESS: Yes. Specifically, I would  
19 like to insert on line 14, after 2001, I am sorry,  
20 after--I think it's probably easier, Your Honor, if I  
21 insert a new sentence on line 17 of that paragraph.

22 JUDGE STOCKHOLM: That's fine.

23 THE WITNESS: That just reads, on October  
24 16, 2001, a revised Joint Proposal was submitted to

1 the Commission.

2 MR. GAVILONDO: Your Honor, in as much as we  
3 are in the nature of clarification at this point, may  
4 I just mention--can I try to correct the correction?

5 JUDGE STOCKHOLM: You may, sure.

6 MR. GAVILONDO: Simply that the date of the  
7 revised Joint Proposal was November 6, 2001, not  
8 October 16th.

9 JUDGE STOCKHOLM: Is the copy of this  
10 testimony that you have given or will give, I am not  
11 sure which, to the reporter, be or will be corrected?

12 MR. GAVILONDO: It will be corrected, Your  
13 Honor.

14 JUDGE STOCKHOLM: Thank you. Please  
15 proceed.

16 THE WITNESS: I think at this point we have  
17 established that the perfect is the enemy of the  
18 good.

19 One other correction, on the next page, this  
20 was the substantive change that was made by that  
21 revised submission. On line nine the reference to  
22 159.8 million should read 151.9 million.

23 MS. ASSAF: This is an excerpt of staff's  
24 statement in support.

1 THE WITNESS: That is correct. My  
2 understanding is that that statement in support was  
3 amended on the record at the hearing in this case.  
4 We copied this from the original submission.

5 The third and fourth changes are the same.  
6 And they are on page 24 and 25 of this document, and  
7 on line six of page 24 I refer to Mr. Richer. That's  
8 incorrect. That should be a reference to Mr. Nadeau  
9 and Mr. Dowd.

10 And similarly, the last correction is on  
11 page 25 in line four, the reference to Mr. Richer  
12 again. That should be Mr. Dowd and Mr. Nadeau.

13 Q. Thank you, Mr. Reilly. With those changes and  
14 corrections, do you adopt this testimony as your own  
15 as if given today on the record?

16 A. Yes, I do.

17 Q. Thank you. Turning to an exhibit that has been  
18 premarked as Exhibit 4 in this proceeding for  
19 identification purposes, formerly identified as  
20 LJR-1 and--I am sorry, Your Honor.

21 A. I have a copy of that.

22 Q. Thank you, Mr. Reilly. Mr. Reilly, could you  
23 describe that exhibit for the record.

24 A. That document consists of a cover letter and a

1 multi-page document submitted by the staff in  
2 connection with the Joint Proposal that was the  
3 basis for the merger rate plan submitted in support  
4 of the settlement to the Commission in the 2001  
5 hearings.

6 Q. That exhibit has been marked for identification  
7 as exhibit 4 in this proceeding. Mr. Reilly, I  
8 would like to call your attention to a seven-page  
9 document dated September 26, 2006, and ask if you  
10 can identify that for the record.

11 A. Yes. That document is the rebuttal testimony  
12 that I submitted in this proceeding.

13 Q. Was that rebuttal testimony prepared by you or  
14 under your supervision?

15 A. Yes, it was.

16 Q. Do you adopt that testimony as your own in the  
17 proceeding?

18 A. Yes, I do.

19 MR. GAVILONDO: Thank you.

20 JUDGE STOCKHOLM: Do you have any  
21 corrections to that testimony?

22 THE WITNESS: No, I do not.

23 MR. GAVILONDO: Your Honor, with that, we  
24 have no further questions on direct at this time and

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I tender the witness for cross-examination.

(The following is the prefiled testimony of  
Lawrence J. Reilly:)

1           **RESPONSIVE TESTIMONY OF LAWRENCE J. REILLY**

2

3           **Introduction**

4   Q:   Please state your name and business address for the record.

5   A:   My name is Lawrence J. Reilly. I am Executive Vice President and  
6       General Counsel of National Grid, and my business address is 25 Research  
7       Drive, Westborough, Massachusetts 01582.

8

9   Q:   What is your educational background?

10  A:   In 1978, I received a Bachelor of Arts degree *magna cum laude* from the  
11       State University of New York at Albany. In 1982, I received the degree of  
12       Master in City and Regional Planning from the John F. Kennedy School of  
13       Government at Harvard University where I specialized in Energy and  
14       Environmental Policy. Also in 1982, I received a Juris Doctor degree *cum*  
15       *laude* from Boston University School of Law.

16

17  Q:   Please summarize your professional experience.

18  A:   I have been with National Grid and its predecessor company (New  
19       England Electric System) in a variety of professional positions over the  
20       past 24 years. I joined the Company as an Attorney in the corporate legal  
21       department in 1982. In that capacity I provided legal advice to system

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LAWRENCE J. REILLY

1 companies in the areas of finance and securities law as well as  
2 environmental licensing and permitting. In 1987, I became legal counsel  
3 to the Company's Rhode Island subsidiary. In that capacity my  
4 responsibilities included advising the Company on a variety of regulatory  
5 and rate matters as well as environmental licensing and permitting. In  
6 July 1990, I became Director of Rates with responsibility for wholesale  
7 and retail rate matters for all system companies. In 1993, I was elected  
8 Vice President and assumed additional responsibility for retail revenue  
9 requirements. Effective June 1, 1996, I was elected President of the  
10 Company's Massachusetts distribution company. I became President of  
11 our Rhode Island and New Hampshire distribution companies in January  
12 1997, and October 1997, respectively. As President of our New England  
13 distribution companies, my responsibilities included transmission and  
14 distribution system operations, customer service, and business service  
15 functions. Effective January 1, 2001, I became Senior Vice President and  
16 General Counsel for our US Holding Company; I was elected Executive  
17 Vice President in September 2005. In my current capacity, I have overall  
18 responsibility for U.S. legal matters affecting the Company. I am also  
19 responsible for Regulatory Strategy and Services, Corporate  
20 Communications, Federal Affairs, and Corporate Security. I also serve as

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LAWRENCE J. REILLY

1           our Chief Compliance Officer in the US.

2

3    Q:    Have you previously testified before the Commission?

4    A:    Yes, in 2001, I testified in support of the Merger Rate Plan that was  
5           approved in Case No. 01-M-0075, *Niagara Mohawk Power Corporation –*  
6           *Merger Rate Plan*, Opinion No. 01-6 (issued December 3, 2001).

7

8    Q:    Please describe your involvement in the negotiation of the Merger Rate  
9           Plan currently in effect for the Company.

10   A:    I led the team that negotiated on behalf of National Grid and Niagara  
11          Mohawk Power Corporation (the “Company”) with the Department of  
12          Public Service Staff (“Staff”) and numerous other parties the terms of the  
13          Merger Rate Plan.

14

15   Q:    What is the purpose of your testimony in this proceeding?

16   A:    My testimony responds to arguments made in Staff testimony proposing  
17          adjustments to the deferrals proposed by Niagara Mohawk pursuant to the  
18          terms of the Merger Rate Plan. Specifically, I will respond to arguments  
19          in which Staff’s adjustments appear to be inconsistent with the terms and  
20          purpose of the Merger Rate Plan. First, I will introduce the other



1 witnesses who will be responding to the specific adjustments proposed by  
2 Staff.

3 **Other Company Witnesses**

4 Q: What other witnesses are submitting responsive testimony on behalf of the  
5 Company?

6 A: The following witnesses are providing testimony on behalf of the  
7 Company:

8 Mr. James M. Molloy and Mr. William R. Richer testify with  
9 regard to various adjustments proposed by Staff, as well as Staff's  
10 proposed recommendations for audit procedures and Staff's proposal for a  
11 write-off of goodwill.

12 Mr. James J. Bonner Jr. and Mr. Scott D. Leuthauser testify to  
13 describe and support the Company's current and forecast deferral balances  
14 for Standby Service Lost Revenue and Disputed Station Service Revenue,  
15 and to respond to arguments made by Staff purporting to show that the  
16 Company should not be permitted to recover these deferral balances.

17 Mr. Bonner and Mr. Lee A. Klosowski testify regarding the  
18 Customer Service Backout Credits deferral and the Economic  
19 Development Fund deferral. Messrs. Bonner and Klosowski explain why  
20 Staff's proposed adjustment to the Customer Service Backout Credits

1            deferral should be rejected, and explain that the Company accepts Staff's  
2            proposed adjustment regarding the Economic Development Fund deferral.

3            Mr. Richer, Mr. Steven W. Tasker, and Mr. Molloy testify in  
4            response to Staff's proposed adjustments to the Company's deferred  
5            pension expense and other post-employment benefit ("OPEB") expense.

6            Mr. Clement E. Nadeau and Mr. William F. Dowd testify to refute  
7            Staff's assertion that the Company's deferrals for increased pension and  
8            OPEB expense should be offset by alleged cost savings.

9            Mr. Michael J. Kelleher, Mr. Tasker, and Mr. James J. Fletcher  
10           testify with regard to Staff's proposed adjustments to the Company's  
11           deferred generation stranded costs, the treatment of nuclear-related  
12           Statements of Financial Accounting Standards ("SFAS") 109 costs, and  
13           Staff's proposed adjustments with respect to Loss on Sale of Buildings,  
14           Site Investigation and Remediation ("SIR") program deferrals, and  
15           Carrying Charges on 2006-2007 non-pension and OPEB balances.

16           Mr. Leuthauser testifies to rebut Staff's proposed adjustments to  
17           the deferral associated with the Company's efforts related to  
18           implementation of the new elevated voltage testing and facilities  
19           inspection programs mandated by the Commission.

20           Mr. Patrick M. Pensabene testifies to explain why the proposed

1 adjustments offered by Staff to the deferral associated with the Company's  
2 Major Storm Restoration Costs should be rejected.

3 Mr. Joseph G. Sauvage, of Lehman Brothers Holdings Inc.,  
4 testifies in response to Staff's claim that the Company should write off the  
5 goodwill balance currently carried on its books.

6 Mr. Alan Abrams, of Towers Perrin, testifies to explain certain  
7 benchmarking analyses upon which the Company relied in connection  
8 with the negotiation of changes to pension and OPEB benefits during the  
9 Company's 2004 labor negotiations.

10

11 **The Merger Rate Plan**

12 Q: Please describe the general structure of the Merger Rate Plan.

13 A: The Merger Rate Plan was submitted to the Commission on October 11,  
14 2001, as part of a Joint Proposal supported by the Company, Staff, and  
15 numerous other parties to resolve in a comprehensive, integrated, and  
16 detailed manner the issues raised by the merger of the Company and  
17 National Grid, including issues relating to the Company's rates. The Joint  
18 Proposal and the Merger Rate Plan were the product of extensive  
19 negotiations that involved the substantial commitment of energy, time, and  
20 resources by all Participants. Throughout the testimony of the Company's

On November 6, 2001,  
The Joint the Company  
submitted a  
revised Joint  
Proposal.

1 witnesses, "Merger Rate Plan," "Rate Plan," "Merger Joint Proposal," and  
 2 "Joint Proposal" are all used to refer to the plan approved by the  
 3 Commission on December 3, 2001 in Case 01-M-0075.

4 While the Merger Rate Plan involves numerous interdependent  
 5 provisions addressing both electric and gas service, its principal provisions  
 6 affecting electric service, as described by Staff in its Statement of Support  
 7 for the Joint Proposal, were as follows:

8 The Joint Proposal provides cumulative electricity delivery  
 9 rate decreases of ~~\$159.8~~ <sup>\$157.9</sup> million in the first year, followed  
 10 by a freeze on those electric delivery rates [subject to  
 11 specified adjustments] through December 31, 2011. It also  
 12 includes a write off of approximately \$851 million of  
 13 nuclear stranded costs. The Joint Proposal imputes synergy  
 14 savings expected to be produced by the merger, establishes  
 15 an earnings sharing mechanism, provides for the possibility  
 16 of a rate reset (reduction only) and ensures that a portion of  
 17 any savings from subsequent mergers inure to ratepayer's  
 18 benefit. In addition, the Joint Proposal extends the service  
 19 reliability performance standards, through a Service  
 20 Quality Assurance Program, enhances the customer service  
 21 protections contained in the Power Choice Order. . . . It also  
 22 includes a Market Match Program, customer service  
 23 backout credit, Energy Service Company (ESCO)  
 24 Satisfaction Survey, and the coordination of marketer  
 25 registration and customer transfer requirements in Niagara  
 26 Mohawk and National Grid Service territories to facilitate  
 27 the development of the competitive market.  
 28

29 (Staff Statement of Support at 1-2 (footnotes omitted). For the  
 30 Commission's convenience, Staff's Statement of Support is provided as

1 Exhibit \_\_\_ (LJR-1.) As this description makes clear, the primary  
2 bargain reflected in the Merger Rate Plan incorporated an immediate  
3 reduction of the Company's electric delivery rates, followed by an  
4 approximate ten-year freeze in those rates, subject to adjustment through  
5 mechanisms reflected in the Rate Plan.

6  
7 Q: What were the principal mechanisms in the Rate Plan that allowed for  
8 adjustments in the Company's electric delivery rates?

9 A: Aside from separate reconciling charges, as the Commission described in  
10 its December 27, 2005 Order in this proceeding, the Merger Rate Plan  
11 provides for the reset of the variable component of competitive transition  
12 charges ("CTCs") every two years during the rate freeze period. In  
13 addition, the Rate Plan allows for an adjustment in the event of a  
14 reclassification of costs, and provides for a Rate Re-opener in the year  
15 beginning January 1, 2007 in the event that Niagara Mohawk's cumulative  
16 earnings through the end of 2005 exceeded an 11.75 percent return on  
17 equity. These latter adjustments have not occurred, because the Company  
18 has not experienced a reclassification of costs and because its cumulative  
19 earnings under the Rate Plan have equaled a return on equity of only 8.69  
20 percent. This re-opener will be revisited each year through the balance of

1 the Rate Plan period, or until the re-opener is actually triggered.

2 In addition, the Merger Rate Plan incorporates about twenty  
3 deferral mechanisms under which the Company is permitted to defer or  
4 required to credit certain costs, as well as the effects of certain events on  
5 its revenues, for later recovery or return in electric delivery rates.

6

7 Q: Are the deferral mechanisms an important component of the Merger Rate  
8 Plan?

9 A: Absolutely. The initial reduction in electric delivery rates and the  
10 subsequent ten-year freeze in those rates presented significant risks for  
11 both the Company and customers, that, unless appropriately mitigated,  
12 could threaten the Company's long-term financial integrity, its ability to  
13 provide reliable, high-quality service to its customers, and its ability to  
14 make and support the infrastructure investments required to maintain  
15 reliable service and facilitate the operation of a robust, competitive  
16 electricity commodity market. A long-term rate freeze also could result in  
17 rates that turned out to be either much too high or much too low, relative  
18 to the Company's costs. The deferral mechanisms provided in the Merger  
19 Rate Plan are one of the principal vehicles through which these risks are  
20 mitigated.

1

2 Q: Were the Staff and other parties aware of the importance of the deferral  
3 mechanisms to the overall bargain reflected in the Merger Rate Plan and  
4 Joint Proposal?

5 A: Yes. The participants negotiated extensively over the package of deferral  
6 mechanisms that was included in the Merger Rate Plan. It was recognized  
7 and understood that the fixed electricity delivery rates were subject to  
8 adjustment under various provisions of the Merger Rate Plan including,  
9 but not limited to, the deferral mechanisms. Staff explicitly alluded to the  
10 possibility of such adjustments in its Statement of Support for the Joint  
11 Proposal:

12 The lower delivery rates are locked in for the entire  
13 duration of the Rate Plan, but for several provisions that  
14 could lead to rate adjustments in the form of surcharges,  
15 surcredits or base delivery rate changes. These provisions,  
16 which are discussed in more detail below, include: (1) the  
17 transmission revenue adjustment clause (Section 1.2.3.1);  
18 (2) the System Benefits Charge (Section 1.2.3.2); (3)  
19 adjustments for deferrals (Section 1.2.3.4); (4)  
20 reclassification of costs (Section 1.2.3.5); (5) rate re-  
21 openers (reductions to rates only) (Section 1.2.3.6); and (6)  
22 adjustments in the event of poor service quality (Section  
23 1.2.3.7).

24  
25 (Exh. \_\_\_ (LJR-1) at 6-7.) Staff also noted the specific deferral  
26 mechanisms included in the Merger Rate Plan and supported the  
27 reasonableness of the package of deferral mechanisms:

1                   The Joint Proposal contains a number of deferrable  
2 items, which are set forth in Sections 1.2.4.1 through  
3 1.2.4.20 of the Joint Proposal. On the surface, this number  
4 of potentially deferrable items may appear to over protect  
5 the company with too many protections or to create the  
6 possibility that ratepayers may be subject to future hidden  
7 rate increases. However, a closer look at the specific  
8 deferral clauses indicates otherwise.  
9

10           (Exh. \_\_\_ (LJR-1) at 10-11 (footnote omitted).)

11           Moreover, the Staff recognized that the deferrals operated for the  
12 benefit of customers, as well as the Company. It stated that six of the  
13 deferrals (the existing balance, service quality penalties, excess earnings  
14 sharing, new services and royalties, follow-on merger credits, and credits  
15 for the delay in the effective date) benefited only customers. Another six  
16 of the deferrals (tax and accounting changes, legislative and regulatory  
17 changes, site investigation and remediation costs, the economic  
18 development fund, stranded cost mitigation, and pension and OPEB  
19 expense) were symmetric. Finally, the Staff noted that eight deferrals (the  
20 renewables cap, the customer outreach incremental costs, investments in  
21 years seven through ten of the rate plan, loss of revenue from changes to  
22 rules 12, 44, and 52, extraordinary inflation, extraordinary storm costs,  
23 and customer service backout credits) would only add amounts to the  
24 deferral account. Nevertheless, the Staff recognized that the deferrals  
25 were appropriate and reasonable, concluding that:



1                   While these difficult-to-project costs could have been built  
2                   into base rates, such an approach would have resulted in a  
3                   lower rate decrease. By using the deferral approach, neither  
4                   customers nor the company are penalized by overly  
5                   optimistic/pessimistic forecasts.  
6

7    Q:    Has the Merger Rate Plan operated as intended?

8    A:    Yes. The Company has met its commitments under the Rate Plan to  
9           reduce and stabilize delivery rates. It has undertaken to implement the  
10           programs to produce the synergy savings that were reflected in the  
11           forecasts in the Rate Plans, and it has improved the financial integrity of  
12           the Company. At the same time, we have implemented the Commission's  
13           policies for more open and competitive markets and for a more robust  
14           transmission network. The service quality standards have generally been  
15           met; where they have not, we have developed detailed action plans to  
16           improve performance and achieve them.

17                   The deferral account was instrumental in achieving reasonable  
18           financial performance. It has allowed for the deferral of events that were  
19           unanticipated at the time that the Joint Proposal was approved, crediting to  
20           customers changes that were beneficial and deferring the consequences of  
21           those that imposed additional costs or obligations on the Company. The  
22           deferral account generally has a \$100 million threshold, before a rate  
23           change is triggered. This threshold was not reached in the first two years

1 of the Rate Plan and thus delivery rates have remained stable over the first  
2 four years of the Plan. At the time of the Second CTC Reset, the trigger,  
3 which is based on the deferral balance as of June 1, 2005, was reached,  
4 leading to the adjustment in the second CTC Reset filing. The Company,  
5 working with the Staff, developed an alternative rate proposal that  
6 mitigated the effects of the implementation of rate adjustments associated  
7 with the deferral account, leading to the approval by the Commission of  
8 the two rate adjustments of \$100 million each in this case. Thus, despite  
9 the unanticipated changes that led to the deferrals, we have been able to  
10 maintain relatively stable delivery rates through the first six years of the  
11 Rate Plan. At the same time, the Company has been able to maintain  
12 relatively stable earnings that were critical to returning Niagara Mohawk  
13 to financial health. As indicated earlier, during the five years since the  
14 Rate Plan was implemented, Niagara Mohawk's cumulative return on  
15 equity calculated under the Rate Plan was 8.69 percent -- below the return  
16 used in the Rate Plan, but significantly better than the financial  
17 performance of Niagara Mohawk as a stand alone company. The return  
18 has contributed to the increase in Niagara Mohawk's bond ratings by two  
19 notches from BBB to A by Standard and Poors and from Baa3 to Baa1 by  
20 Moody's, and provided the financial resources necessary for Niagara

1 Mohawk to increase its investment in infrastructure substantially over  
2 historic levels and over the levels in financial forecasts underlying the  
3 Merger Rate Plan.

4

5 Q: Has the deferral account operated as intended?

6 A: Yes. During the period since the effective date of the Rate Plan, the  
7 deferrals have operated both ways, and have reflected changes that were  
8 not anticipated at the time of the Joint Proposal. Consistent with the  
9 Staff's comments in support of the Rate Plan, the first six of the deferrals  
10 have operated to reduce the deferral balance: The existing deferral  
11 balance has been credited to customers; service quality penalties have  
12 been credited to the customers' account; no excess earnings have occurred  
13 and therefore no sharing has happened; a small amount has been credited  
14 for royalties; follow-on merger credits will occur, because we have closed  
15 the purchase of Rhode Island natural gas operations from Southern Union  
16 and we have proposed a credit if the KeySpan transaction is approved; and  
17 we have provided a credit for the delay in the closing of the Niagara  
18 Mohawk transaction. The symmetrical deferrals have also operated as  
19 intended: tax and accounting changes have resulted in credits for  
20 customers associated with accelerated depreciation after September 11 and

1 the Medicare Reform Act; legislative or regulatory changes have generally  
2 added new obligations to the Company through the enhanced safety  
3 inspection program adopted by the Commission and discussed by Mr.  
4 Leuthauser and by reducing revenues associated with the treatment of  
5 standby generation by the Commission and the Federal Energy Regulatory  
6 Commission; site investigation and remediation costs have reconciled to  
7 the \$15 million annual allowance in rates, producing an increase in the  
8 deferral account; the economic development fund has also reconciled to  
9 the allowance in rates and as a result of the high commodity costs (and  
10 lower CTC charges) is now producing a reduction in the deferral account;  
11 stranded cost mitigation has also resulted in adjustments; and pensions and  
12 OPEBs were among the biggest contributors to the increase in the deferral  
13 account. Four of the next five entries—renewables; customer outreach  
14 and education; religious rates; and investments in years seven through  
15 ten—have produced little activity as the Staff projected in its comments,  
16 but the last item in the list – the loss of revenue from changes to rules 12,  
17 44 and 52 – is, together with a later settlement that amended the joint  
18 proposal, involved in the station service deferral that is now at issue in the  
19 case. Only two of the final three clauses referenced by the Staff have been  
20 triggered in the four years since the merger. Deferrals have been booked

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1 for extraordinary storms with incremental costs above the specified  
2 deductibles in the rate plan and for backout credits. No deferral has  
3 occurred for extraordinary inflation.

4 In short, the deferral mechanism has operated both ways to limit  
5 the agreed upon risks for both the customers and the Company, as  
6 intended in the Merger Rate Plan.

7

8 Q: Against this backdrop, do you have any concerns with the approach that  
9 Staff has taken to recommending adjustments to the deferrals proposed by  
10 the Company?

11 A: Yes, I do. The Company endeavored in its filing to implement the deferral  
12 mechanisms of the Merger Rate Plan accurately and faithfully. We  
13 acknowledge and accept the responsibility and right of Staff and other  
14 parties to review the Company's proposed adjustments and the underlying  
15 calculations. In some areas, Staff has pointed out errors or omissions in  
16 our calculations, which is perfectly appropriate. As explained in the  
17 testimony of other Company witnesses, the Company accepts many  
18 adjustments proposed in Staff's testimony, where those adjustments serve  
19 the appropriate purpose of ensuring that the deferrals accurately and  
20 correctly implement the agreed upon provisions of the Merger Rate Plan.

1                   On the other hand, other adjustments proposed by Staff are not  
2                   directed to implementing the terms of the Merger Rate Plan, but amount  
3                   instead to attempts to modify the Rate Plan agreed upon by the parties and  
4                   approved by the Commission. Despite the clear recognition of the risks  
5                   and rewards of the deferral account when the Joint Proposal was reached,  
6                   Staff in its testimony now seems to believe that there is something wrong  
7                   with the deal today, contending at page 17 of its testimony that: "It is safe  
8                   to say that the parties to the Merger Joint Proposal never anticipated  
9                   anything of this magnitude." As a result, Staff is proposing disallowances  
10                  to the deferral account that are not consistent with the agreement reached  
11                  among the parties and approved by the Commission. These efforts to  
12                  modify the comprehensive, integrated bargain embodied in the Joint  
13                  Proposal are, in my judgment, inappropriate. Moreover, they represent an  
14                  ill-advised approach to public policy and the protection of the interests of  
15                  consumers that is the Commission's ultimate responsibility.

16

17    Q:    Before getting into specific examples that give rise to your concern, could  
18           you explain why you believe that adjustments that would prevent the  
19           operation of deferral mechanisms incorporated in the Merger Rate Plan are  
20           inappropriate and ill-advised?

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1 A: As I explained, and as Staff acknowledged at the time, the Merger Rate  
2 Plan was the result of extensive negotiations that produced a balanced,  
3 integrated package of provisions. That package was not ideal from the  
4 standpoint of any party, including the Company, but it was at least  
5 minimally acceptable to all. Moreover, as Staff also acknowledged at the  
6 time, the Merger Rate Plan overall was in the best interests of customers,  
7 and included numerous provisions to ensure that customers' interests  
8 would remain well-served throughout the period covered by the Rate Plan.  
9 The Staff also acknowledged that the deferral mechanisms themselves  
10 represented a reasonable balance of interests of consumers and the  
11 Company. It would be fundamentally unfair for the Commission now to  
12 prevent the Merger Rate Plan, including its deferral mechanisms, from  
13 operating in accordance with the terms of the approved Joint Proposal, as  
14 Staff unfortunately urges in many aspects of its testimony. Moreover, if  
15 the Commission were to accept Staff's position, regulated entities and  
16 other interested parties would be reluctant to enter into settlement  
17 proposals that provide rate stability and other long-term benefits to  
18 consumers and the public in general. That, in turn, could stifle the  
19 willingness of investors to support the necessary investment in electricity  
20 delivery infrastructure that the State critically needs to maintain reliable

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1 service and to allow markets to function competitively.

2

3 Q: Can you provide an example of a Staff adjustment that would prevent  
4 deferral mechanisms from operating in accordance with the Merger Rate  
5 Plan?

6 A: Yes. As explained in greater detail in the testimony of Mr. Leuthauser and  
7 Mr. Bonner, the Merger Rate Plan specifically authorized the deferral of  
8 effects (above a certain threshold) on the Company's loss of revenues  
9 associated with its station service rate and other costs or revenues  
10 associated with legal or regulatory changes. Relying on this provision (as  
11 well as specific provisions described in their testimony), the Company  
12 proposed to defer the effects on its electric delivery revenues of orders by  
13 this Commission and later by the Federal Energy Regulatory Commission  
14 ("FERC") that limit or bar the Company from collecting revenues under  
15 the provisions of its Commission-approved tariff authorizing charges for  
16 its provision of standby service and station service to generator/customers.  
17 Staff proposes to eliminate these deferrals in their entirety, even though  
18 Staff does not challenge the Company's showing that a regulatory change  
19 within the scope of the deferral mechanism occurred following the  
20 negotiation and approval of the Merger Rate Plan.



1                   Staff's position rests almost entirely on its assertion that the  
2                   proposed deferral of lost standby service and station service revenues does  
3                   not satisfy generally applicable Commission policies on cost deferrals  
4                   because the Company cannot show that the revenues it would have  
5                   received in the absence of the FERC-mandated regulatory change were  
6                   reflected in a line item in the historic sales forecast that was submitted as  
7                   part of the support for base electric delivery rates in the Merger Rate Plan.

8

9    Q:    Why do you view this provision as an unwarranted departure from the  
10           Merger Rate Plan?

11   A:    There are three principal reasons why I view Staff's position on the  
12           standby service/station service revenue deferral as a troubling and  
13           inappropriate departure from the Merger Rate Plan.

14                   First, Staff seems to accept that the deferral proposed by the  
15                   Company is authorized by and consistent with the explicit terms of the  
16                   Merger Rate Plan. At least, Staff does not identify any respect in which  
17                   the proposed deferral is inconsistent with the Merger Rate Plan's deferral  
18                   provisions or is inaccurately calculated. Instead, Staff proposes an  
19                   additional requirement for the deferral that is not present in the Merger  
20                   Rate Plan and opposes the deferral because, in Staff's view, it does not

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1           satisfy this additional requirement. In this respect, Staff is plainly  
2           proposing a modification to the Merger Rate Plan that restricts the  
3           operation of provisions upon which the Company explicitly relied.

4                       Second, more broadly, Staff's position that a deferral must satisfy  
5           the general requirements of Commission policy for cost deferrals, even  
6           where the deferral is authorized by specific provisions of the Merger Rate  
7           Plan, would effectively render meaningless the process of negotiating  
8           deferral provisions in a rate settlement and submitting them for  
9           Commission approval. If general policy considerations on deferrals trump  
10          the specific provisions negotiated by the parties and accepted by the  
11          Commission to govern deferrals in a particular case, as Staff seems to  
12          argue, then it is difficult to see what purpose is served by the settlement  
13          process. Moreover, the selective application of Staff's approach to impose  
14          new requirements for deferrals that benefit the Company (or any other  
15          party, for that matter) would unfairly undermine the legitimate  
16          expectations of parties, such as the Company, that rely on the  
17          Commission's approval of the negotiated deferral mechanisms to balance  
18          concessions they made on other issues covered by the settlement.

19                       Third, Staff's position that cost or revenue deferrals must be  
20          justified by comparison to specific line items in the cost and revenue

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1 analysis submitted with the Merger Rate Plan is entirely unjustified.  
2 Those items that reconcile to specific line items are expressly stated in the  
3 Merger Rate Plan. For example, the reconciling balances for education  
4 and outreach expenses are expressly set forth in Attachment 8, p. 3 and  
5 Schedule 1; the amounts for Site Investigation and Remediation in  
6 Attachment 14; the amounts for economic development in Attachment 15;  
7 and the amounts for pensions and OPEBs in Attachment 16. Absent the  
8 express reconciliation provisions, the costs and revenues were not  
9 reconcilable. Thus, no one expected the line items making up the bulk of  
10 Company's base delivery costs and revenues over the ten-year Rate Plan  
11 period to exactly or even approximately match the line items in the  
12 historic period. In this respect, the Rate Plan rates represent a "black  
13 box." The historic analysis was presented only to show that, overall, the  
14 reduced electric delivery rates represented a reasonable starting point that  
15 could be maintained through the Rate Plan period, but only if the  
16 negotiated deferrals and other adjustment mechanisms were permitted to  
17 operate as set forth in the Merger Rate Plan.

18 The deferral mechanisms that authorize the deferral of lost station  
19 service and standby service revenues do not require a comparison with  
20 line items in the historic cost and revenue analysis and it is inappropriate

1           for Staff to add such a requirement, particularly given that requirements  
2           for line item reconciliations for other items were set forth in the Merger  
3           Rate Plan. In short, the parties understood how to implement line item  
4           reconciliations and did so when reaching the original agreement. If a  
5           provision requiring reconciliation with a specific line item is not included  
6           for revenue changes due to regulatory or legal changes – and it is not – the  
7           Commission should conclude that its omission was intentional, and that  
8           the parties intended to place the risk and reward of sales variations other  
9           than those caused by regulatory changes on the Company in a manner that  
10          is consistent with the Commission's policy.

11                 If Staff's proposal to add such a requirement to defeat the proposed  
12          deferral were accepted and applied on a consistent basis, the whole  
13          structure of the Merger Rate Plan would be compromised. The Merger  
14          Rate Plan would essentially be converted from an arrangement in which  
15          the Company has the burden of managing its overall balance of costs and  
16          revenues within the revenue stream provided by the frozen rates, subject to  
17          the agreed deferral and adjustment mechanisms, to one in which all  
18          changes in each line item affecting its costs and revenues are reviewed in  
19          every CTC reset proceeding. In essence, a long-term rate freeze would  
20          become its polar opposite: a stream of rate cases repeated throughout the

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1 Rate Plan period. This is inappropriate and inconsistent with the original  
2 agreement.

3

4 Q: Can you provide other examples of Staff adjustments that are inconsistent  
5 with the Merger Rate Plan's provisions?

6 A: Yes. As explained by ~~Mr. Richer~~ *Messrs. Dowd and Nadeau*, Staff has suggested reductions to the  
7 deferral accounts for savings in Niagara Mohawk's union contracts that  
8 have no basis in the rate plan. Moreover, as discussed in the testimony of  
9 Mr. Richer and Mr. Molloy, the interest adjustment for the NYPA  
10 Memorandum of Understanding is inconsistent with the Commission's  
11 implementing orders and the Memorandum of Agreement between the  
12 Staff and the Company dated March 31, 2003. Mr. Bonner and Mr.  
13 Klosowski also explain that the Staff proposal to disallow customer  
14 service backout credits provided to customers who no longer take service  
15 from the Company, but instead purchase their commodity directly from  
16 the NYISO, is also inconsistent with the parameters of the Joint Proposal.  
17 Mr. Tasker and Mr. Fletcher explain that the Staff has disregarded the  
18 terms of the Rate Plan to double count the credit to customers associated  
19 with the one month delay in the Joint Proposal insofar as it seeks to credit  
20 the amortization of the Nine Mile stranded cost amortization two times—

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1 first, in the one month delay provision of the Joint Proposal and, again,  
2 under the Nine Mile agreement. Mr. Molloy explains that the Staff is not  
3 treating third party billings associated with pensions and OPEBs in the  
4 manner contemplated by the Rate Plan. Finally, ~~Mr. Richer~~ <sup>Messrs. Dowd and Nadeau</sup> explains that  
5 the Staff's proposal to deny the deferral of certain management pension  
6 and OPEB costs by treating them as "costs to achieve" merger savings is  
7 inconsistent with the Rate Plan.

8 These examples, together with other examples identified in the  
9 testimony of the Company's other witnesses illustrate the unfortunate fact  
10 that many of Staff's adjustments represent inappropriate attempts  
11 unilaterally to rewrite the Joint Proposal approved by the Commission.  
12 Staff in this case has gone beyond auditing the Company's accounting for  
13 the deferrals to assure compliance with the Joint Proposal and the other  
14 Commission authorizations – a role that would be entirely appropriate and  
15 which we do not challenge. Staff is instead seeking to modify these  
16 agreements and authorizations because it no longer finds the result of the  
17 Commission approved Rate Plan to be acceptable. Staff's standard is  
18 inappropriate; the Rate Plan should be construed and implemented  
19 according to its terms and to fulfill its purpose. The Joint Proposal,  
20 including the Rate Plan, was a fair, balanced, and carefully drawn

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1           agreement; it has operated according to its terms in a fair and balanced  
2           fashion. The Commission should review the issues presented in the case  
3           in that context, and honor the commitments made by both the Company  
4           and the Staff at the outset.

5

6           Conclusion

7    Q:    Thank you. I have no further questions at this time.

1  
2  
3

**REBUTTAL TESTIMONY OF  
LAWRENCE J. REILLY**

4 **I. Introduction**

5 Q: Please state your name and business address for the record.

6 A: My name is Lawrence J. Reilly. My business address and credentials were  
7 set forth in my responsive testimony, filed in this proceeding on  
8 September 1, 2006.

9

10 Q: What is the purpose of your rebuttal testimony?

11 A: I will respond briefly to certain assertions made by Staff witnesses Denise  
12 A. Gerbsch and Robert A. Visalli (the "Staff Panel") in their Responsive  
13 Testimony filed on September 19, 2006 with respect to the interpretation  
14 of the Merger Rate Plan and the implementation of its deferral provisions  
15 in this proceeding. I note that although I am not responding to every point  
16 made in the Staff Panel testimony, my silence should not be construed as  
17 agreement with the arguments presented by the Staff Panel that are not  
18 addressed. I also note that, in this rebuttal testimony, I will use defined  
19 terms and acronyms with the meanings defined in my responsive  
20 testimony.

21



1    **II.    Response to Staff Assertions Concerning the Merger Rate Plan**

2    Q:    Do you have any comments on the Staff Panel's interpretation of the  
3            Merger Rate Plan?

4    A:    Yes. In its testimony, the Staff Panel describes the Merger Rate Plan in a  
5            way that is consistent with the Company's view and my previous  
6            testimony. On page 66 of its responsive testimony (lines 6-18), the Staff  
7            Panel states:

8                    The Merger Joint Proposal, like most joint proposals, is an  
9                    intricately constructed, delicately balanced settlement.  
10                   There are numerous gives and takes in these settlements,  
11                   and individual components and terms may not seem all that  
12                   fair when evaluated individually. However, when taken as  
13                   a whole, the individually perceived 'unfair' terms result in  
14                   a fairly balanced overall joint proposal. Indeed, that is why  
15                   Clause 3.3, which expressly conditions the Merger Joint  
16                   Proposal upon Commission acceptance of all provisions  
17                   without change or condition, was included.

18           I find nothing to quarrel with in this statement, which is entirely consistent  
19           with my own descriptions of the Merger Joint Proposal in my responsive  
20           testimony (see page 6, lines 13-20, and page 18, lines 1-14). However,  
21           many of the positions that the Staff Panel takes with respect to particular  
22           deferrals at issue in this proceeding – which are addressed by the other  
23           witnesses presenting responsive and rebuttal testimony on behalf of  
24           Niagara Mohawk – appear to be inconsistent with its view of the Merger  
25           Rate Plan, as expressed in the passage I quoted above. That is, many of

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1 the adjustments proposed by Staff are based on Staff's view that the  
2 operation of the particular deferral mechanism, as agreed upon among the  
3 parties and approved by the Commission, produces a result that is unfair in  
4 their eyes. In proposing these adjustments, the Staff Panel loses sight of  
5 the integrated, balanced nature of the Joint Proposal.

6

7 Q: What implications does the integrated, balanced nature of the Merger Joint  
8 Proposal have for this proceeding?

9 A: I understand the purpose of this proceeding to be to ensure that the  
10 Company's entries in the deferral account correctly and accurately  
11 implement the provisions of the Merger Joint Proposal. In this way, the  
12 "intricately constructed, delicately balanced" structure of the Merger Joint  
13 Proposal will be preserved. As I said in my earlier testimony, it is entirely  
14 appropriate for Staff and other parties to review the accuracy of the  
15 Company's deferrals and their consistency with the provisions of the  
16 Merger Joint Proposal for this purpose.

17 However, it is inappropriate for any party to use this proceeding to  
18 attempt to modify the Merger Joint Proposal and, in doing so, upset the  
19 balance of "gives and takes" that Staff agrees produced a "fairly balanced  
20 overall joint proposal." Notwithstanding its recognition that the Merger  
21 Joint Proposal is a fair and balanced package, the Staff Panel's responsive

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1 testimony appears to confirm my earlier impression that many of Staff's  
2 adjustments represent an unjustified attempt to revise the Merger Joint  
3 Proposal, based on Staff's view that individual deferral provisions that  
4 have operated in the Company's favor are now "unfair."

5

6 Q: Can you provide an example?

7 A: Yes. In my previous testimony, I pointed to Staff's proposed disallowance  
8 of any deferral for station service revenues lost due to the decisions of the  
9 Commission, the Federal Energy Regulatory Commission, and the courts  
10 as an unwarranted departure from the Merger Joint Proposal and, in  
11 particular, a refusal to permit Section 1.2.4.3 of the Merger Joint Proposal,  
12 which allows for the deferral of cost and revenue impacts of legal and  
13 regulatory changes, to operate as negotiated and accepted by the  
14 Commission. The Staff Panel's discussion of this issue in its responsive  
15 testimony only serves to confirm the accuracy of this description.

16

17 Q: Why is that?

18 A: As Mr. Bonner and Mr. Leuthauser explain in their responsive and rebuttal  
19 testimony, the Staff Panel does not base its opposition to this deferral on a  
20 claim that the Company failed to apply the language of Section 1.2.4.3 and  
21 other relevant provisions of the Merger Joint Proposal and other

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1 settlements. Instead, the Staff Panel chastises the Company for basing its  
2 deferral on what the language of Section 1.2.4.3 clearly requires: a  
3 comparison of the revenues the Company can charge in light of the  
4 regulatory change to those it could have charged if the regulatory change  
5 had not occurred. I view the Staff Panel's continued opposition to a  
6 deferral that is authorized by and consistent with the Merger Joint  
7 Proposal as tantamount to an attempt to modify the "delicately balanced"  
8 settlement.

9 This impression is also confirmed by the Staff Panel's insistence  
10 (page 23, line 4 – page 24, line 2) that if the Commission finds the deferral  
11 of lost station service revenues to be consistent with the Merger Joint  
12 Proposal – as we believe it must – the Commission should exercise the  
13 authority reserved in Section 3.5 of the Joint Proposal to disallow the  
14 deferral on the ground that Niagara Mohawk's rates are in excess of just  
15 and reasonable rates. This demonstrates that the Staff Panel's position  
16 rests on its belief that applying Section 1.2.4.3 in accordance with its  
17 language leads to an unreasonable outcome on this deferral issue, not on  
18 any failure by the Company to calculate the deferral in accordance with  
19 the provision's requirements. Even if this were true – which it is not – it  
20 represents an abrupt departure from Staff's view, expressed on page 66  
21 (lines 12-14), that the Merger Joint Proposal must be "taken as a whole"

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1 and, on that basis, is "a fairly balanced overall joint proposal." It also  
2 represents a marked shift in position from Staff's previous testimony,  
3 which never mentioned Section 3.5 as a basis for its opposition to the  
4 station service lost revenue deferrals.

5

6 Q: Do you have any other comments on Staff's reliance on Section 3.5 of the  
7 Merger Joint Proposal in its responsive testimony?

8 A: Yes. Staff's reliance on Section 3.5 is inappropriate in this proceeding  
9 and, in any event, does not support its proposed disallowance of all station  
10 service lost revenue deferrals. First, as I discussed earlier, this proceeding  
11 was established to make sure Niagara Mohawk accurately implemented  
12 the deferral provisions of the Merger Rate Plan, not to consider whether  
13 those provisions should be changed using the Commission's reserved  
14 power to reduce rates that exceed just and reasonable levels.

15 Second, even if this issue were properly before the Commission in  
16 this proceeding, the Staff Panel is proposing to misapply Section 3.5.  
17 Section 3.5 establishes as a predicate a finding that the rates established in  
18 accordance with the Merger Rate Plan "are in excess of just and  
19 reasonable rates for Niagara Mohawk's electric and gas service." The  
20 provision thus requires an evaluation of the overall level of the Company's  
21 rates, not a review of the reasonableness of any particular deferral item.

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1 Just as Staff agrees that it is the overall balance of the Merger Rate Plan's  
2 provisions that demonstrates the reasonableness of the Rate Plan, it is the  
3 end result of those provisions that determines whether the resulting rates  
4 are in excess of just and reasonable levels.

5 The Staff Panel does not even attempt to show that Niagara  
6 Mohawk's rates, including the recovery of deferred station service lost  
7 revenues and the other deferrals at issue, exceed just and reasonable rates  
8 for the electric and gas service the Company provides. In fact, I do not see  
9 how Staff could make that showing since: (a) as I mentioned in my earlier  
10 testimony, Niagara Mohawk's cumulative earnings under the Rate Plan  
11 have equaled a return on equity of only 8.69 percent; (b) should the  
12 Company's cumulative earnings rise in the future, the Rate Plan requires  
13 the Company to share earnings above the specified cap with customers;  
14 and (c) Staff has not finished its audit of the Company's earnings through  
15 December 31, 2005. Staff's opposition to the deferral of lost station  
16 service revenues or any of the other deferrals proposed in this case simply  
17 cannot form the basis for the exercise of extraordinary relief under Section  
18 3.5.

19

20 **III. Conclusion**

21 Q: Thank you. I have no further questions at this time.

1 JUDGE STOCKHOLM: Thank you very much.

2 Mr. Mager.

3 MR. MAGER: I believe staff is going to go  
4 first, Your Honor, on all cross of the company's  
5 witnesses.

6 JUDGE STOCKHOLM: Okay. Please proceed.

7 MS. ASSAF: Thank you, Your Honor.

8 CROSS EXAMINATION

9 BY MS. ASSAF:

10 Q. Good morning, Mr. Reilly.

11 A. Good morning.

12 Q. If you could turn to page three of your  
13 September 1st testimony, line ten.

14 A. Yes, I have got that.

15 Q. Mr. Reilly, you state that you lead the team  
16 that negotiated the merger Joint Proposal on behalf  
17 of the company; is that correct?

18 A. Yes.

19 Q. Could you give me, perhaps you know the number,  
20 but at least an estimate of how many negotiating  
21 sessions took place from the time the company filed  
22 its petition in March of 2001 until the merger Joint  
23 Proposal was filed in October 2001?

24 A. I don't have a precise number, but I am sure it

1 was in dozens.

2 Q. At least 20, 30? Just an order of magnitude.

3 A. I would think that's about right. At some  
4 points we were meeting more than one day a week  
5 during that period.

6 Q. Perhaps two or three.

7 A. We did take a month off there I think somewhere  
8 along the line, but there were a lot of  
9 negotiations.

10 Q. How many of the negotiating sessions did you  
11 personally attend?

12 A. Not all, but I would say the majority.

13 Q. The majority of them? Does the company still  
14 maintain the sign in sheets for the merger Joint  
15 Proposal?

16 A. I don't know.

17 Q. If you have them could you provide the sign in  
18 sheets?

19 A. We can certainly check for that.

20 MR. GAVILONDO: We can take a record request  
21 to that effect.

22 JUDGE STOCKHOLM: Fine.

23 MS. ASSAF: Thank you.

24 Q. If you could turn to page 13 of your testimony,



1 lines 13 through 17. This is in the nature of a  
2 clarification. You stated that the company's  
3 cumulative return on equity during the five years  
4 since the rate plan was implemented was  
5 8.69 percent; is that correct?

6 A. I am sorry. I just missed the page number  
7 again.

8 Q. I am sorry. Page 13, starting at line 13.

9 A. Yes. Could you read the question back.

10 Q. Sure. I was just actually quoting your  
11 testimony that you indicated that during the five  
12 years since the rate plan was implemented Niagara  
13 Mohawk's cumulative return on equity calculated  
14 under the rate plan was 8.69 percent; is that  
15 correct?

16 A. Yes.

17 Q. Just to clarify, did you mean four years?

18 A. The rate plan will be five years old next year,  
19 so, since--yes, that's probably correct, this is  
20 probably through '05.

21 Q. Four years, thank you. Is the 8.69 percent  
22 that you have listed an unaudited quantification?

23 A. I don't know the answer to that.

24 Q. So you don't know whether or not staff has

1 audited that number?

2 A. That is correct. I don't know.

3 Q. And then probably--

4 JUDGE STOCKHOLM: If I can keep you on that

5 sentence just for clarification in my own mind.

6 What is the difference between the company that has

7 an 8.69 percent cumulative return and Niagara Mohawk

8 as a stand alone company? What are the differences?

9 THE WITNESS: The notion of the stand alone

10 company was really referring to the question of what

11 might have happened if Niagara Mohawk had not been a

12 party to the merger. So, I think the--at the time of

13 the merger with National Grid Niagara Mohawk was in

14 very extreme financial distress with not a healthy

15 return and little or no earnings at all, and the

16 merger and the rate plan associated with it and the

17 large write offs that occurred as part of the merger

18 brought the company back to financial health. That's

19 really what I was trying to reference there.

20 JUDGE STOCKHOLM: But you are not talking

21 about two differently defined--other than by the

22 merger?

23 THE WITNESS: Correct.

24 JUDGE STOCKHOLM: I'm sorry. Go ahead, Ms.

1 Assaf.

2 BY MS. ASSAF:

3 Q. Mr. Reilly, could you just turn to page seven  
4 of your rebuttal testimony for a moment.

5 A. Yes, I got that.

6 Q. Line 14. Don't you indicate there that staff  
7 has not finished its audit of the company's earnings  
8 through December 31, 2005?

9 A. Yes.

10 Q. Flipping you back to your September 1st  
11 testimony, page 16, lines 11 and 12. You state  
12 there that the company has endeavored in its filing  
13 to implement the deferral mechanisms of the merger  
14 rate plan accurately and faithfully; is that  
15 correct?

16 A. Yes, it is.

17 Q. Do you happen to have a copy there of the  
18 merger Joint Proposal, or can you get one?

19 A. I have one in my case, yes. Okay. Sorry, I  
20 don't have all the parts to it, but I have the Joint  
21 Proposal.

22 Q. I am referring specifically to section 1.2.4.

23 A. I believe I have that.

24 Q. It's entitled "deferral account".

1 A. Page 15?

2 Q. Yes. Could you read the third sentence in that  
3 paragraph out loud, for the record, please.

4 A. The deferral account shall be subject to audit  
5 by the DPS staff and Niagara Mohawk shall compile  
6 and file a report with the Commission on July 1st of  
7 each year detailing activity in the deferral  
8 account.

9 Q. Do you know how many July 1st reports have been  
10 filed?

11 A. No, I do not.

12 Q. Would you take, subject to check, that no  
13 report has been filed on any July 1st since the  
14 merger rate plan began?

15 A. I don't know whether that's true or not.

16 Q. Thank you. You did not take that--I'm sorry.

17 A. I responded I don't know whether that's the  
18 case or not.

19 Q. Would you take it subject to check?

20 JUDGE STOCKHOLM: Take what subject to  
21 check, the date of the filing or the existence of  
22 the filing?

23 MS. ASSAF: The existence of July 1st  
24 filings in each of the years of the merger Joint

1 Proposal.

2 JUDGE STOCKHOLM: Let me head off a little  
3 bit here. I will take official notice that the  
4 company filed one of those reports within the last  
5 couple of days because I got a copy of it.

6 Now, beyond that, counselor, I don't have  
7 facts or documents I could bring to the record, but  
8 I do know that one was filed recently late.

9 MS. ASSAF: Your Honor, when you say you  
10 are referring to a report that wasn't exactly filed  
11 on that date but had the information you believe  
12 should be in there?

13 JUDGE STOCKHOLM: The letter represented  
14 that it was a July 1st report that was being filed  
15 late, yes. The cover letter said that.

16 BY MS. ASSAF:

17 Q. Mr. Reilly, are you familiar with that  
18 particular report or the letter?

19 A. No, I am not.

20 Q. Thank you.

21 JUDGE STOCKHOLM: Does staff have that  
22 document?

23 MS. ASSAF: We do, Your Honor.

24 Q. If you turn to your testimony on page 20, lines

1 four through seven. Can the company show how much  
2 station service revenues were reflected in a line  
3 item in an historic sales forecast that was  
4 submitted as part of the support for the case  
5 delivery rates in the merger Joint Proposal?

6 A. I don't know the answer to that. I believe  
7 Mr. Bonner would be the right person to respond to  
8 that detailed question.

9 Q. What does--when you refer to the historic sales  
10 forecast, does that forecast match and correlate to  
11 the revenue forecast that was used to establish the  
12 merger Joint Proposal base delivery rates?

13 JUDGE STOCKHOLM: Could I have that question  
14 reread.

15 (Question read by the reporter.)

16 A. That's my understanding of the staff's  
17 position, that since there is--staff's position is  
18 that sales forecast is critical for determining the  
19 deferral under this provision.

20 BY MS. ASSAF:

21 Q. When you refer to the historic sales forecast  
22 you indicated that it was submitted as part of the  
23 support for the base electric delivery rates. What  
24 other evidence of support or what other types of

1 support were submitted?

2 A. What other support was submitted for the base  
3 delivery rates that were set as part of the--

4 Q. For the sales forecast, historic sales forecast  
5 that you referred to here.

6 A. I don't know the detailed documentation that  
7 was submitted with the sales forecast. Again,  
8 Mr. Bonner may well.

9 Q. You don't know whether any information was  
10 submitted as part of any statement in support for  
11 the merger Joint Proposal that might have supported  
12 this forecast, the revenue forecast?

13 A. Could I have that question again, please.

14 JUDGE STOCKHOLM: Would you restate it,  
15 counsel.

16 BY MS. ASSAF:

17 Q. Was there any information submitted as part of  
18 any party statements in support to the merger Joint  
19 Proposal that might have supported the revenue  
20 forecast in the merger Joint Proposal? Do you know  
21 if any party added additional information in their  
22 statement in support?

23 A. I am not aware of anything in their statements  
24 of support of the merger Joint Proposal. My

1 reference here was actually support for the rate  
2 filing, rates themselves, back as part of the  
3 underlying initial cost of service data that was the  
4 foundation for the merger Joint Proposal.

5 Q. The statements in support which supported the  
6 merger rate plan, off which the basis was the  
7 original filing, was there anything in those  
8 statements in support that might have addressed  
9 those issues?

10 A. I don't know.

11 Q. Is it the company's position that the merger  
12 rate plan revenue forecast includes some unknown or  
13 unquantifiable amounts for station service revenues  
14 in each of the ten years of the merger Joint  
15 Proposal?

16 A. Mr. Bonner is the right person to respond to  
17 the company's position on that question.

18 Q. Right. If you could look at page 22, line 12  
19 of your testimony, or actually even beginning before  
20 that. You suggest in that portion of your testimony  
21 that you believe no one expected the line items  
22 making up the bulk of the base delivery costs and  
23 revenues would actually match and somehow there is a  
24 black box. Strike that.



1 Mr. Reilly, how did the station service  
2 revenues get in the 2002 through 2011 merger Joint  
3 Proposal revenue forecasts?

4 A. Again, that's--Mr. Bonner could explain the  
5 details, but as I understand the high level it's a  
6 comparison of what the revenues would have been with  
7 and without the regulatory change that occurred.

8 Q. These forecasts, the forecasts I am referring  
9 to are the 2002 through 2011 Joint Proposal  
10 forecasts filed back in 2001.

11 A. I am not familiar with the details on what's in  
12 or not in those forecasts. Again, Mr. Bonner is the  
13 right person to ask that. I thought you were asking  
14 me a question about our deferral filing.

15 JUDGE STOCKHOLM: Mr. Reilly, are you  
16 familiar with the actions that were taken by FERC or  
17 this Commission or otherwise that reduced the amount  
18 that you could charge under your tariffs for this  
19 kind of service, for station service? Are you  
20 familiar with what happened and the background, if  
21 you will.

22 THE WITNESS: In a highest level I  
23 understand it was a change in the calculation, a  
24 netting out on a 30 day I believe period which had

1 the effect of substantially undermining the  
2 company's ability to recover revenue from power  
3 stations.

4 JUDGE STOCKHOLM: From a legal perspective,  
5 do you know if this was an order of FERC, for  
6 example?

7 THE WITNESS: Yes. There were a number of  
8 orders of FERC on this and it's been appealed to the  
9 District Court in DC, Circuit Court.

10 JUDGE STOCKHOLM: Mr. Gavilondo, are there  
11 documents in this record, and I apologize, I don't  
12 have an encyclopedic memory, are there documents in  
13 this record that contain the rulings of FERC that  
14 undermine this issue?

15 MR. GAVILONDO: I don't recall, Your Honor,  
16 that there are any specific documents in the record,  
17 but I believe there are citations and references to  
18 case numbers in the record that relate to the orders  
19 that FERC issued.

20 On this issue I believe there's also  
21 reference to the fact the Court of Appeals--I  
22 believe in the staff's testimony as well as the  
23 company's testimony--the Court of Appeals is  
24 considering this on rehearing at this point. We

1 certainly can provide copies of the relevant FERC  
2 orders if your Honor would like.

3 JUDGE STOCKHOLM: I would appreciate seeing  
4 those orders, please. Go ahead, counsel.

5 BY MS. ASSAF:

6 Q. Mr. Reilly, back on page 20, lines 14 through  
7 16. You indicate that staff seems to accept the  
8 deferral proposed by the company--that the deferral  
9 proposed by the company is authorized by and  
10 consistent with the explicit terms of the merger  
11 rate plan; is that correct?

12 A. That's what I stated, yes.

13 Q. Could you show me in staff's testimony where  
14 staff accepted that proposal?

15 A. I think the staff's rebuttal testimony probably  
16 makes clear that it did not intend that result.

17 Q. Back to page 22, starting on line nine. You  
18 state that no one expected the line items making up  
19 the bulk of the company's base delivery costs and  
20 revenues over the ten year rate plan to exactly or  
21 even approximately match the line items in the  
22 historic period; is that correct? Is that what you  
23 state?

24 A. Yes. That's the sentence.

1 Q. Could you define the historic period here? Are  
2 you referring to the year end June 30, 2000?

3 A. What I meant by that sentence was that the  
4 underlying cost of service that the parties had  
5 before them, and was the foundation for the merger  
6 rate plan, included a number of items that were  
7 subject to deferral and reconciliation. It also  
8 included a large number of items, like a traditional  
9 utility rate case would, that are not reconciled on  
10 a year to year basis.

11 And what I meant by this was that the vast  
12 majority of the elements in the company's cost of  
13 service would not be reconciled, trued up, or in any  
14 way tracked in the sense of seeing how they compared  
15 over time to the estimates that were used to  
16 determine whether the merger rate plan rates were  
17 just and reasonable going forward.

18 Q. When you refer to "the historic period" you  
19 didn't have any particular time frame in mind?

20 A. What I think I meant by that was really the  
21 period--meant to match the underlying cost estimates  
22 in the cost support for the merger rate plan. In  
23 that merger rate plan we had any number of cost  
24 elements that were factored into the estimate of the

1 company's expenses going forward.

2 Diesel fuel, for example, was a part of  
3 that. We had an estimate of that and a projection  
4 of what that was going to be going forward. The  
5 fact that fuel prices are double what they were in  
6 2001 really isn't reconciled and doesn't seem to be  
7 relevant and wouldn't in a normal cost of service.  
8 That's what I meant by that. Even though we had an  
9 estimate in the underlying cost of service, we don't  
10 track that to actuals.

11 Q. Thank you. You go on to state further in that  
12 same sentence that you believe that at least in that  
13 respect the rate plan rates represent a black box;  
14 is that correct?

15 A. Yes, that's the sentence.

16 Q. Is there any mention of a black box in the  
17 merger Joint Proposal?

18 A. I don't believe so.

19 Q. In the Commission's order adopting or approving  
20 the Joint Proposal?

21 A. I don't believe so.

22 Q. In any party's statement in support?

23 A. I don't believe so.

24 Q. Thank you.

1 A. Again, my intent there was merely just to say  
2 that's not reconciled, that part of the cost of  
3 service would not be reconciled on a year to year or  
4 a periodic basis.

5 Q. When you say that no one expected the line  
6 items making up the bulk of the base costs and  
7 revenues to exactly match that period, how do you  
8 know no one expected that?

9 A. I guess I took a little license. I don't think  
10 anyone could reasonably have expected that.

11 Q. If the merger Joint Proposal was a one-year  
12 deal, could we have expected some sort of  
13 approximate matching of actuals to the forecast, do  
14 you think?

15 A. Yes, I would think so.

16 Q. And if it was a two-year deal, do you think we  
17 could still achieve some approximate matching?

18 A. I think the longer the period of time from the  
19 underlying cost of service to reality, the further  
20 out of date those estimates are going to be, the  
21 less likely those estimates will track actuals.

22 And to me and to the Commission I believe  
23 the longer that period of time becomes the less  
24 relevant the underlying cost data is, and the more

1 important the company's financial returns are in  
2 establishing whether rates are just and reasonable.

3 Q. If we could expect approximate matching at  
4 least in year one, perhaps in year two, why are you  
5 suggesting here that we have a black box for those  
6 years, or however many years we go to get too far  
7 out to have matching?

8 A. What we had in the merger rate plan was a  
9 ten-year proposal and it was agreed to. The  
10 underlying concept was to set rates for a long  
11 period of time, put the burden upon the company to  
12 manage its cost within its revenues. As part of  
13 that underlying deal we credited customers for  
14 50 percent of the estimated synergies before we  
15 established or identified and captured the first  
16 one.

17 So, the company bore the risk of actually  
18 identifying those synergies. We dropped the rates,  
19 and the company was living with its revenues like a  
20 competitive business would do, where it's not able  
21 to just raise prices as costs go up. We were forced  
22 to manage within our revenues and find efficiencies  
23 and achieve the synergy savings that were captured.

24 As part of the fundamental trade off, all

1 the parties agreed that certain items would be too  
2 risky to leave within that period. And that's where  
3 the deferral items and the reconciling items that  
4 are referred to and the--as which were a fundamental  
5 part of the merger rate plan came from.

6 And the black box is really just the core  
7 part of the cost of service, like diesel fuel is the  
8 example I used, that the company was left to take  
9 the risk on. If prices in the market or the costs  
10 should go up or down, that's the company's problem  
11 to deal with that. So, I think it has to do with  
12 the ten-year horizon we were looking at and the  
13 fundamental risk allocations as agreed to here.

14 Q. Were there forecasts in the merger Joint  
15 Proposal for each year?

16 A. I believe there were.

17 Q. I will ask the question again I think. Is  
18 there a reason there is a black box or you are  
19 considering a black box even for year one in this  
20 case?

21 A. The intent--certainly, I don't believe anyone's  
22 intent was to look at this as a one-year deal. The  
23 intent was to look at this as a ten-year rate plan.  
24 And as part of that we had a series of cost



1 projections, but they were reasonable at the time  
2 they were made. To the best of everyone's ability  
3 after negotiations and discovery, that's what they  
4 were.

5 But as with any projection, as time goes on  
6 they become less and less accurate, as would be the  
7 case in a single one year cost of service. Once  
8 time goes on, the underlying cost of service  
9 elements get higher or lower than actual costs.

10 Q. Right. I understand that as time goes on. I  
11 guess I am wondering why in this case, when there  
12 were forecasts for each of the years, why in year  
13 one of the rate plan, why there is a black box or  
14 why the company's position is there is a black box  
15 for that year and for year two, the early years?

16 A. That was the fundamental trade. There was no  
17 ability to reconcile the costs of service, whether  
18 those estimates were high or low, with the exception  
19 of the specifically enumerated deferrals or  
20 reopeners or risk reward sharing mechanisms.

21 Q. Is it your position that every one year rate  
22 agreement also operates as a black box?

23 A. It probably does. I think to the extent that  
24 rates are set and that as the company moves on,

1 without specific deferral items the individual  
2 elements of the cost of service aren't reconciled or  
3 tracked unless they are specifically required.

4 Q. I was going to say I know you're not, but I  
5 don't believe you are an accountant; is that true?

6 A. That's absolutely true.

7 Q. Do you believe that there is a difference  
8 between costs and revenues? Those are different  
9 concepts?

10 A. Yes.

11 Q. Is it the company's position that the  
12 multi-year Power Choice Settlement was also a black  
13 box as far as the station service revenues are  
14 concerned?

15 A. Again, Mr. Bonner addresses that in detail.

16 JUDGE STOCKHOLM: If you don't mind, let me  
17 see if I can paraphrase some of this conversation so  
18 I understand as well your opinion. Would it be fair  
19 to say, as you just had this conversation, that the  
20 entire deal is not a black box, it's only a black box  
21 to the extent that there are not individual items to  
22 be trued up?

23 THE WITNESS: Yes.

24 JUDGE STOCKHOLM: Is that fair?

1 THE WITNESS: Yes.

2 JUDGE STOCKHOLM: Are there provisions for  
3 revenues to be trued up?

4 THE WITNESS: Well, I believe regulatory  
5 change, such as the one we have experienced on the  
6 station service, could affect the revenues. And  
7 regulatory change is defined broadly enough in the  
8 merger rate plan Joint Proposal to cover revenues as  
9 well as costs.

10 JUDGE STOCKHOLM: Okay, but as a general  
11 matter revenues are not trued up; is that right?

12 THE WITNESS: As a general matter, I believe  
13 that's the case.

14 JUDGE STOCKHOLM: Okay. So, revenues would  
15 fall on the black box side, in your view of the--

16 THE WITNESS: In general. I think as one of  
17 the things the company consciously--one of the risks  
18 that the company consciously took was the risk for  
19 the sales forecasts, so if the economy declined that  
20 was our burden and our risk.

21 JUDGE STOCKHOLM: Okay.

22 BY MS. ASSAF:

23 Q. I might paraphrase a bit of the conversation  
24 that you just had with your Honor. Are you saying

1 that the black box means that there is no true up?

2 A. There is--the fundamental deal was that there  
3 is no true up over the ten years unless it was  
4 specifically provided for in the merger rate plan.  
5 And there were 20 odd specific cases where a true up  
6 was provided for, some of which only went to the  
7 benefit of customers, some of which went either way  
8 depending upon how the actuals were, and some of  
9 which only went to the company's favor.

10 Aside from the specifically enumerated true  
11 ups and trackers and deferrals, and reconciling  
12 clauses like the system benefit charge, the  
13 underlying cost of service in my view was not  
14 subject to any further reconciliation.

15 And the company--that was the risk that the  
16 company accepted as it went forward. And the  
17 company accepted that risk on the basis and with the  
18 understanding that the specific things that were  
19 carved out and were reconcilable and trackable and  
20 deferrable were going to be treated as such.

21 Q. Was there any cost of service underlying year  
22 one of the plan?

23 A. Again, I believe Mr. Bonner or others would be  
24 in a better position to give you detailed answers to

1 that, but my understanding is that there was cost of  
2 service prepared for the estimated costs for the  
3 whole period.

4 Q. Turn to page 22, lines three through seven.  
5 Actually, we are there, aren't we? You provide  
6 examples of those items that do reconcile specific  
7 line items; is that correct?

8 A. Yes. I don't believe this is a complete list,  
9 but these are some.

10 Q. The examples you give are outreach and  
11 education, expenses, SIR costs, economic  
12 development, costs and reviews, pensions and OPEB;  
13 am I correct?

14 A. Those are the examples listed, correct.

15 BY MS. ASSAF:

16 Q. Are there any specific amounts to reconcile to  
17 for each of these items that's in an attachment in  
18 the merger Joint Proposal?

19 A. I believe that's the case, yes.

20 Q. Are there any other attachments which provide  
21 for any other specific amounts?

22 A. Again, Mr. Bonner has I believe it's one of his  
23 exhibits a detailed document that explains for each  
24 of the deferral items the basis for those

1 calculations, so he would probably--it's better to  
2 ask him the details on that.

3 Q. If you could look at page 23, lines four  
4 through seven. You state that, in a provision  
5 requiring reconciliation a specific line item is not  
6 included for revenue changes due to regulatory or  
7 legal changes, and it is not, the Commission should  
8 conclude that its omission was intentional; is that  
9 correct?

10 A. Yes.

11 Q. Does your statement only apply to revenue  
12 changes or does it apply to any item in the merger  
13 Joint Proposal that requires reconciliation where  
14 there is no specific line item included in any  
15 attachment?

16 A. It would be both revenue and expense.

17 Q. So, anything without a line item?

18 A. That is deferral, yes.

19 Q. Do you have clause 1.2.4.16 of the merger Joint  
20 Proposal available to you?

21 A. Yes. On page 23?

22 Q. Yes. That clause allows the company to defer  
23 costs of major investments in years seven through  
24 ten; is that correct?

1 A. I believe it gives the company the right to  
2 petition the Commission for approval to defer costs.  
3 It doesn't give a right to defer any costs.

4 Q. Right. Essentially it says if it can  
5 demonstrate a proposed investment was incremental to  
6 the original forecast underlying the rates agreed to  
7 in this Joint Proposal and at any expenses or  
8 savings that go beyond such forecast; is that  
9 correct?

10 A. Yes.

11 Q. Does the merger Joint Proposal have any  
12 attachment which has a specific line item in it for  
13 this?

14 JUDGE STOCKHOLM: For what?

15 Q. The major investments in years seven through  
16 ten of the rate plan period.

17 A. I don't believe it's attached to the merger  
18 rate plan, but there is probably some underlying  
19 document somewhere that details that.

20 Q. Could you or at some point have the company  
21 provide us where you believe that information is?

22 A. Yes.

23 MR. GAVILONDO: Your Honor, if I may, I  
24 believe if we read on in that particular section it

1 says, and I am reading from I believe it's the third  
2 sentence to this. This is on page 23 of the  
3 document that Attorney Assaf was referencing and  
4 it's section 1.2.4.16.

5 The third sentence reads, "To this end,  
6 Niagara Mohawk shall, within six months of the  
7 effective date and every two years thereafter, file  
8 with the Commission a five-year capital and expense  
9 budget including therein a schedule of projects  
10 consistent with and developed from the capital  
11 expenditures forecast underpinning this Joint  
12 Proposal".

13 Now, Your Honor, I am not sure whether or  
14 not we have been making those filings or not, but  
15 nevertheless, I believe that this provision provides  
16 some basis for the measurement that was intended in  
17 this deferral provision.

18 Q. If you could just look back at the language  
19 that I was pointing to, it's that the proposed  
20 investment was incremental to the original ten-year  
21 forecast underlying rates, correct?

22 A. Right.

23 Q. So, I guess my request stands. We would like  
24 to see where you believe that specific line item is



1 for which you would then show it was incremental. I  
2 am not sure that's a sentence, but you understand  
3 what I am asking for?

4 A. I think so. You are looking for the projected  
5 transmission capital expenditure budget for the  
6 ten-year--that was included in the original ten-year  
7 rate plan; is that correct?

8 Q. That is correct.

9 A. I believe that such a document exists and it's  
10 readily available.

11 Q. Thank you.

12 JUDGE STOCKHOLM: If the company would  
13 provide that to staff.

14 MR. GAVILONDO: Yes, Your Honor.

15 JUDGE STOCKHOLM: I think the record also  
16 needs to be informed with regard to whether or not  
17 the company has filed in accordance with the  
18 language that counsel just read biannual I guess  
19 reports on their capital budgets. If you would at  
20 some appropriate time inform the record of that.

21 MR. MAGER: Your Honor, if I may, when the  
22 company provides staff with copies of requested  
23 documents could we get copies as well?

24 JUDGE STOCKHOLM: Absent some objection by

1 the company on a document by document basis,  
2 certainly.

3 MR. MAGER: Thank you.

4 JUDGE STOCKHOLM: By the way, it just  
5 occurred to me that I should make something clear  
6 which I intended at the very outset. Those of you  
7 who know me and have seen me behind the bench before  
8 know that I am prone to ask a few questions now and  
9 again.

10 Without any prejudice to you, I can  
11 sometimes ask questions that are not appropriate.  
12 And it doesn't bother me in the slightest if you  
13 object. So, I just want you to understand that you  
14 do have the right to do that. If you think that's  
15 appropriate, please, feel free.

16 But you can't object to any of the ones I  
17 have already asked. Forget that.

18 MS. ASSAF: Your Honor, could I just have  
19 about two or three minutes side bar?

20 JUDGE STOCKHOLM: You may. How much more do  
21 you think you have?

22 MS. ASSAF: Another 15, 20 minutes.

23 JUDGE STOCKHOLM: We will take about a  
24 15-minute break and we will be thinking about lunch

1 around the 1:00 hour.

2 (Recess taken.)

3 JUDGE STOCKHOLM: Back on the record. Ms.  
4 Assaf, are you ready?

5 MS. ASSAF: Yes, Your Honor.

6 BY MS. ASSAF:

7 Q. Mr. Reilly, before we took our little break we  
8 were discussing the company providing information on  
9 the major investments for years seven to ten to try  
10 to find some supporting documentation.

11 We would like to request that when you  
12 provide that information we would like you to  
13 indicate whether or not it's actually in the merger  
14 Joint Proposal or some other supporting  
15 documentation.

16 A. I understand. We will provide the  
17 documentation and where it came from.

18 Q. Assuming the information is from some source  
19 other than the merger Joint Proposal, but some other  
20 supporting documentation, can the company provide  
21 that same sort of information for every other item,  
22 such as station service?

23 JUDGE STOCKHOLM: I am not sure I understand  
24 that question. Where are you going? What are you

1 trying to accomplish, counsel?

2 MS. ASSAF: Your Honor, we are trying to  
3 understand whether or not the company has  
4 information for what underlies the various items,  
5 various different items, for example, station  
6 service number, and we are trying to understand  
7 whether or not they do have some supporting  
8 documentation, be it the merger Joint Proposal or  
9 something else, where they could identify those  
10 numbers and what was their understanding of what was  
11 in the forecasts for the merger Joint Proposal.

12 JUDGE STOCKHOLM: But you have asked the  
13 question so broadly that the company would have to  
14 go back and give you the answer with regard to every  
15 piece of information in every exhibit they filed  
16 assuming you don't otherwise know it.

17 BY MS. ASSAF:

18 Q. Let me ask specifically. We had asked  
19 specifically for the major investments. Let me ask  
20 specifically for the station service revenues and  
21 any supporting documentation you have and where that  
22 would come from.

23 A. I will defer that to Mr. Bonner, but I am sure  
24 he can search the company records if we have

1 anything like that. My recollection, and fairly  
2 clear recollection, on the question about the  
3 capital investment is that it is included in one of  
4 the attachments to the Joint Proposal. One of the  
5 schedules does include a forecast of capital budget  
6 for transmission and distribution and other major  
7 components, so I just have to spend a minute and put  
8 my hands on that.

9 Q. You will do that for that and for the station  
10 service also?

11 A. Yes.

12 Q. Thank you.

13 A. If it exists.

14 Q. I hear you. If you could turn to page 23,  
15 lines 17 through 19. You suggest in that section  
16 that staff's incremental or decremental standard  
17 that staff has testified to would change the merger  
18 rate proposal rate plan to one in which all changes  
19 in each line item affecting its costs and revenues  
20 are reviewed in every CTC proceeding; is that  
21 correct?

22 A. I think that's what the lines you refer to say.  
23 I think you need to get the context of this from the  
24 beginning of that paragraph, which is referring to

1 the fact that the staff's proposal, which is to read  
2 in my view a new requirement to the rate plan, which  
3 would require a deferral calculation based on an  
4 individual line item when one is not called for by  
5 the Joint Proposal, and apply that on a consistent  
6 basis, as stated in line 12, to all the line items  
7 in the black box and everywhere else in the  
8 company's cost of service, we would be forever  
9 calculating and truing up and tracking expenses.  
10 That was really the intent of my point.

11 Q. Is it staff's proposal, this incremental,  
12 decremental through rate standard, or is it actually  
13 prong three of the Commission's three prong test,  
14 for determining whether a deferral is allowable?

15 A. I understand that the Commission has looked at  
16 three factors and I believe that the rate settlement  
17 addresses all three factors constructively in its  
18 detailed provisions, and the formula for incremental  
19 impact is, under the Joint Proposal, a before and  
20 after the regulatory change as would be applied to  
21 the case of a tax change as well.

22 Q. I am asking you more generally whether or not  
23 the proposal that staff had is strictly a staff  
24 proposal, or whether or not you were actually

1 identifying one of a test that the Commission uses  
2 when they do deferral?

3 A. I think what the staff has done is reference  
4 the Commission's policy as if we were before the  
5 Commission without a rate plan, to put that deferral  
6 in context. If we had no long term rate plan and a  
7 regulatory change occurred, we could--and going back  
8 to the example you asked before about if there was  
9 just a one year rate plan and our actuals varied  
10 significantly from our expectations because of maybe  
11 a change in the way station service is recovered.

12 Without a long term rate plan, to put that  
13 in context, we would have two choices. We could  
14 either file a new rate case or we come before the  
15 Commission with a deferral petition asking for  
16 permission for deferral for certain revenues.

17 In that context, the sort of analysis that  
18 you described and the Commission rules would be  
19 addressed, but we are not in the scenario. We are  
20 in a scenario where we have a merger Joint Proposal  
21 that was agreed to by the parties, reviewed and  
22 approved by the Commission, and we are implementing  
23 that rate plan here.

24 Q. Under any circumstances should that test be

1 used, the incremental, decremental test for  
2 determining whether any of the merger Joint Proposal  
3 costs are deferrable?

4 A. Sure. Where there are specific line items that  
5 we are measuring, for example, SIR costs or  
6 hazardous waste remediation costs and a specific  
7 allowance in rates, and because of those projects  
8 you don't know whether there will be big expense in  
9 one year or a little expense in the next year, there  
10 is a provision that you can true up the incremental  
11 or decremental amount to the allowance built into  
12 rates.

13 There is a number of provisions where the  
14 deferral mechanism works and are appropriate in some  
15 cases. In those cases it was clearly established in  
16 the Joint Proposal.

17 Q. Do you know if there is a--stray voltage falls  
18 into that category?

19 A. Stray voltage is something that I think  
20 came--the incremental testing requirements came  
21 about after the Joint Proposal, and I think  
22 Mr. Leuthauser is the right person to address  
23 questions on that to. He's in the room, I think.

24 Q. Is it your position staff should not be



1 attempting to determine if every cost the company is  
2 attempting to defer is incremental to what's built  
3 into rates, or decremental--incremental or  
4 decremental?

5 A. Yes. In particular where the standard is not  
6 based on a line item attachment for the cost of  
7 service, but more based on with or without the  
8 regulatory or accounting or legislative change, a  
9 reference back to the underlying cost of service is  
10 not appropriate.

11 Q. Mr. Reilly, at any time prior to the merger  
12 Joint Proposal being approved by the Commission did  
13 the company expect deferrals over the ten-year  
14 period to be anywhere near the 1.388 billion now  
15 being estimated by the company?

16 A. I don't believe we ever had an estimate of what  
17 the deferrals would be one way or the other. I  
18 think we knew that the deferral, the items that were  
19 set aside for deferral, could be big items.

20 And I think the staff recognized as well  
21 that because of the fact that they could be big,  
22 they were unknown or unknowable perhaps, that it was  
23 very risky for the company or customers to take that  
24 risk, and that it was better for all parties to set

1 those items aside and have them deferred or  
2 reconciled over time.

3 I think as you look at the items that are in  
4 the deferral account, I think by far the largest one  
5 is the pension and OPEB related item, which really  
6 comes from the Commission's statement of policy,  
7 which has been in place since 1993, and not really  
8 the merger rate plan.

9 So even if, again, we were on a--we didn't  
10 have a rate plan and we had one year annual rate  
11 cases every year, the same pension and OPEB  
12 deferrals would be before the Commission and having  
13 the same impact on our customers, except in a series  
14 of annual true ups under the statement of policy as  
15 opposed to pursuant to this long term rate plan.

16 Q. Is it your understanding that the Commission  
17 has an obligation to set just and reasonable rates?

18 A. Yes.

19 Q. Do you--not that we know what the Commission  
20 would absolutely have done--do you think the  
21 Commission would have approved a merger Joint  
22 Proposal as being reasonable and in the public  
23 interest if it had known in advance the deferrals  
24 might amount to \$1.4 billion?

1 A. I think that if the parties had known that the  
2 deferrals were going to amount to that level and  
3 were in agreement that they were prudently incurred  
4 costs or uncontrollable costs that were legitimate  
5 customer expenses, we would have designed them into  
6 the rate plan in some way.

7 If they are--as pension and OPEB expenses  
8 are legitimate customer expenses, if we had known  
9 they were going to be what they were we would have  
10 addressed that. If we were omnipresent and we were  
11 prescient and knew it, we probably would have  
12 addressed it, but we put it aside because we didn't  
13 want to have either party pay the risk premium  
14 associated with guessing wrong on that.

15 Q. Whether the parties might have addressed it or  
16 not, if we placed before the Commission a rate plan  
17 that had the potential to have \$1.4 billion  
18 ratepayer price tag at the end of it, do you think  
19 the Commission would have considered that reasonable  
20 and in the public interest?

21 A. I think the Commission did realize in its order  
22 approving this that there could be big deferrals. I  
23 believe there is a reference to that effect in the  
24 Commission order. So yes is the answer. The

1 possibility of big deferrals was always present.

2 Q. Okay. The Joint Proposal has a \$100 million  
3 band around the deferral.

4 A. Right.

5 Q. Would you consider \$1.4 billion an order of  
6 magnitude or more higher than that \$100 million  
7 band?

8 A. You are taking \$1.4 billion, but that's a  
9 ten-year number, I believe, over the whole period of  
10 the rate plan and comparing it to an annual  
11 threshold of \$100 million, I don't think that's a  
12 fair comparison.

13 Q. You don't consider it some order of magnitude  
14 higher than even if you had done \$100 million in  
15 each of ten years?

16 A. I will stipulate that \$1.4 billion is order of  
17 magnitude higher than \$100 million if that's  
18 important, but I think the question is, and I also  
19 think that if we had known and were certain that  
20 there were going to be these deferrals we would have  
21 had a different rate plan that we submitted to the  
22 Commission, but they weren't known or knowable.

23 That was the reason we designed the rate  
24 plan the way we did, to protect the company and

1 customers, because these could have gone the other  
2 way, as sometimes they do.

3 Q. Thank you. Could I ask you to turn to your  
4 rebuttal testimony, page three. This is line 17.  
5 You indicate that it's inappropriate for any party  
6 to use this proceeding to attempt to modify the  
7 Joint Proposal; is that correct?

8 A. Yes.

9 Q. Are you generally familiar with the testimony  
10 of Mr. Molloy and Mr. Richer?

11 A. Generally.

12 Q. Could you turn to--I realize, Your Honor, it's  
13 not in the record yet--but turn to the testimony of  
14 Mr. Molloy and Mr. Richer, pages 51 to 52. It's  
15 their reply testimony.

16 A. I don't have that.

17 MS. ASSAF: Could someone provide it to him?

18 MR. GAVILONDO: Is that reply testimony or--

19 MS. ASSAF: The reply testimony.

20 JUDGE STOCKHOLM: Is that Richer, Molloy and  
21 Tasker?

22 MS. ASSAF: No. Just Molloy and Richer.

23 JUDGE STOCKHOLM: Volume 1?

24 MS. ASSAF: Volume 2 of the September 1st.

1 JUDGE STOCKHOLM: September 1st. Could I  
2 have that page again?

3 MS. ASSAF: It actually starts on the bottom  
4 of 51 to the top of 52.

5 JUDGE STOCKHOLM: Now I am with you anyway.  
6 We will get the witness there in a minute.

7 MR. GAVILONDO: Your Honor, just for the  
8 record, Mr. Molloy and Mr. Richer are in the room  
9 and are available to testify today as well.

10 JUDGE STOCKHOLM: Understood. We are  
11 waiting, counselor. Is there a question?

12 MS. ASSAF: Yes. I was giving the witness a  
13 little time to read that portion of it.

14 JUDGE STOCKHOLM: I see. Okay.

15 BY MS. ASSAF:

16 Q. Is it your understanding, Mr. Reilly, the  
17 company panel is modifying the methodology set forth  
18 in attachment ten of the merger Joint Proposal for  
19 computing the share of follow on synergy savings  
20 allocable to Niagara Mohawk?

21 A. I don't believe that's the case but, again, I  
22 am not as good a witness on this as Mr. Molloy or  
23 Richer would be.

24 Q. We'll ask them. Page seven of your rebuttal

1 testimony, starting at line five, lines five through  
2 18, you address the reasonableness of the company's  
3 rates; is that fair?

4 A. Well, in particular, I am responding to the  
5 suggestion of staff that even if the Commission  
6 should decide that the company is correct in its  
7 interpretation of how the deferral for station  
8 service and the regulatory change associated with  
9 that should be calculated, the staff goes on to  
10 suggest that that is somehow unjust and unreasonable  
11 and create unjust and unreasonable rates, and the  
12 Commission should use its power under section 3.5 to  
13 undo that result. That's what I am responding to in  
14 this paragraph.

15 Q. You make several points concerning the  
16 reasonableness. First one I believe is that the  
17 company has not earned its allowed return for the  
18 first four years; is that correct?

19 A. Yes. I think in particular, I think, you know,  
20 as I read section 3.5 in the Joint Proposal, it is a  
21 broad catchall provision, not related to any  
22 specific deferral item, but it's one paragraph long  
23 and it is, in fact, the very last paragraph in the  
24 Joint Proposal.

1 I think it may help the record if I just  
2 read it in that nothing in this Joint Proposal shall  
3 be construed to limit the Commission's authority to  
4 reduce Niagara Mohawk's rates should it determine in  
5 accordance with Public Service Law that the  
6 established rates are in excess of just and  
7 reasonable rates for Niagara Mohawk's electric and  
8 gas service.

9 The reason for that provision being included  
10 was to provide a stop gap in the event that the  
11 company's revenues were significantly in excess of  
12 allowed or somehow the returns that were generated  
13 under the Joint Proposal. Notwithstanding the  
14 projections that are built in in terms of earnings  
15 sharing and deferrals that go both ways, the  
16 Commission still had the ability to protect  
17 customers and open up and undo the rate plan if the  
18 public interest required it.

19 And the analog to that was another  
20 comparable provision in the Joint Proposal that gave  
21 the company the right to file for new rates if its  
22 rates of returns were too low. They were both the  
23 safety net provisions for both the Commission and  
24 company built into the merger rate plan.



1 Q. What you have just described is the company's  
2 understanding of what that section meant.

3 A. Yes.

4 Q. Actually, back to your testimony, there was  
5 three points of reasonableness that you pointed out.  
6 The first, as we discussed, is that the company had  
7 not earned its allowed rate of return.

8 The second reason was that if in the future  
9 the company overearns there's an earning sharing  
10 mechanism; is that correct?

11 A. Yes.

12 Q. And the third is that the staff hasn't even  
13 completed its audit for the first four years so we  
14 can't form a basis of reasonableness.

15 A. Yes.

16 Q. Is it your opinion that the only measure of  
17 reasonableness is whether a company overearns?

18 A. I think that's the best measure of  
19 reasonableness. Again, I think my earlier testimony  
20 suggested that when a cost of service gets stale and  
21 the further away you get from that cost data,  
22 estimated data being current, the passage of time  
23 makes reference back to underlying cost data which  
24 was reasonable at the time less relevant than

1 comparing actual revenues and actual net income and  
2 actual returns to reasonably allowed returns.

3 It's by virtue of that type of analysis that  
4 companies are often fortunate enough to be able to  
5 stay out of filing for rates because they are able  
6 to increase productivity efficiencies, reduce costs  
7 in some way, that offsets parts of their costs of  
8 service that are increasing over time.

9 So, the proper measure, I would submit, for  
10 just and reasonable rates, is not a retroactive look  
11 at cost of service, but more how are the company's  
12 earnings compared to the reasonable level.

13 Q. If the company is doing something inefficient  
14 that causes the earnings to drop below the allowed  
15 ROE, would the fact that the actual ROE is below the  
16 allowed ROE prove that rates are reasonable?

17 A. No. If the company was doing something  
18 inefficient that should be stopped.

19 Q. In the merger Joint Proposal is there--well, do  
20 you know whether there is a historic EBCap that was  
21 calculated?

22 A. That was an issue in the rate plan negotiations  
23 and I am not the right person to respond to  
24 questions about that.

1 Q. Would you take subject to check that the EBCap  
2 was calculated to be \$465 million?

3 A. Yes.

4 JUDGE STOCKHOLM: Where was that calculated,  
5 counsel?

6 THE WITNESS: On page 12 of volume 1 of the  
7 1/17/01 financial forecast and supporting work  
8 papers, Your Honor.

9 Q. Would you also take subject to check that the  
10 company's earnings report for the year ending  
11 December 31st, '05 the company shows a negative  
12 EBCap adjustment of 60.7 million?

13 A. I don't believe I have seen the '05 data. Is  
14 this in the settlement agreement or is this a new  
15 filing the company made?

16 Q. This is in a report that the company filed.

17 A. I will accept that subject to check. Again,  
18 Mr. Molloy probably can answer questions about that.

19 MS. ASSAF: For the record, that's on page  
20 eight of the June 29, '06 filing.

21 JUDGE STOCKHOLM: What June 29, '06 filing?

22 MS. ASSAF: The earnings report.

23 JUDGE STOCKHOLM: Is that a monthly or  
24 annual?

1 MS. ASSAF: It's an annual.

2 JUDGE STOCKHOLM: Annual filing, okay.

3 BY MS. ASSAF:

4 Q. So, just sort of doing the math, that's a  
5 negative swing in cash efficiency of approximately  
6 \$526 million; is that correct?

7 A. I don't know if that's a proper comparison of  
8 those two numbers. I am afraid I can't answer that.

9 Q. Mr. Reilly, could I refer you to section  
10 1.2.5.3 of the Joint Proposal, the earnings share  
11 price, page 30.

12 A. Yes. I have got that.

13 Q. If you could just review that section. Isn't  
14 it true that 90 percent--if there is--that 90  
15 percent of the earnings are covered under this  
16 section of the overearnings versus--that 90 percent  
17 of it would be covered under this section. Let me  
18 just give you a basis there. I'm sure I'm confusing  
19 you.

20 Earlier you were referring to the section in  
21 the merger Joint Proposal concerning the  
22 Commission's authority, and you indicated that that  
23 sort of a fallback if there is--the earnings really,  
24 the excess earnings goes too high, whatever.

1           Doesn't this provision provide for at least  
2           90 percent of that to be covered under the excess  
3           earnings provision of the merger Joint Proposal?  
4           Aren't we only referring if at all to excess  
5           earnings of only that last ten percent in section  
6           3.5?

7           A.       I think the way we understood this to work is  
8           that if the company was extremely successful in  
9           achieving efficiencies, or if the economy were to be  
10          extremely good and sales revenues were up and our  
11          profits were up, that would be good for both the  
12          company and customers.

13                 And this was built in to have a sharing, and  
14          the sharing between the company and customers--the  
15          customer's share goes up as excess earnings as  
16          measured by the three formulas here, the three bands  
17          specified in section 1.2.5, and to the point where  
18          you get to excess earnings of 16 percent or higher,  
19          90 percent of the excess would go to customers,  
20          that's true.

21                 We are unfortunately nowhere near that happy  
22          event to be sharing that sort of excess earnings  
23          with customers.

24                 MS. ASSAF: Thank you, Mr. Reilly.

1 I have no further questions, Your Honor.

2 JUDGE STOCKHOLM: Mr. Mager.

3 MR. MAGER: Thank you, Your Honor.

4 EXAMINATION BY MR. MAGER:

5 Q. Mr. Reilly, do you recall some  
6 cross-examination with Ms. Assaf concerning the  
7 expectations going into the rate plan and  
8 specifically--

9 A. There must have been some.

10 Q. There was discussion of \$1.4 billion in  
11 deferrals over a 10-year period. Do you recall that  
12 discussion?

13 A. Yes, I do.

14 Q. In response to some of the questions you  
15 pointed out that the \$1.4 billion applied to a  
16 ten-year period. Do you recall that?

17 A. Yes.

18 Q. And just to put the company's deferral request  
19 in a more timely context, is it fair to say that  
20 approximately halfway through the rate plan the  
21 company's now before the Commission seeking approval  
22 of approximately \$670 million in deferrals?

23 A. I thought the number was a little bit less than  
24 that, but I would have said somewhere in excess of

1 600--slightly in excess of \$600 million over a  
2 period of two years, which has been moderated by the  
3 company to extend over probably three years or  
4 longer under our proposal to smoothe the impact of  
5 this on customers.

6 Q. Through about half of the rate plan the  
7 company's deferrals have totaled in excess of \$600  
8 million.

9 A. Both deferrals to date and forecast deferrals  
10 through the end of 2007, I believe.

11 Q. And do you recall discussing how the rate plan  
12 included a provision where deferrals were compared  
13 to \$100 million threshold?

14 A. Yes.

15 Q. Do you recall saying that that was the type of  
16 annual comparison?

17 A. Yes.

18 Q. Wouldn't you agree that's actually a biennial  
19 comparison? Isn't it once every two years that  
20 comparison is made in the CTC reset filing, which  
21 occurs every two years?

22 A. I believe that's correct. The point I was  
23 trying to make is that there is a threshold either  
24 way of \$100 million before we seek to recover

1 anything from customers or give it back, to  
2 recognize that the Commission and the parties wanted  
3 there to be a stable rate plan to the extent there  
4 could.

5 Q. And in the first CTC reset under the rate plan  
6 the \$100 million threshold was not exceeded,  
7 correct?

8 A. Correct.

9 Q. Now two years later the requested deferrals are  
10 roughly six times the threshold, correct?

11 A. Correct.

12 Q. And you believe that was intended or  
13 anticipated at the time of the rate plan?

14 A. Well, I think that if you--what I was trying to  
15 say was I don't think anybody had a particular  
16 anticipation or expectation one way or the other,  
17 what there would be. And what I was trying to say,  
18 I think we recognized that they could be this big or  
19 really could be bigger, and I think the Commission  
20 in its order recognized that they could be very big.

21 I was also trying to make the point that the  
22 largest factor here is the statement of policy on  
23 pension and OPEBs is my understanding is the biggest  
24 contributor to that, which is something that was



1 going to happen independent of the ten-year rate  
2 plan. If we were on a single year rate plan with--  
3 following the statement of policy, we would have the  
4 same sorts of issues.

5 Q. Well, in discussing what the parties did  
6 intend, or what their expectations were at the time,  
7 isn't it true that this rate plan was sold to the  
8 Commission by the signatories as a plan that would  
9 provide rate stability for customers?

10 A. Well, I think you are overstating what was told  
11 to the Commission. I think the reason I attached to  
12 my testimony the staff's statement of support for  
13 the proposal was because it was excellent and very  
14 well balanced.

15 It explained there was a period it was going  
16 to provide stability, but there were also  
17 projections built in that could increase or decrease  
18 expense for customers down the road.

19 I don't think we ever, the staff or the  
20 company or any one signatory, promised that it was  
21 going to be stable rates independent of any  
22 movement. It was always caveated by the fact there  
23 could be potential deferrals here.

24 Q. Do you recall if Niagara Mohawk, in supporting

1 the Joint Proposal to the Commission, touted the  
2 rate stability that would be provided by the rate  
3 plan?

4 A. Touted?

5 Q. Did the company high light rate stability as  
6 one of the reasons why the Commission should approve  
7 or adopt the proposed rate plan?

8 A. I think that was certainly a factor. I think  
9 the \$151 million rate reduction was a factor that we  
10 focused customers and stakeholders on. I think the  
11 expansion of our economic development program was a  
12 factor that we focused customers on.

13 I think--

14 Q. Let me just stop you.

15 A. I don't think it was one--my point--I don't  
16 mean to interrupt, but I don't think there was just  
17 one factor that we said was the reason for approving  
18 the rate plan. It was that was one of several  
19 factors. And expectation was that--and, frankly, at  
20 this point rates have been stable and we are coming  
21 on halfway through the rate plan with a very stable  
22 profile so far.

23 Q. Let's talk about that in a second. We are in  
24 agreement that as one of many reasons supporting the

1 proposal rate stability was cited by the company?

2 A. I am sure it was. I haven't gone back and  
3 looked at the press materials, but I am sure we  
4 mentioned that.

5 Q. In terms of rate stability, the company's  
6 proposal, as I understand, is to increase rates by  
7 \$300 million effective 4/1/06 and 1/1/07, and then  
8 as I understand the rest of the proposal, is the  
9 remaining through deferrals would be rolled over for  
10 recovery during a future CTC reset period; is that  
11 your understanding?

12 A. I don't believe that's correct.

13 Q. So the company would not recover anything above  
14 the \$300 million?

15 A. I believe what the company proposed, and was  
16 ultimately approved by the Commission I believe  
17 after some discussions with the staff--I don't know  
18 if there was a particular settlement on this or not,  
19 but there was a \$100 million revenue increase on  
20 April 1, 2006. There is prescheduled an additional  
21 \$100 million revenue increase, incremental increase,  
22 for calendar year '07.

23 Q. Let me just stop you. That's \$300 million over  
24 the '06/'07 period, correct?

1 A. Right. And the expectation would be that I  
2 think we are getting to the point where we project  
3 we will be doing estimates of deferrals beyond that,  
4 but the hope is that that rate level for the  
5 following year, without a need for further increase,  
6 might be sufficient to pick up the vast majority of  
7 the remaining deferrals.

8 Q. With respect to the remaining deferrals, the  
9 company is still proposing to recover I guess over  
10 \$300 million in additional deferrals on top of the  
11 \$300 million that's reflected in the rate increases?

12 A. What we specifically did, I think, in the  
13 interest of stabilizing rates and minimizing bill  
14 impacts for customers, was extend beyond what--and  
15 with the Commission's approval extend beyond the  
16 strict limit.

17 The Joint Proposal I believe gave us the  
18 right to collect the full shortfall actual and  
19 forecast during the two-year period, and we  
20 voluntarily agreed to extend that--I believe we  
21 expected over a three-year period without sufficient  
22 significant increase in the third year we will be  
23 able to recover the vast majority of the deferrals.

24 Q. That's assuming there are no deferrals beyond

1 '07, correct?

2 A. That is correct.

3 Q. That's not the company's projection, is it?

4 A. I think one of the things that the company did  
5 was in coming up with that plan was forecast out,  
6 and that's probably why the \$1.4 billion number is  
7 in the record here, as we were looking at beyond the  
8 strict two-year horizon in the interest of  
9 moderating impacts on customers to see what kind of  
10 a projection, what kind of stable, small increases  
11 might mitigate the increase.

12 I believe--I think it's probably premature  
13 and I am certainly not the right person to ask about  
14 what the projections are, but I think it's possible  
15 there will be minimal increases beyond this, but I  
16 think other people in the room are better to ask  
17 about that.

18 Q. I won't get into the details behind the \$1.4  
19 billion, but I would like to just follow up on that  
20 very general number. As I understand it, the  
21 company has approval to recover \$300 million in  
22 deferrals through '07, correct?

23 A. That's my understanding, yes.

24 Q. And then the rest of the rate plan goes from

1 2008 to 2011, correct?

2 A. Correct.

3 Q. During that four-year period the company is  
4 projecting an additional 1.1 billion in deferrals to  
5 be recovered?

6 A. I don't know if that's correct. In fact, I  
7 don't believe that's correct, but I am not the best  
8 person to answer.

9 Q. At what point does the recovery of deferrals  
10 defeat the goal of rate stability? At what point  
11 can you no longer say that the rate plan has kept  
12 rates stable?

13 A. I don't know as a matter of policy. I think,  
14 you know, that the things that are, again, driving  
15 the deferrals and driving the costs up, to the  
16 extent it's pension and OPEB-related expenses, those  
17 have been found to be reasonable expenses to  
18 reconcile their legitimate costs of service, cost of  
19 doing business.

20 We have to pay pension and other benefits to  
21 our workers. And to the extent those costs are  
22 going up because health care costs are going up, or  
23 because investment returns are going down and  
24 causing--not helping as much in funding those

1 benefits as they did in prior years, those are  
2 legitimate costs that have to be recovered somehow,  
3 whether it's through a deferral mechanism or whether  
4 it's through a traditional one year rate case.  
5 Those are legitimate costs of doing business that  
6 need to be recovered.

7 Q. So, you don't have an opinion how much recovery  
8 would be required before rate stability was  
9 frustrated?

10 A. I think that's probably in the eye of the  
11 beholder.

12 Q. Sitting here today you don't have an opinion on  
13 that?

14 A. I don't really have an opinion on that, no.

15 Q. With respect to the deferral request, in  
16 general your understanding is that the company's  
17 request for deferrals need to be--must be audited by  
18 staff and then approved by the Commission, correct?

19 A. Yes.

20 Q. And what is the role of the Commission in  
21 approving the deferral request? Does the Commission  
22 have any discretion?

23 A. I think the Commission always has discretion.  
24 I think the Commission, though, should be bound by

1 the terms of our Joint Proposal, which the  
2 Commission has approved.

3 Q. So, is the Commission--do you believe the  
4 Commission has the authority if it believed it was  
5 necessary to modify the Joint Proposal if it thought  
6 that would be in the public interest?

7 A. I do think that's what section 3.5 of the Joint  
8 Proposal was there for, to give the Commission,  
9 especially this Commission, or the Commission that  
10 approved the Joint Proposal could cede its authority  
11 to future Commissions. And I think that's why that  
12 provision was in there.

13 But I do think that it would be a very high  
14 burden for any Commission to take that step, which I  
15 think would be viewed as quite a drastic step.

16 Q. Hasn't Niagara Mohawk sought various  
17 modifications to the Joint Proposal since it was  
18 adopted by the Commission?

19 A. I don't think there have been any truly  
20 significant modifications sought of the sort that  
21 would disallow hundreds of millions of dollars of  
22 recovery of costs.

23 Q. Is that your definition of what constitutes a  
24 significant modification, if it's in the hundreds of



1 millions?

2 A. I would think hundreds of millions is  
3 significant, yes.

4 Q. Anything below it is not?

5 A. No. For the record, I go a lot lower than \$100  
6 million before it's significant for me.

7 Q. Thank you. I just want to follow up one line  
8 of questioning that Ms. Assaf asked you concerning  
9 the incremental and decremental test. Do you recall  
10 that?

11 A. Yes.

12 Q. That's a test that staff is applying to certain  
13 items in the company's deferral request, correct?

14 A. Yes.

15 Q. Now, I am just not clear of your response. I  
16 believe it had to do with station power. Are you  
17 saying that the company satisfied the incremental,  
18 decremental test or that the test is not applicable?

19 A. I am saying that we satisfied the test, which  
20 the details of how that test should be implemented  
21 have been enumerated in the Joint Proposal. And in  
22 the Joint Proposal it calls for a with and without  
23 the type--with and without the regulatory change is  
24 the measure--the way you measure whether there is an

1 incremental or decremental impact on revenue.

2 That's my point.

3 I believe it's entirely consistent with the  
4 way all the deferral mechanisms have been designed  
5 in the Joint Proposal. What we were really trying  
6 to do here was to take certain pieces--we were  
7 trying--the company was willing to accept risk of  
8 living within its revenues for the vast majority of  
9 its cost of service. We consciously took certain  
10 cost items with everyone's consent and agreement.

11 Outside of that, I unfortunately used the  
12 word black box, I will never do that again, but we  
13 took certain costs and expenses outside of that area  
14 and said we are going to true these up and defer  
15 them, and basically put them on the same footing  
16 that the company would be on if it didn't have a  
17 ten-year rate plan.

18 So, for example, if we were to file a cost  
19 of service today for a brand new rate case there  
20 would be, in my opinion, no doubt that the lost  
21 revenue from the station service rulemaking would be  
22 recovered. Unfortunately, it wouldn't be recovered  
23 from the generators, it would be recovered from MI's  
24 customers, and the rest of our customer base, but

1 those costs would be reallocated and recovered.

2 The same way that today's--if we filed a  
3 cost of service with today, with today's SIR,  
4 environmental clean up costs in it, that would be  
5 recovered in rates. And all that the deferral  
6 provisions in the rate plan did were move those  
7 outside of the ten year plan horizon and put them on  
8 a footing that was comparable to the place where the  
9 company would have been but for the rate plan.

10 Q. With respect to the last part of your answer,  
11 just to be clear, that's what you are proposing  
12 here, it's to recover station power revenues that  
13 the company is not recovering from wholesale  
14 generators and to recover them from all retail  
15 customers as far as this case?

16 A. That's correct. That's the result of actions  
17 beyond the company's control that the company has  
18 vigorously opposed in a variety of forums, including  
19 most recently at the Circuit Court of Appeals in  
20 Washington.

21 MR. MAGER: I have no further questions,  
22 Your Honor.

23 JUDGE STOCKHOLM: Before I turn this back to  
24 you, Mr. Gavilondo, there were some numbers in the

1 last series of questions that I am curious about and  
2 you may not be the right witness to answer these.  
3 If so, just tell me who it is.

4 If I understood correctly, the CTC reset  
5 happens every two years?

6 THE WITNESS: Right.

7 JUDGE STOCKHOLM: At the end of year two--  
8 which must have been 2003; is that right?

9 THE WITNESS: I believe that's right.

10 JUDGE STOCKHOLM: At the end of year two,  
11 the deferral pot, if you will, was less than \$100  
12 million?

13 THE WITNESS: Correct.

14 JUDGE STOCKHOLM: At the end of year four it  
15 was more than \$300 million, and at the end of year  
16 six you are estimating it to be over \$600 million?

17 THE WITNESS: Right.

18 JUDGE STOCKHOLM: Does that all make sense?  
19 Am I right about that?

20 THE WITNESS: I believe that's right and  
21 you're about at the limit of my capability on this.

22 JUDGE STOCKHOLM: Maybe what I'll do is  
23 manage to get this question clear on the record and  
24 then the right person can answer it, but let me see

1       how far I can push here.

2               And I guess what bothers me is this is not--  
3       if I were to put these numbers on a graph it would  
4       not be a straight line. It wouldn't be an even  
5       curve. It would show a huge increase in deferral  
6       amounts in years three and four over what they were  
7       in years one and two.

8               Do you know why? What's driving that? Why  
9       did that increase all of a sudden between the end of  
10      year two and the end of year four? What was the  
11      great acceleration? Do you know the answer to that  
12      question?

13              THE WITNESS: Rather than have me speculate  
14      I think that would be better for one of the other  
15      witnesses. Mr. Tasker or Molloy or one of the  
16      accounting people would probably be better for that.

17              JUDGE STOCKHOLM: Okay. It's about ten  
18      after 1:00. Counselor, do you know what you want to  
19      do in terms of redirect here, or would you like to  
20      take a break and come back after 50 minutes or so  
21      and deal with it then?

22              MR. GAVILONDO: We have no redirect, Your  
23      Honor.

24              JUDGE STOCKHOLM: No redirect, that's very

1 good. Any other questions? Hearing none, you are  
2 excused, Mr. Reilly. Thank you very much for your  
3 testimony.

4 (Witness excused.)

5 And we will be in recess until 2:00, but  
6 before that, was there something else? Is there  
7 anything else we need to deal with before we break?

8 MR. GAVILONDO: I don't believe so, Your  
9 Honor, no.

10 JUDGE STOCKHOLM: All right. Fine. We will  
11 be in recess until 2:00.

12 (Lunch recess taken.)

13 JUDGE STOCKHOLM: Back on the record.  
14 Mr. Gavilondo, it is your next witnesses. You have  
15 the floor.

16 MR. GAVILONDO: Thank you, your Honor. As a  
17 preliminary matter I would like to mention when we  
18 were introducing the exhibits of Mr. Abrams this  
19 morning I omitted including a copy of exhibit AA-1  
20 as marked in the prefiled. Now, this was an exhibit  
21 for which the company sought confidential  
22 protection, and I believe your Honor this morning  
23 granted that protection.

24 We did not submit it into the hearing

1 exhibits this morning. We would like to do so at  
2 this time as a confidential exhibit. In terms in  
3 the booklet it appeared in before we ripped it out  
4 of the book, I believe it was volume 4 of the  
5 September 1, 2006 submission.

6 JUDGE STOCKHOLM: Volume 1, September 1st.

7 MR. GAVILONDO: Mr. Abrams' testimony was  
8 volume 4 of September 1st.

9 JUDGE STOCKHOLM: Volume 4, September 1st.

10 MR. GAVILONDO: That is a redacted exhibit.

11 JUDGE STOCKHOLM: Under the redactions I  
12 show nothing for AA-1.

13 MR. GAVILONDO: Right, the entire exhibit is  
14 redacted.

15 JUDGE STOCKHOLM: Now, my question is: Why  
16 do we need this information in the record?

17 MR. GAVILONDO: This information pertains to  
18 a comparative of Niagara Mohawk's benefits versus  
19 the benefits that are provided by other companies  
20 and it's done by Towers Perrin for a number of  
21 utilities essentially for money. They provide this  
22 information at the request for utilities. It's  
23 proprietary when they prepare it for the utilities  
24 that pay for it.

1 JUDGE STOCKHOLM: Understood. I don't have  
2 any problem with the proprietary nature of it, but  
3 the testimony that we put in of Mr. Abrams doesn't  
4 have any proprietary information in it, so how is  
5 this exhibit going to tie up together with that, and  
6 do we need these--let me ask staff: Do we need  
7 these numbers in the exhibit? Are you familiar with  
8 the document we are talking about?

9 MS. ASSAF: We are, your Honor, and we don't  
10 believe we need the numbers for purposes of the  
11 testimony and the record.

12 MR. GAVILONDO: If the staff doesn't--is not  
13 going to be addressing this piece of Mr. Abrams'  
14 testimony, I don't believe we need to submit it into  
15 the record in this case and create a separate  
16 confidential.

17 One scheduling matter, we were able to reach  
18 Mr. Sauvage and he is available tomorrow to testify  
19 and will be here mid-morning tomorrow to the extent  
20 we can put him in on the schedule.

21 JUDGE STOCKHOLM: Any objection?

22 MS. ASSAF: No, Your Honor.

23 MR. GAVILONDO: At this time I would like to  
24 call Mr. Bonner and Mr. Klosowski to the stand. If



1       you could each state and spell your name for the  
2       record.

3               MR. BONNER: My name is James J. Bonner,  
4       Jr., B-o-n-n-e-r.

5               MR. KLOSOWSKI: Lee A. Klosowski,  
6       K-l-o-s-o-w-s-k-i.

7               JAMES J. BONNER, JR., and LEE A. KLOSOWSKI,  
8       after first having been duly sworn, were examined and  
9       testified as follows:

10              MR. GAVILONDO: We have not had an  
11       opportunity to have the Mr. Klosowski and Mr. Bonner  
12       joint testimony premarked for the record. I would  
13       like to do that at this time.

14              JUDGE STOCKHOLM: That's fine.

15              MR. GAVILONDO: Submitting first the  
16       September 1st responsive testimony of James J. Bonner  
17       and Lee A. Klosowski, and the rebuttal testimony  
18       dated September 26th also of Mr. Bonner and Mr.  
19       Klosowski.

20              And as exhibits we have an exhibit labeled  
21       JJB/LAK 1, six pages, and we would like to have that  
22       marked for identification. That was included with  
23       the rebuttal testimony dated September 26th.

24              And the second exhibit number which I

1 believe is in the same page of that book at page  
2 number 163 in the lower right-hand corner would be  
3 JJB/LAK 2. It's a 19 page exhibit.

4 JUDGE STOCKHOLM: The two documents counsel  
5 just identified will be marked for identification as  
6 exhibits 5 and 6 respectively.

7 (Exhibits 5 and 6 marked for  
8 identification.)

9 DIRECT EXAMINATION

10 BY MR. GAVILONDO:

11 Q. Mr. Klosowski and Mr. Bonner, before you I  
12 believe you have copies of the document dated  
13 September 1, 2006. September 1st document is 24  
14 pages long. Could one of you identify the document  
15 for the record?

16 A. (Bonner) Yes. It was the responsive testimony  
17 of James J. Bonner, Jr., and Lee A. Klosowski filed  
18 on September 1st of this year.

19 Q. Thank you. Do you have any changes or  
20 corrections?

21 A. (Bonner) No, I do not.

22 (Klosowski) No.

23 Q. Thank you. Turning to the document dated  
24 September 26, 2006 entitled rebuttal testimony of

1 James J. Bonner, Jr., and Lee A. Klosowski, this  
2 document is a total of nine pages. Could one of you  
3 identify that for the record?

4 A. (Bonner) That document is the rebuttal  
5 testimony of James J. Bonner and Lee A. Klosowski  
6 filed on September 26th of this year.

7 Q. Do you have any changes or corrections to that?

8 A. (Bonner) No, I do not.

9 (Klosowski) No.

10 Q. Were these documents, this testimony, prepared  
11 by you or under your supervision?

12 A. (Bonner) Yes, it was.

13 (Klosowski) Yes, it was.

14 Q. Do you adopt the documents and prefiled  
15 testimony as your testimony in this proceeding?

16 A. (Bonner) Yes, I do.

17 (Klosowski) Yes, I do too.

18 MR. GAVILONDO: Thank you. At this time,  
19 your Honor, I tender the witnesses for  
20 cross-examination.

21 JUDGE STOCKHOLM: Thank you, counselor.

22 The exhibits you identified before, were  
23 they prepared by you or under your direction?

24 MR. BONNER: Yes, your Honor.

1 MR. KLOSOWSKI: Yes, your Honor.

2 JUDGE STOCKHOLM: Do you have any  
3 corrections to those exhibits?

4 MR. BONNER: No, I do not.

5 MR. KLOSOWSKI: I do not.

6 JUDGE STOCKHOLM: Exhibits 5 and 6 will be  
7 marked for identification and the testimony that  
8 was just described will be copied into the record  
9 as though given orally.

10 (Exhibits 5 and 6 marked for  
11 identification.)

12 (The following is the prefiled testimony  
13 of James J. Bonner, Jr., and Lee A. Klosowski:)

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Case 01-M-0075

JAMES J. BONNER JR. and LEE A. KLOSOWSKI

1           **RESPONSIVE TESTIMONY OF JAMES J. BONNER JR. AND**  
2   **LEE A. KLOSOWSKI**  
3

4   **I.    Introduction**

5   Q:    Please state your names and business addresses.

6   A:    [By Mr. Bonner] My name is James J. Bonner Jr. I am employed by  
7           Niagara Mohawk Power Corporation d/b/a National Grid ("Niagara  
8           Mohawk" or "Company"), and my business address is 300 Erie Blvd  
9           West, Syracuse, NY 13202.

10   A:   [By Mr. Klosowski] My name is Lee A. Klosowski. I, too, am employed  
11           by Niagara Mohawk and my business address is 300 Erie Blvd West,  
12           Syracuse, NY 13202.

13

14   Q:    Mr. Bonner, what is your educational background?

15   A:    I graduated from Northeastern University, Boston, Massachusetts, in 1976  
16           with a Bachelor of Science in Electrical Engineering (Power Systems).

17

18   Q:    Mr. Klosowski, what is your educational background?

19   A:    I graduated from the Rochester Institute of Technology in June 1977 with  
20           a Bachelor of Science in Mechanical Engineering. In 1987, I received a  
21           Masters of Business Administration from Syracuse University.

22

Case 01-M-0075

JAMES J. BONNER JR. and LEE A. KLOSOWSKI

1 Q: Mr. Bonner, in what capacity are you employed at Niagara Mohawk?

2 A: I am Manager, Electric Pricing for New York. In that capacity, I am  
3 responsible for supervising a professional staff engaged in the study,  
4 analysis, design, and regulatory filing of National Grid's electric service  
5 rates, surcharge factors, contracts, and tariff provisions; and in providing  
6 guidance for the proper implementation and interpretation thereof.

7

8 Q: Mr. Klosowski, in what capacity are you employed at Niagara Mohawk?

9 A: I am Director, Gas Supply and Transportation. In that capacity I am  
10 responsible for planning, contracting and purchasing gas commodity to  
11 serve Niagara Mohawk's gas sales customers that have not migrated to  
12 competitive suppliers. I am also responsible for planning, contracting and  
13 scheduling the interstate pipeline capacity and storage needed to deliver  
14 the gas from the point of purchase to Niagara Mohawk's distribution  
15 network. In addition I have responsibility for managing and accounting  
16 for gas delivered to Niagara Mohawk's distribution network by  
17 competitive suppliers (Marketers or ESCOs) for use by their customers.

18

19 Q: Mr. Bonner, please summarize your professional experience.

20 A: From 1976 through 1983, I was employed by the Belcher Division of  
21 Dayton Malleable Inc., a malleable iron foundry located in Easton,

Case 01-M-0075

JAMES J. BONNER JR. and LEE A. KLOSOWSKI

1 Massachusetts, as Plant Engineer. My duties included plant maintenance  
2 management, energy management, capital budgeting, and production  
3 engineering. In 1983, I joined Eastern Edison Company as Consumer  
4 Service Engineer for the Brockton Division and transferred to the Rate  
5 Department of EUA Service Corporation in 1985 as an Associate Rate  
6 Engineer. I was promoted to Rate Engineer in 1987, to Senior Rate  
7 Engineer in 1989, to Supervisor of Rate Design in 1991, and to Manager  
8 of Retail Pricing and Rate Administration in 1999. In 2000, I joined  
9 National Grid USA Service Company as Principal Analyst in the  
10 Distribution Financial Analysis Department. I assumed my present duties  
11 as Manager, Electric Pricing for National Grid in New York in May 2002.

12

13 Q: Mr. Klosowski, please summarize your professional experience.

14 A: I joined Niagara Mohawk in 1977 as a Mechanical Engineer – Nuclear and  
15 Fossil Engineering, in 1981 was promoted to Lead Mechanical Engineer –  
16 Nuclear Engineering, and in 1987 to Manager/General Supervisor –  
17 Nuclear Engineering. In 1994, I became Niagara Mohawk's Supervisor –  
18 Regulatory and Pipeline Affairs, and in 1996, Manager – Gas Supply. In  
19 1998 I became Manager – Retail Access. In April 2002, I was promoted  
20 to my present position.

21

Case 01-M-0075

JAMES J. BONNER JR. and LEE A. KLOSOWSKI

1 Q: Mr. Bonner, have you previously testified before the Commission?

2 A: Yes. I have previously testified before the Commission in Case 01-M-

3 0075, *Joint Petition of Niagara Mohawk Holdings, Inc. Niagara Mohawk*

4 *Power Corporation, National Grid plc and National Grid USA for*

5 *Approval of Merger and Stock Acquisition*, on November 9, 2001, and in

6 Case 01-E-1847, *In the Matter of the Compliance Filing of Niagara*

7 *Mohawk Power Corporation in Response to Opinion No. 01-4 on Standby*

8 *Service Rates*, on April 22, 2002. In addition, I have testified in numerous

9 proceedings before the Massachusetts and Rhode Island public utility

10 commissions since 1985.

11

12 Q: Mr. Klosowski, have you previously testified before the Commission?

13 A: Yes, in rate proceedings regarding gas supply and unbundling of utility

14 services in Case No. 95-G-1095.

15

16 Q: Would you please describe the areas regarding which you will testify?

17 A: We will testify regarding the Customer Service Backout Credits deferral

18 and the Economic Development Fund deferral.

19

20 Q: Please describe how your testimony is organized.



1 A: In Section II, we discuss the Customer Service Backout Credits deferral,  
2 and explain why Staff's proposed adjustment to this deferral should be  
3 rejected. In Section III, we discuss the Economic Development Fund  
4 deferral, for which Niagara Mohawk accepts Staff's proposed adjustment.

5

6 **II. Customer Service Backout Credits**

7 **Background**

8 Q: Could you briefly explain what Customer Service Backout Credits are?

9 A: Certainly. Customer Service Backout Credits ("CSBCs") refer to credits  
10 that Niagara Mohawk provides to retail customers under P.S.C. No. 207  
11 Electricity tariff Rule No. 42 ("Rule 42") who participate in the  
12 Company's Retail Access Program under P.S.C. No. 207 Electricity tariff  
13 Rule No. 39 ("Rule 39"), thereby electing to secure their electric  
14 commodity needs from a supplier other than the Company. Niagara  
15 Mohawk has provided Customer Service Backout Credits under Rule 42,  
16 with the Commission's approval, since the adoption of the PowerChoice  
17 Settlement Agreement<sup>1</sup> in 1998. The current levels of Customer Service  
18 Backout Credits were established by the Commission in the PowerChoice

---

<sup>1</sup> Cases 94-E-0098 *et al*, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation for Electric Service*, "Order Concerning Tariff Amendments Setting Rates for All Customer Classes and Implementing a Retail Access Program," (August 26, 1998).

1 Year 4/5 Order<sup>2</sup>. These levels were continued in the Merger Rate Plan.  
2 Specifically, residential customers served under P.S.C. No. 207 Electricity  
3 Service Classification Nos. 1, 1-B, and 1-C ("SC-1, SC-1B, and SC-1C")  
4 and non-demand metered customers served under P.S.C. No. 207  
5 Electricity Service Classification No. 2 ("SC-2ND") who obtain  
6 commodity service from an alternative supplier receive a Customer  
7 Service Backout Credit of 4 mills per kWh; demand-metered customers  
8 and street-lighting customers receive a credit of 2 mills per kWh.

9  
10 Q: Does the Merger Rate Plan Joint Proposal provide for the deferral of  
11 revenues foregone by the Company due to the provision of Customer  
12 Service Backout Credits?

13 A: Yes. Section 1.3.3 of the Merger Rate Plan Joint Proposal provides as  
14 follows:

15 Niagara Mohawk shall recover any difference between the  
16 Customer Service Backout Credit and Niagara Mohawk's  
17 SRAC [short-run avoided cost], for which the Parties agree  
18 to use the figure of \$0.0005 per kilowatt-hour, at this time,  
19 through the mechanism set forth in Section 1.2.4.9 until the  
20 Commission provides an alternative mechanism or method  
21 to recover these costs at the time unbundled rates for  
22 Niagara Mohawk are implemented.

---

<sup>2</sup> Cases 94-E-0098 *et al*, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation for Electric Service*, "Tariff amendments filed by Niagara Mohawk Power Corporation addressing Years 4 and 5 rates for P.S.C. No. 207 - Electricity, and P.S.C. No. 214 - Outdoor Street Lighting," (August 29, 2001).

1 Section 1.2.4.9 states that "Niagara Mohawk shall include in the Deferral  
2 Account . . . the difference between the Customer Service Backout Credits  
3 provided pursuant to Section 1.3.3 to customers choosing to take service  
4 from an energy service provider other than Niagara Mohawk and SRAC."

5

6 **Deferrals and Proposed Staff Adjustments**

7 Q: Did the Company's filing include deferral balances for Customer Service  
8 Backout Credits?

9 A: Yes. The Company's filing included two deferral balances for Customer  
10 Service Backout Credits. The first relates to \$10.3 million of Customer  
11 Service Backout Credits that accrued prior to the implementation of the  
12 PowerChoice Year 4/5 rates on September 1, 2001, which were governed  
13 by the corresponding provisions of the PowerChoice settlement. The  
14 second relates to Customer Service Backout Credits that have accrued  
15 during the remaining term of PowerChoice from September 2001 through  
16 January 2002 and under the Merger Rate Plan Joint Proposal. The actual  
17 deferral balance through June 30, 2005 is \$50.0 million. The projected  
18 deferral balance for the remainder of the CTC Reset Period is \$105.4  
19 million.

20

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1 Q: What adjustments does Staff propose to the deferral balances for Customer  
2 Service Backout Credits?

3 A: Staff does not propose any adjustment to the deferral balance associated  
4 with Customer Service Backout Credits accrued under the first three years  
5 of PowerChoice. Staff does propose, however, to exclude a portion of the  
6 deferral for Customer Service Backout Credits that have been provided  
7 during the final months of PowerChoice and during the Merger Rate Plan  
8 period. On August 17, 2006, Staff in its response to a Company  
9 information request revised its recommended adjustments to exclude  
10 short-run avoided costs as follows:

11

<b>DPS Staff CSBC Proposed Adjustments<sup>3</sup></b>				
<u>Period</u>	<u>Original</u>	<u>Proposed Adjustment</u>	<u>Difference</u>	
2/1/02 – 6/30/05	\$9,226,233	\$6,919,675	\$2,306,558	
7/1/05 – 12/31/05	\$1,633,167	\$1,224,875	\$408,292	
1/1/06 – 2/28/06	\$505,163	\$378,872	\$126,291	
<b>TOTAL</b>	<b>\$11,364,563</b>	<b>\$8,523,422</b>	<b>\$2,841,141</b>	

12  
13

**TABLE 1**

14

15 Q: What is the basis for Staff's proposed adjustment?

16 A: Staff does not challenge either the eligibility of the Customer Service  
17 Backout Credits for deferral or the Company's calculation of the actual or

<sup>3</sup> Response to Information Request No. 393 (NMPC-5) (August 17, 2006).

1 forecast deferral balances. However, Staff contends that Niagara Mohawk  
2 violated its tariff by providing Customer Service Backout Credits to retail  
3 customers who purchase electricity supplies themselves ("Direct  
4 Customers"), in addition to those who purchase their electricity needs  
5 through a third-party Energy Service Company ("ESCO"). Staff takes the  
6 position that, under Niagara Mohawk's tariff, only customers served by a  
7 third-party ESCO, but not Direct Customers (i.e., customers who act as  
8 their own ESCO), are eligible for Customer Service Backout Credits.  
9 Therefore, it contends, Niagara Mohawk should not be allowed to defer  
10 \$8,523,422 of Customer Service Backout Credits provided to Direct  
11 Customers through February 28, 2006. (This disallowance does not reflect  
12 \$1,616,214 of Customer Service Backout Credits that have been provided  
13 or are forecasted to be provided to station service customers, which Staff  
14 would disallow under another of its adjustments.)<sup>4</sup> Staff recommends  
15 allowing Niagara Mohawk to submit a filing to modify its tariff to make  
16 Direct Customers eligible for the credits, at which time the Company  
17 should be permitted to defer the credits provided during the six months  
18 preceding the tariff filing.

19

---

<sup>4</sup> *Id.*

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1 Q: Does the CSBC Deferral of \$10.3 million for the first three years of  
2 PowerChoice that Staff accepts without adjustment include deferral of  
3 CSBC due to Direct Customers?

4 A: Yes it does. Staff obviously recognizes that such deferral of CSBC due to  
5 Direct Customers is proper here.

6

7 Q: Does Staff distinguish between CSBC Deferrals attributable to Direct  
8 Customers under the remaining term of PowerChoice and such deferrals  
9 under the Merger Rate Plan?

10 A: Yes, Staff did. Staff did not propose an adjustment is attributable to the  
11 PowerChoice Year 4/5 period which commenced on September 1, 2001  
12 and ended on January 31, 2002, presumably because the Memorandum of  
13 Agreement ("MOA")<sup>5</sup> resolved deferral account balances through that  
14 period (except, as discussed in the testimony of Mr. Molloy and Mr.  
15 Richer, for later activities that were not and could not be known at the  
16 time, but which affected those balances). Nevertheless, as part of its audit  
17 of the initial balances of Merger Rate Plan Attachment 11 deferrals under  
18 the MOA, Staff reviewed and accepted the initial balance of the CSBC

---

<sup>5</sup> Case 01-M-0075, *Joint Petition of Niagara Mohawk Holdings, Inc., Niagara Mohawk Power Corporation, National Grid Group plc and National Grid USA for Approval of Merger and Stock Acquisition. MEMORANDUM OF AGREEMENT*, "Order Adopting Memorandum of Agreement," September 4, 2003

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1           Deferral which included not only the deferrals under the first three years  
2           of PowerChoice, but also the deferral for the first four months (September  
3           2001 through December 2001) of PowerChoice Year 4/5. Included in  
4           these latter deferrals were amounts deferred after September 2001, when  
5           the tariff change that altered the eligibility criteria from "alternate  
6           supplier" to "ESCOs" took place. Staff had an early opportunity at the  
7           time of the MOA discussions in 2002 and 2003 to raise this issue and did  
8           not do so. The Company therefore was unaware of Staff's view that the  
9           tariff change that took effect as of September 2001 denied Customer  
10          Service Backout Credits to Direct Customers.

11

12    Q:    Does Staff claim that it is appropriate to deny Customer Service Backout  
13          Credits to Direct Customers?

14    A:    No. Staff seems to agree that Direct Customers, as well as customers  
15          served by third-party ESCOs should receive Customer Service Backout  
16          Credits. It argues, though, that the tariff does not allow for that result.  
17          Moreover, Direct Customers create the same long term savings in  
18          customer care and collection costs, which is the underlying basis for  
19          granting Customer Service Backout Credits, as do customers served by an  
20          ESCO. There is no rational reason for excluding Direct Customers from  
21          CSBC, nor does Staff assert that there is.

1

2 Q: Does Staff have anything to say about the consequences of its reading of  
3 Niagara Mohawk's tariff for the Direct Customers who received the  
4 Customer Service Backout Credits?

5 A: Staff acknowledges that Niagara Mohawk could issue rebills to recoup the  
6 Customer Service Backout Credits it provided (erroneously, in Staff's  
7 view) to Direct Customers in accordance with the rebilling provisions of  
8 P.S.C. No. 207 Electricity tariff Rule No. 26.11. Those provisions  
9 authorize the Company to make adjustments to correct errors on bills  
10 going back up to two years for non-residential customers. Staff  
11 recommends that the Company not issue such revised bills, and offers the  
12 six-month deferral discussed above as an alternative.

13

14 **Response to Staff Adjustments**

15 Q: Is Staff correct that Niagara Mohawk's tariff does not allow it to provide  
16 Customer Service Backout Credits to Direct Customers?

17 A: No, Staff's position is based on a novel and unreasonably narrow  
18 interpretation of Niagara Mohawk's tariff. Staff is correct in its statement  
19 that Rule 42 of the tariff specifies that Customer Service Backout Credits  
20 are "applicable to any customer who takes ESS [Electricity Supply  
21 Service] from an ESCO." But Staff is wrong to read this language as



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1 excluding Direct Customers from eligibility for Customer Service Backout  
2 Credits.

3

4 Q: Why is that?

5 A: The basic reason why the language of Rule 42 should not be read to make  
6 Direct Customers ineligible for Customer Service Backout Credits is that a  
7 Direct Customer functions as its own ESCO. Each Direct Customer  
8 makes the necessary arrangements to procure the electric energy and  
9 capacity needed to meet the needs of a retail customer – itself. That is  
10 precisely what a third-party ESCO does, except that it does so for third-  
11 party customers and therefore must meet qualifications established by the  
12 Department of Public Service for the provision of service to the public.  
13 That one distinction does not present a valid basis for giving Customer  
14 Service Backout Credits to retail customers served by a third-party ESCO,  
15 but not to Direct Customers that function as their own ESCOs.

16

17 Q: Is Staff's interpretation of Niagara Mohawk's tariff to exclude Direct  
18 Customers from eligibility for Customer Service Backout Credits  
19 consistent with the Merger Joint Proposal?

20 A: No. Section 1.3.3 of the Merger Joint Proposal, approved by the  
21 Commission in Case 01-M-0075, recognizes that all retail customers who

1 are eligible to obtain commodity service from a supplier other than the  
2 Company are entitled to Customer Service Backout Credits if they do so.  
3 That section provides in part that "All of Niagara Mohawk's customers are  
4 eligible to select an alternative supplier for their commodity needs.  
5 Customers selecting an alternative supplier shall be credited with a  
6 Customer Service Backout Credit . . ." The Merger Joint Proposal thus  
7 recognizes that Direct Customers, as well as customers served by a third-  
8 party ESCO, are eligible for Customer Service Backout Credits.

9  
10 Q: Has the Commission used the term "ESCO" to encompass a Direct  
11 Customer serving as its own ESCO, as well as an ESCO serving  
12 unaffiliated customers, as you interpret Niagara Mohawk's tariff?

13 A: Yes. The Commission's Uniform Business Practices<sup>6</sup> generally treat  
14 ESCOs, Direct Customers, and Marketers interchangeably. Indeed, in its  
15 1999 order in Case No. 98-M-1343, the Commission stated, "ESCO is  
16 used in this Order to refer to energy service companies, natural gas  
17 marketers and direct customers, where applicable."<sup>7</sup> The Commission has  
18 thus used "ESCO" in the same way it is used in Rule 42: to refer both to  
19 ESCOs serving third-party customers and Direct Customers. Interpreting

---

<sup>6</sup> Incorporated in P.S.C. No 207 Electricity tariff as Addendum No. 6.

<sup>7</sup> Case No. 98-M-1343, *In the Matter of Retail Access Business Rules*, n.2 (January 22, 1999).

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1 Rule 42 to make both classes of customers eligible for Customer Service  
2 Backout Credits is consistent with the Commission's usage of the term  
3 "ESCO."  
4  
5 Q: Can you think of any other reason to deny Customer Service Backout  
6 Credits to Direct Customers?  
7 A: No, and Staff does not identify any. The Customer Service Backout  
8 Credit was established in recognition of the fact that the Company will not  
9 incur certain costs in the long run associated with supplying commodity  
10 service to customers that purchase electric energy and capacity elsewhere.<sup>8</sup>  
11 Also, charging those customers for Niagara Mohawk's commodity supply  
12 costs when they also have to pay their own suppliers would obviously  
13 discourage them from seeking competitive supplies. These factors apply  
14 equally to Direct Customers and customers served by third-party ESCOs.  
15 Reading Niagara Mohawk's tariff to deny Customer Service Backout  
16 Credits to Direct Customers would lead to an absurd and obviously

---

<sup>8</sup> The level of the CSBC is predicated upon an end-state assumption that the utility is no longer the provider of commodity service to any of its customers. See Case 00-M-0504, *Proceeding on Motion of the Commission Regarding Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets and Fostering Development of Retail Competitive Opportunities*, "Statement of Policy on Unbundling and Order Directing Tariff Filings", (August 25, 2004). Since such long-term cost reductions are realized over time as customers migrate from utility to non-utility commodity service, a cost recovery mechanism is usually provided for the utility to recapture the difference between actual CSBC and its short-run avoided costs. For National Grid, that mechanism is provided for in § 1.3.3 of the Merger Rate Plan Joint Proposal.

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1 unintended result that is contrary to the Commission's Retail Access  
2 Policy.<sup>9</sup>

3

4 Q: Has Niagara Mohawk's tariff always included the language in Rule 42 that  
5 Staff relies on for its interpretation?

6 A: No. Rule 42 was modified to include the current language as part of the  
7 resolution of the Company's filing in Case 94-E-0098 to establish rates for  
8 Years 4 and 5 of PowerChoice, which was made on April 27, 2001, and  
9 modified twice in July 2001.

10

11 Q: Please describe the circumstances of that filing with respect to Customer  
12 Service Backout Credits.

13 A: Prior to that filing, the total amount of Customer Service Backout Credits  
14 provided to each service class was capped at a specified dollar level. In  
15 addition, the levels of the CSBCs, which were established for each service  
16 class, were much higher. As originally proposed in the PowerChoice  
17 Settlement Agreement<sup>10</sup> and as approved by the Commission in its August  
18 28, 1998 Order in Case 94-E-0098, CSBCs under Rule 42 were to be

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<sup>9</sup> Case 00-M-0504, *Proceeding on Motion of the Commission Regarding Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets and Fostering Development of Retail Competitive Opportunities*, "Statement of Policy on Further Steps Toward Competition in Retail Energy Markets", (August 25, 2004).

<sup>10</sup> Case 94-E-0098 *et al*, Niagara Mohawk Power Corporation, *PowerChoice Settlement Agreement*, (March 19, 1998), Section 5, pp. 69-70.

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1 available only for the first three years of PowerChoice. Thus, on April 27,  
2 2001 in its initial PowerChoice Year 4/5 Compliance filing, the Company  
3 proposed to cancel Rule 42 and cease paying CSBCs. It was at the behest  
4 of Staff and other parties to then on-going Merger Rate Plan negotiations,  
5 that the Company agreed to continue Rule 42 but with a new design and  
6 cost recovery method designed by Staff itself. In its July 2, 2001 first  
7 supplementary PowerChoice Year 4/5 filing, the Company proposed its  
8 present version of Rule 42 in a draft tariff leaf. This new version of Rule  
9 42 eliminated the service class caps, established lower levels of CSBC,  
10 reduced the number of different credits to two from four, set the short-run  
11 avoided cost rate to 0.5 mills per kWh, and established a deferral for the  
12 difference between the CSBC and the stipulated short-run avoided cost  
13 rate. These provisions would eventually be carried forward and  
14 incorporated into the Merger Rate Plan without change. The revisions to  
15 Rule 42 specified the adjusted levels of the Customer Service Backout  
16 Credits and also substituted the acronym, "ESCO," which was defined in  
17 the tariff, with the undefined phrase, "alternate supplier." On August 15,  
18 2001, the Staff issued a memorandum recommending approval of the  
19 Company's proposal, as amended, which the Commission adopted on  
20 August 29, 2001. The revised Customer Service Backout Credits took  
21 effect on September 1, 2001.

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1 Q: Was there any indication in the PowerChoice proceeding that the  
2 substitution of "ESCO" for "alternate supplier" in Rule 42 was intended or  
3 interpreted to deny Customer Service Backout Credits to Direct  
4 Customers?

5 A: No. To the contrary, in its memorandum recommending approval of the  
6 proposed revisions to the Customer Service Backout Credit mechanism,  
7 Staff described that mechanism as "designed to provide a bill credit to  
8 customers who chose to participate in [Niagara Mohawk's] Retail Access  
9 Program, thus receiving their commodity service from an alternate service  
10 provider." Both Direct Customers and customers served by third-party  
11 ESCOs "participate in [Niagara Mohawk's] Retail Access Program."  
12 Moreover, at no time during the discussions with Staff during May and  
13 June 2001 regarding the redesign of Rule 42 did Staff suggest that Direct  
14 Customers were not covered by the Rule.

15 Direct Customers had been receiving CSBC under Rule 42 since  
16 November 1999 when the New York Independent System Operator  
17 ("NYISO") commenced commercial operation.<sup>11</sup> As Staff correctly notes,  
18 it would be inappropriate now to interpret the revised Rule 42 to deny  
19 Customer Service Backout Credits to Direct Customers, since it would

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<sup>11</sup> The first three Direct Customers, a city, a town, and a county, began receiving commodity service from the NYISO within days after November 18, 1999, the date the NYISO commenced commercial operation.

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1 introduce unjustified distinctions, and potentially perverse incentives, as  
2 between similar customers. At the time the foregoing Rule 42 changes  
3 were being discussed, Staff had already proposed that the CSBC be  
4 continued in the Merger Rate Plan negotiations. Clearly, these changes  
5 were intended to bridge the period between end of Power Choice Year 3  
6 and the Effective Date of the Merger Rate Plan. It is inconceivable that  
7 the tariff change proposed by the Company and supported by Staff was  
8 intended to exclude Direct Customers from the CSBC benefits they were  
9 then receiving and were expecting to continue to receive post-Merger.  
10 Certainly, Staff did not apprise the Commission that this would be the  
11 result of approving the Rule 42 changes.

12

13 Q: Are there any other indications that Staff did not initially view the  
14 language of Rule 42 as excluding Direct Customers from eligibility for  
15 Customer Service Backout Credits?

16 A: Yes. As I mentioned earlier, Staff did not challenge the deferral of  
17 Customer Service Backout Credits accrued during the PowerChoice  
18 period, which extended through January 31, 2002—the Merger Rate Plan  
19 rates took effect the following day—and accepted the deferral for those  
20 credits, after Staff's own review and audit found that deferral to be correct,  
21 as part of the 2003 Memorandum of Agreement. However, the language

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1 in Rule 42 on which Staff relies to deny the deferral of post-Merger Rate  
2 Plan Customer Service Backout Credits was already in effect during the  
3 last five months of the PowerChoice period. Staff's current interpretation  
4 of that language therefore represents a new interpretation of the tariff and  
5 a change in position on its part.

6

7 Q: Do you have any comments about Staff's recommendation that the  
8 Company should file a tariff modification to add an explicit reference to  
9 Direct Customers in Rule 42 and, if it does so, to allow the Company to  
10 defer the Customer Service Backout Credits provided to Direct Customers  
11 during the preceding six months?

12 A: Yes. When Staff raised this issue through its information requests in this  
13 proceeding, which was the first time anyone suggested that Direct  
14 Customers were not eligible for Customer Service Backout Credits, the  
15 Company considered submitting a filing to modify Rule 42 to explicitly  
16 refer to Direct Customers, seeking treatment as a "housekeeping" filing. It  
17 is important to note that the filing utility does not have the authority to  
18 determine whether a filing is a proper housekeeping filing or not: this is a  
19 function of Staff. If Staff opposes that designation, the filing will not be  
20 deemed a housekeeping filing. In recent years, Staff has followed a  
21 practice under which it only designates a filing as "housekeeping" if the



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1 changes are insignificant in nature, or merely correct tariff language not in  
2 compliance with an express directive of the Commission, and the changes  
3 have no effect on Company revenues or customer's bills. In this instance,  
4 Staff's indication in this proceeding that it now interpreted Niagara  
5 Mohawk's tariff to deny Customer Service Backout Credits to Direct  
6 Customers led the Company to conclude that a filing would not meet this  
7 limited standard. In these circumstances, submission of a filing before  
8 Staff's new position was addressed in this proceeding seemed likely to  
9 waste the time and resources of the Commission and the parties by  
10 opening a new proceeding to adjudicate an issue that was clearly going to  
11 be addressed in the instant proceeding in any event.

12

13 Q: Are there any other issues?

14 A: Yes. In its final comments on the Customer Service Backout Credit issue,  
15 Staff alleges the Company did not comply with its own tariff by failing to  
16 require station service Direct Customers to file Retail Access Program  
17 Form 4 under P.S.C. 207 Electricity tariff Rule 39.6.4.

18

19 Q: Is Staff correct?

20 A: No. NYISO Station Power customers did not submit Retail Access Form  
21 4 to obtain power directly from the NYISO because they were not required

1 to do so. The Company filed in Case 01-E-1847 on July 10, 2003 (“July  
2 10 Filing”) revisions to its P.S.C. No. 207 Electricity Service  
3 Classification No. 7 - *Sale of Standby Service to Customers with On-Site*  
4 *Generation Facilities* (“SC-7”). These revisions addressed the NYISO’s  
5 tariff filing with the Federal Energy Regulatory Commission (“FERC”)  
6 related to station power service. In the filing, the company stated that  
7 those station power customers opting to “self-serve” their electric energy  
8 requirements directly through the NYISO would be eligible under Rule 39  
9 to be treated as “Direct Customers” of the NYISO.<sup>12</sup> Also included in this  
10 filing was Special Provision J for SC-7 and an updated Form G that  
11 applies specifically to these agreements. These new instruments for SC-7  
12 NYISO Station Power service replaced Retail Access Program Form 4 for  
13 these customers. The Commission approved the Company’s July 10  
14 Filing in Case 03-E-1016 *Niagara Mohawk Power Corporation –*  
15 *Proposed Tariff Revisions to S.C. No. 7 to Provide Unbundled*  
16 *Transmission and Distribution Rates For NY ISO Station Service*  
17 *Customers (filed in Case 01-E-1847)* on November 25, 2003 (“November  
18 25 Order”).

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<sup>12</sup> [T]o the extent generators have fulfilled all of the requirements of the NYISO to obtain commodity service directly from the NYISO, they would be eligible under Rule 39 of the Company’s retail access tariff to be treated as “Direct Customers” of the NYISO. . . . Prospectively, such eligible generators will be treated as “Direct Customers” and not be billed commodity service under the Company’s SC-7 tariff. [July 10 Filing, Filing Letter, p. 2]

1 **III. Economic Development Fund**

2 Q: Please briefly explain the Economic Development Fund issue.

3 A: The Merger Rate Plan Section 1.2.4.7 permits Niagara Mohawk to defer  
4 the difference between the amounts included in base rates and actual  
5 amounts of Empire Zone Rider discounts, discounts provided under  
6 Service Classification Nos. 11 and 12 ("SC-11 and SC-12") and  
7 incremental non-labor costs associated with New Program Initiatives  
8 under Section 1.2.10.2 of the Merger Rate Plan. In its testimony, Staff  
9 proposed an adjustment relating to discounts granted to customers under  
10 former SC-12 Section No. 7, Special Rule for Certain Customers  
11 Previously Receiving Optional Service, ("SC-12 Optional Customers").  
12 This issue relates to the actual balance of such deferral amounts as June  
13 30, 2005.

14

15 Q: Staff's testimony proposes adjustments to the Economic Development  
16 Fund deferral account. What is your understanding of what Staff  
17 proposes?

18 A: As we understand the testimony, Staff suggests that the Economic  
19 Development Fund deferral be increased by \$14,755 to account for the  
20 difference between the estimated and actual discounts given to SC-12

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1 Optional Customers for the month of January 2002. We accept Staff's  
2 proposed adjustment.

3

4 Q: Does the Company agree with Staff's forecast of the 2006-2007 deferrals?

5 A: The Company does not necessarily disagree with Staff's forecast of the  
6 2006-2007 deferrals, however, we are unsure how the Staff derived the  
7 numbers in their testimony. The Staff correctly states that the Company  
8 revised its forecast downward in its June 16, 2006 letter to the  
9 Commission in Case 01-M-0075, Filing Pursuant to the Order Approving  
10 and Modifying, In Part, Economic Development Program Proposals and  
11 Requiring Additional Filing. In that correspondence, the Company  
12 proposed to reduce the forecast for 2006 by \$17,378,688 and the forecast  
13 for 2007 by \$14,272,715 for a total reduction of \$31,651,403. However,  
14 Staff has proposed a reduction over the two years of \$27,769,426. As  
15 Staff states, the forecast for 2006 and 2007 is not a specific allowance or  
16 disallowance, but an estimate of future deferrals. Therefore, we can  
17 accept Staff's adjustment.

18

19 IV. Conclusion

20 Q: Thank you. I have no further questions at this time.

1  
2  
3

**REBUTTAL TESTIMONY OF  
JAMES J. BONNER JR. and LEE A. KLOSOWSKI**

4 **I. Introduction**

5 Q: Please state your names and business addresses.

6 A: [By Mr. Bonner] My name is James J. Bonner Jr. My business address  
7 and credentials were set forth in our responsive testimony, filed in this  
8 proceeding on September 1, 2006.

9 A: [By Mr. Klosowski] My name is Lee A. Klosowski. My business address  
10 and credentials, too, were set forth in our responsive testimony, filed in  
11 this proceeding on September 1, 2006.

12

13 Q: What is the purpose of your rebuttal testimony?

14 A: We will respond briefly to certain assertions regarding the Customer  
15 Service Backout Credits deferral presented in the testimony of Staff  
16 witnesses Denise A. Gerbsch and Robert A. Visalli (the “Staff Panel) in  
17 their Responsive Testimony filed on September 19, 2006. We note that,  
18 due to the limited time available, and because we fully described the basis  
19 for the deferral in our earlier testimony, we are not responding to every  
20 point made in the Staff Panel testimony. Our silence should not be  
21 construed as agreement with the arguments presented by the Staff Panel  
22 that we do not address. We also note that, in this rebuttal testimony, we

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1 will use defined terms and acronyms with the meanings defined in our  
2 responsive testimony.

3

4 Q: Do you sponsor any exhibits?

5 A: Yes, we have two exhibits. Exhibit \_\_\_\_ (JJB/LAK-1) is a redacted copy  
6 of the summary pages of the Company's Response to Information Request  
7 ("IR") No. 422 (PSC-358 Visalli (RAV-131)) and Exhibit  
8 \_\_\_\_ (JJB/LAK-2) is a corrected calculation of Staff's adjustment for  
9 Customer Service Backout Credits to Direct Customers, including  
10 redacted responses to IRs from which the data in the calculation are  
11 drawn.

12

13 **II. Response to Assertions Regarding Customer Service Backout Credits**

14 Q: Do you have any comments on the Staff Panel's assertion on page 95,  
15 lines 20-22, that your earlier testimony did not address the Staff Panel's  
16 "basic underlying reason for [its] proposed disallowance?"

17 A: Yes. This assertion is unfounded. In our earlier testimony, we noted  
18 explicitly (on page 9, lines 1-5, among other places) Staff's contention that  
19 the Company violated its tariff by providing Customer Service Backout  
20 Credits to Direct Customers who purchase electricity supplies themselves  
21 in addition to those who purchase their electricity needs through a third-

1 party Energy Service Company (“ESCO”). We then stated directly, on  
2 page 12, line 17, through page 13, line 2, that we disagreed with Staff’s  
3 interpretation of Niagara Mohawk’s tariff, and proceeded to explain the  
4 bases of our disagreement over approximately seven pages of testimony.  
5 Accordingly, Staff’s assertion that we did not address the basic rationale  
6 underlying its proposed adjustment is based on an obvious misreading of  
7 our earlier testimony.

8  
9 Q: What did you identify as the bases of your disagreement with Staff?

10 A: We identified seven reasons why Staff’s position was based on an  
11 incorrect interpretation of Niagara Mohawk’s tariff. We first explained  
12 that each Direct Customer functions as its own ESCo and, therefore, the  
13 language of Rule 42 of the tariff making Customer Service Backout  
14 Credits available to any customer taking service from an ESCo  
15 encompasses Direct Customers (page 13, lines 5-15). That is, under  
16 Niagara Mohawk’s tariff, an ESCo is any entity that supplies electric  
17 supply service, including a Direct Customer that supplies electric supply  
18 service to itself. We next explained that our interpretation, but not Staff’s,  
19 is consistent with the Merger Joint Proposal, which recognizes that Direct  
20 Customers, as well as customers served by a third-party ESCo, are eligible  
21 for Customer Service Backout Credits (page 13, line 20 – page 14, line 8).

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1 Third, we explained that our interpretation, but not Staff's, is also  
2 consistent with Commission rules and orders in which the term "ESCO" is  
3 used to refer both to ESCOs serving third-party customers and Direct  
4 Customers (page 14, line 13 – page 15, line 3). Fourth, we explained that  
5 our interpretation, but not Staff's, is consistent with the purpose of giving  
6 Customer Service Backout Credits to customers who make alternative  
7 arrangements to procure energy (page 15, line 7 – page 16, line 2) and  
8 with Commission policy set forth in Case 00-M-0504.<sup>1</sup> Fifth, we  
9 explained that our interpretation, but not Staff's, is consistent with Staff's  
10 recommendation to the Commission in 2001 to approve the tariff language  
11 that it would now interpret to deny Customer Service Backout Credits to  
12 Direct Customers (page 18, lines 5-14). Sixth, we explained that our  
13 interpretation, but not Staff's is consistent with the circumstances  
14 surrounding the proposal and adoption of that tariff language, which  
15 demonstrate the common intention to continue to provide Customer  
16 Service Backout Credits to Direct Customers and to customers taking  
17 service from third-party ESCOs (page 18, line 15 – page 19, line 11).  
18 Seventh and finally, we noted that Staff did not advance its current

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<sup>1</sup> See Case 01-M-00504, *Proceeding on Motion of the Commission Regarding Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets, and Fostering the Development of Retail Competitive Opportunities - Unbundling Track*, **STATEMENT OF POLICY ON UNBUNDLING AND ORDER DIRECTING TARIFF FILINGS**, (Issued and Effective August 25, 2004).



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1 interpretation of the Company's tariff during the discussion that led to the  
2 2003 Memorandum of Agreement ("MOA"), even though the language in  
3 Rule 42 on which Staff relies to deny the deferral of post-Merger Rate  
4 Plan Customer Service Backout Credits was already in effect (page 19,  
5 line 16, – page 20, line 20; also, page 10, line 10 – page 11, line 10).

6

7 Q: Does the Staff Panel address the reasons you gave for disagreeing with  
8 their interpretation of the Company's tariff to deny Customer Service  
9 Backout Credits to Direct Customers?

10 A: Not in any meaningful way. Staff does not contradict or even address any  
11 of the first six reasons we gave for our interpretation of Niagara  
12 Mohawk's tariff to make Customer Service Backout Credits available to  
13 Direct Customers, as well as customers served by third-party ESCOs. It  
14 does address the seventh reason by offering its claims that the deferral  
15 associated with the PowerChoice period "is insignificant" and, in any case,  
16 Staff just missed the issue when it was auditing the Company's deferral  
17 balances prior to the MOA (see page 94, lines 9-18). Staff's admission of  
18 its oversight, however, provides no affirmative support for its strained  
19 interpretation of the tariff to reach a result that obviously was not intended  
20 either by the Company or by Staff, and is inconsistent with Commission  
21 policy. It is also worth noting that the deferrals for Customer Service

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1           Backout Credits to Direct Customers during the PowerChoice period  
2           constituted about \$1.4 million, or over 13% of the total deferrals for  
3           Customer Service Backout Credits during this period. This is shown on  
4           Exhibit \_\_ (JJB/LAK-1).

5  
6    Q:    Do you have any comments about the Staff Panel's assertion on page 97,  
7           lines 22-24, that you admitted in your earlier testimony that Niagara  
8           Mohawk is providing Customer Service Backout Credits to Direct  
9           Customers in violation of the language in its tariff?

10   A:    Yes. As we have stated, we spent about eight pages of our earlier  
11           testimony stating that the tariff's reference to the provision of Customer  
12           Service Backout Credits to customers served by ESCOs encompasses  
13           Direct Customers acting as their own ESCOs and explaining why that is  
14           so. We did not "admit" that providing the credits to Direct Customers  
15           violates the tariff either there, or in the portion of our testimony cited by  
16           Staff (page 20, line 7 – page 21, line 11). In that passage, we explained  
17           why we had not submitted a tariff filing to modify the language once Staff  
18           notified the Company of its new interpretation of that language. Nowhere  
19           in that explanation did we express agreement with Staff's new  
20           interpretation.

1                   Similarly, in the IR response also cited by Staff, we explained that  
2                   the tariff language was broad enough to apply to “Direct Customers [that]  
3                   are basically acting as their own ‘ESCO,’” and is appropriately interpreted  
4                   to give effect to its clear intention: “to provide a credit to customers on  
5                   their service bills if they elect to take Electricity Supply Service (“ESS”)  
6                   from an alternative energy supplier, which includes both Energy Service  
7                   Companies (“ESCOs”) and Direct Customers of the NYISO.” We did not  
8                   admit that applying the tariff to provide credits to Direct Customers was  
9                   improper, though we acknowledged that the issue could be clarified  
10                  through a housekeeping filing. Such a clarification filing, if made and  
11                  adopted, would in no way affect the number, type or identity of the  
12                  customers that receive the Customer Service Backout Credits from the  
13                  population that receives those credits today. In our earlier testimony we  
14                  explained why we concluded, in light of this proceeding, why submitting  
15                  such a filing seemed like an unnecessary use of resources.

16

17    Q:    Given your interpretation of the tariff, which concludes that the language  
18            authorizes direct service customers to receive the Customer Service  
19            Backout Credit, do you agree with the Staff’s contentions about  
20            retroactive ratemaking?

1 A: No. It is Staff, who is suggesting that we implement a new construction of  
2 the tariff retroactively to deny customers the benefit of a credit that is  
3 consistent with the Commission's policy, authorized under Niagara  
4 Mohawk's tariff, and has been consistently applied by the Company to  
5 Direct Customers since the opening of retail markets in New York,  
6 without prior objection from Staff. Niagara Mohawk is not proposing to  
7 apply a new interpretation of its tariff retroactively, Staff is suggesting that  
8 the Commission retroactively adopt the new reading, which as we have  
9 indicated is inconsistent with the Commission's policy and Niagara  
10 Mohawk's past practice.

11 Given this background, Staff's discussion (pages 96-99) of  
12 limitations on backbilling under the Commission's regulations have no  
13 application to the case, and its suggestion of a penalty at page 99 is totally  
14 unwarranted.

15

16 Q: Do you have any further comments on the issue of Customer Service  
17 Backout Credits?

18 A: Yes. On page 5 of its responsive testimony, the Staff Panel describes the  
19 correction of an error in how it calculated its Customer Service Backout  
20 Credit adjustment, indicating a reduction in its proposed disallowance. In  
21 further reviewing Staff's adjustment, we determined that Staff used the

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1           wrong basis for calculating its adjustment (\$9.2 million instead of the  
2           correct basis of \$8.9 million). Although the Company does not believe  
3           any disallowance is appropriate, using the corrected basis for calculating  
4           the adjustment (assuming, for the sake of analysis, that any adjustment is  
5           warranted), would result in a proposed Staff disallowance of \$6,692,123  
6           instead of \$6,919,675 as originally proposed. The calculation, as well as  
7           redacted IR responses from which the data used in the calculation were  
8           drawn, are provided as Exhibit \_\_ (JJB/LAK-2).

9

10   **III. Conclusion**

11   Q:   Thank you. I have no further questions at this time.

1 JUDGE STOCKHOLM: Cross-examination.

2 MS. ASSAF: Thank you, Your Honor.

3 CROSS EXAMINATION

4 BY MS. ASSAF:

5 Q. Good afternoon, panel. If I could ask you to  
6 turn to page 19 on your September 1st testimony.

7 A. (Bonner) I am there.

8 Q. At around line 20 you indicate or you state in  
9 part that staff's own review on audit found the  
10 deferral to be correct; do you see that?

11 A. (Bonner) Yes, I do.

12 Q. Could you tell us how you know the staff audit  
13 of the premerger Joint Proposal CSBC included a  
14 segment on whether the deferred balance had a CSBC  
15 for direct customers?

16 A. (Bonner) Could you repeat the question again.

17 Q. Sure. I was asking how you know that staff's  
18 audit of the pre-MJP or merger Joint Proposal CSBCs  
19 include segment on whether the deferred balance had  
20 CSBCs in there for direct customers.

21 A. (Bonner) The CSBCs for direct customers were  
22 definitely within the numbers because the company  
23 had applied it during the pre-merger period.

24 JUDGE STOCKHOLM: Applied what?

1 A. (Bonner) The customer service backout credit to  
2 direct customers.

3 Q. How do you know that staff's audit and that  
4 staff understood that to be the case?

5 A. (Bonner) Staff didn't challenge the amounts at  
6 the time so from that we concluded that staff  
7 understood that the numbers were included in the  
8 deferral amounts.

9 Q. Was there a breakdown or were the CSBCs for  
10 direct customers in any way separately identified?

11 A. (Bonner) Not that I recall.

12 Q. If you could turn to page 21, line 14, and  
13 continuing onto the next page. You essentially  
14 argue that staff's allegation is incorrect that the  
15 company was not in compliance with its own tariff;  
16 is that correct?

17 A. (Bonner) Yes, that is correct.

18 Q. And the alleged non-compliance we are talking  
19 about related to failing to require station service  
20 direct customers to file a retail access program  
21 form four; is that correct?

22 A. (Bonner) Yes, it is.

23 Q. The reason you disagree with staff is because  
24 you say that the direct customers were not required

1 to file a form four; is that correct?

2 A. (Bonner) Yes. In this particular case, these  
3 direct customers.

4 Q. Is that because of the tariff revisions you  
5 discuss on page 22?

6 A. (Bonner) Yes, it is.

7 Q. Prior to the Commission approving that tariff  
8 revision is it correct that the company was not in  
9 compliance with the tariff that was effective up to  
10 that point, up to when the Commission approved the  
11 change?

12 A. (Bonner) I don't understand the reference.  
13 This specific provision is referring to the  
14 customers who were eligible for special provision J  
15 of SC-7. That didn't exist prior to the time that  
16 we are talking about here.

17 Q. So there was no tariff that had anything to do  
18 with these direct customers--retail access tariff  
19 that applied to direct customers prior to  
20 November 25, 2003?

21 A. (Bonner) No, that's not true at all. SC-7  
22 customers, and there are several different  
23 subcategories of SC-7 customers, are generally--the  
24 tariffs that apply to most other customers apply to



1       them as well.

2               In this particular case we were addressing  
3       harmonizing the company's standby service tariff  
4       with the FERC decision to approve the NYISO station  
5       power tariff. And so in this specific case, because  
6       these customers would no longer be taking commodity  
7       service from Niagara Mohawk where many customers do,  
8       not everyone does, in this particular case these  
9       customers would be recognized as direct customers of  
10       NYISO, and that was explained in the July 16th  
11       letter that accompanied the filing in case I think  
12       it's 03-E-1016.

13       Q.       Now I am a little confused. The retail access  
14       program form four, that did exist prior to the  
15       tariff change?

16       A.       (Bonner) Yes, it did.

17       Q.       But there was a requirement and that  
18       requirement applied to who?

19       A.       (Bonner) To most customers that are direct  
20       customers of NYISO under retail access provisions  
21       for the New York Independent System Operator.

22               JUDGE STOCKHOLM: What customers would it  
23       not apply for? You said most.

24               MR. BONNER: Yes. The customers to which it

1 does not apply to are the customers that we are  
2 discussing here. And these customers are covered by  
3 a separate part of the New York Independent System  
4 Operator tariff, which is the sale of station power  
5 to generating stations. It is only that segment  
6 that the form four would not apply.

7 JUDGE STOCKHOLM: Okay.

8 BY MS. ASSAF:

9 Q. Could you provide a reference to the section  
10 you are referring to, the one for which these  
11 customers--the ones that are applicable to these  
12 customers.

13 A. (Bonner) Sure, I might be able to do that. I  
14 am trying to recall if we entered that into the  
15 record. No, but I can provide it.

16 Q. Thank you.

17 JUDGE STOCKHOLM: And you are providing a  
18 provision to the tariff?

19 MR. BONNER: We would be providing a copy of  
20 the letter that accompanied our filing on July of  
21 2003 that explained the treatment of the NYISO  
22 station power customers under SC-7 and why they were  
23 going to be direct customers.

24 BY MS. ASSAF:

1 Q. Could you turn to page seven of your rebuttal  
2 testimony. You are asked a question there about  
3 staff's contentions of retroactive ratemaking. Do  
4 you see that?

5 A. (Bonner) Could you point me to a line number.

6 Q. I am sorry. The bottom of page seven, the  
7 question 17 through 20.

8 A. (Bonner) Where it begins given your  
9 interpretation of the tariff?

10 Q. Yes.

11 A. (Bonner) Yes, I see the question.

12 Q. Could you show us where in staff panel  
13 testimony on this issue they make a reference to  
14 retroactive ratemaking?

15 A. (Bonner) The basis of the answer is it didn't  
16 point to a specific reference in staff's testimony.

17 Q. Thank you.

18 A. (Bonner) It is a statement over the basic  
19 content thereof.

20 Q. There is no particular contention of  
21 retroactive ratemaking?

22 A. (Bonner) No. I don't find those words in  
23 staff's testimony.

24 Q. Thank you. On page eight of your rebuttal

1 testimony, lines one through three, you state that  
2 it's staff who is suggesting we implement a new  
3 construction of the tariff retroactively to deny  
4 customers the benefit of a credit that is consistent  
5 with the Commission's policy; is that correct?

6 A. (Bonner) Yes.

7 Q. Could you please show us where in staff panel  
8 testimony we say anything concerning that.

9 A. (Bonner) Staff's testimony didn't directly  
10 address the issue because this is all part of the  
11 same question. It's a conclusion that follows  
12 logically from the fact they deny the applicability  
13 that the customer service backout credit should have  
14 been applied to direct customers from September 2001  
15 to date.

16 Q. Panel, could you direct your attention to staff  
17 panel testimony, the bottom of 261 to the top of  
18 262?

19 JUDGE STOCKHOLM: Is this the--

20 MS. ASSAF: The August filing, the red one.

21 MR. BONNER: What was the reference again?

22 Q. The bottom of page 261 to the top of page 262.

23 A. (Bonner) Yes, I am there.

24 Q. The question here was whether staff recommended

1 the company issue any rebills, and the answer is no.  
2 Don't they clearly not recommend issuing rebills?

3 A. (Bonner) That is correct, although that's  
4 staff's recommended course of action. The  
5 straightforward interpretation is if staff were  
6 correct on the assertions that rule 42 does not  
7 apply to direct customers is that rebills could have  
8 been issued. So there are actually two courses of  
9 action that might be chosen, but logically that  
10 action could be taken.

11 MS. ASSAF: Thank you. I have no more  
12 questions.

13 JUDGE STOCKHOLM: Mr. Mager.

14 MR. MAGER: I have just a short line, Your  
15 Honor.

16 CROSS EXAMINATION

17 BY MR. MAGER:

18 Q. Generally speaking, you agree that the company  
19 is bound by its tariffs in terms of the rates it can  
20 charge, correct?

21 A. (Bonner) That's true.

22 Q. What is your recommendation, if any, if the  
23 Commission concludes that based on your tariffs you  
24 did not have the authority to give these customers

1 backout credits?

2 A. (Bonner) If we did not have the authority to  
3 charge these customers, if that was the Commission's  
4 conclusion, then the company should either back  
5 bill, which would be the straightforward answer, or  
6 it could adopt, following staff's suggestion, and go  
7 back for a period of time and capture that value and  
8 put it forward into the deferral account. But some  
9 action would have to be taken if it was determined  
10 that the company had incorrectly applied its tariff.

11 Q. And how would the deferrals be treated? I  
12 guess I am not clear with your answer.

13 A. (Bonner) By deferring it--putting it into the  
14 deferral account to be set for collection from other  
15 customers. It would work like any other item in the  
16 deferral account.

17 Q. Why would the company be allowed to defer  
18 credits that it was never authorized to provide in  
19 the first place?

20 A. (Bonner) That would be one choice. The other  
21 choice, the company could recover the money and  
22 choose to back bill its own customers and recover it  
23 that way.

24 Q. Under what policy would the Commission rule

1 that the company did not have the authority to issue  
2 credits under its tariff but still provide deferral  
3 treatment of those amounts?

4 A. (Bonner) Within its general authority to set  
5 just and reasonable rates.

6 Q. And it may do so regardless of the company's  
7 ROE?

8 A. (Bonner) Yes. In this specific instance.

9 Q. So the Commission can make other adjustments to  
10 deferrals under its obligation to set just and  
11 reasonable rates regardless of the company's ROE,  
12 correct?

13 A. (Bonner) I am not following where the  
14 connection--where the return on equity is an  
15 important criteria in that.

16 Q. Okay. Let's take a step back then. The  
17 Commission may make adjustments to proposed  
18 deferrals in order to set just and reasonable rates,  
19 correct?

20 A. (Bonner) It's within the Commission's  
21 authority to make those kinds of decisions, yes.

22 Q. And the Commission can make such decisions  
23 irrespective of the company's specific ROE, correct?

24 A. (Bonner) The Commission would take the return

1 on equity into account in making its determination  
2 of what was just and reasonable, but I don't think  
3 there's any particular prohibition that says if the  
4 ROE was such and such value we could only take such  
5 action.

6 MR. MAGER: Thank you. No further  
7 questions.

8 JUDGE STOCKHOLM: I'm still curious about  
9 the difference between, if any, direct customers that  
10 the backout credits are applicable to and those that  
11 it was not, but then became so because you filed a  
12 tariff. Now, how badly have I screwed up the facts  
13 on that.

14 MR. BONNER: Let's see if we can walk you  
15 through a little bit of the company's viewpoint on  
16 the whole thing. See if I can direct you to my  
17 testimony at--this is the September 1st, the  
18 responsive, at page 12 and it continues on. Let me  
19 just read it into the record.

20 JUDGE STOCKHOLM: It's already in the  
21 record. You don't need to do that.

22 MR. BONNER: Let me give you the references.  
23 Page 12, beginning at line 15, which is where the  
24 question is, and then continuing on right through



1 page 13 and 14.

2 JUDGE STOCKHOLM: Okay, perhaps my lack of  
3 understanding is more basic than that. Staff is  
4 adjusting your proposed deferrals in what way based  
5 on this adjustment?

6 MR. BONNER: They are denying recovery of  
7 the portion of the customer service backout credit  
8 deferral related to the period of time of  
9 September 2001 onward. Their specific adjustment I  
10 think I understand--I can find that in my testimony.  
11 On page eight of that same document, it was listed in  
12 table one, there is a correction to the number which  
13 are later in parts of my testimony that adjust the  
14 very first period, but the staff had put together an  
15 adjustment that went all the way back to February 28,  
16 2006.

17 JUDGE STOCKHOLM: It's your testimony,  
18 correct me if I am wrong, but is your testimony that  
19 you have always provided backout credits in  
20 accordance with your tariff and that therefore your  
21 deferrals are appropriate?

22 MR. BONNER: That is correct.

23 JUDGE STOCKHOLM: I am getting closer. I  
24 will understand it by the time I read the reply

1 brief.

2 MR. BONNER: There was a change in Niagara  
3 Mohawk's tariff that took place at Power Choice year  
4 4/5 which was in September of 2001. The language in  
5 the tariff that was originally set in 1998 and ran to  
6 September 1, 2001 had the word "alternate supplier"  
7 as being a customer signed up with an alternate  
8 supply eligible for the backout credit. At  
9 that point in time, September 2001, the word  
10 "alternate supplier" changes to the word ESCO. In  
11 addition, another change made at the same time makes  
12 clear customers receiving power from the New York  
13 Power Authority for some of their service did not  
14 receive a backout credit for that part.

15 The term alternate supplier and ESCO within  
16 the meaning of rule 42 was intended to be the same  
17 thing. The change that was made in September 2001  
18 was designed to clarify that customers were not  
19 eligible--they did use the term ESCO but in a broader  
20 sense than for other purposes, for example, in using  
21 it for the uniform business practice needs to  
22 distinguish between ESCOs and direct companies for  
23 the purpose of applying things like eligibility for  
24 selling power to other people and, for example,

1 creditworthiness requirements.

2 JUDGE STOCKHOLM: So far I am with you.  
3 What is the distinction we talked about earlier,  
4 however, between those direct customers subject to  
5 this and those direct customers not subject to the  
6 customer service backout credit?

7 MR. BONNER: Are you referring, Your Honor,  
8 to the discussion we were having about certain power  
9 customers being direct customers and whether or not  
10 they complied with form four?

11 JUDGE STOCKHOLM: Right.

12 (Bonner) It's a subset of the issue. These  
13 customers were defined to be direct customers by  
14 actions of the New York Independent System Operator  
15 when they created their station power tariff, and  
16 what it deemed was that the utility company was no  
17 longer providing commodity service in any manner,  
18 way, shape and form to such generators.

19 At that point we set forth in the proposal  
20 they shall be treated as direct customers, so we now  
21 at that point define such customers into the direct  
22 customer class. Though the direct had preexisted,  
23 this is an addition to it that had existed prior to  
24 that time.

1 JUDGE STOCKHOLM: Okay. I think I  
2 understand now. Thank you. I appreciate that.  
3 Anything else before we go to redirect? Okay. I  
4 didn't screw up the record.

5 MR. GAVILONDO: No redirect, Your Honor.

6 JUDGE STOCKHOLM: Thank you. Gentlemen,  
7 thank you very much for your testimony. You are  
8 excused.

9 (Witnesses excused.)

10 MR. GAVILONDO: The next panel scheduled to  
11 appear is Mr. Bonner and Mr. Leuthauser. I would  
12 like to call James Bonner back to the stand and  
13 Mr. Scott Leuthauser. Please state and spell your  
14 names for the record.

15 MR. BONNER: I have already done so. I  
16 think that will suffice.

17 MR. LEUTHAUSER: Scott D. Leuthauser,  
18 L-e-u-t-h-a-u-s-e-r.

19 MR. GAVILONDO: Your Honor, if I may  
20 approach the reporter.

21 JUDGE STOCKHOLM: Sure, absolutely.

22 MR. GAVILONDO: Handing the reporter a copy  
23 of the September 1, 2006 responsive testimony of  
24 James J. Bonner and Scott D. Leuthauser and a copy of

1 the rebuttal testimony of James J. Bonner and Scott  
2 D. Leuthauser dated September 26, 2006. Thank you.  
3 And for identification I have 11 exhibits prepared by  
4 these witnesses, numbered consecutively JJB/SDL 1  
5 through JJB/SDL 11.

6 JUDGE STOCKHOLM: Some of those exhibits  
7 were provided on September 4th and the others were  
8 provided with the rebuttal testimony; is that right?

9 MR. GAVILONDO: Yes, your Honor. JJB/SDL 1  
10 through 5 were provided with the September 1st  
11 testimony and exhibits. JJB/SDL 6 through 11 were  
12 provided with the September 26th responsive  
13 testimony.

14 JUDGE STOCKHOLM: Exhibits numbered 7  
15 through 17 as described by counsel will be marked for  
16 identification.

17 (Exhibits 7 through 17 marked for  
18 identification.)

19 And did you do the testimony?

20 MR. GAVILONDO: Not yet, Your Honor.

21 JUDGE STOCKHOLM: I won't jump the gun.

22 MR. GAVILONDO: Thank you.

23 DIRECT EXAMINATION

24 BY MR. GAVILONDO:

1 Q. Mr. Bonner and Mr. Leuthauser, before you you  
2 have a copy of a document that is 55 pages long  
3 dated September 1, 2006. Could one of you please  
4 describe it for the record.

5 A. (Bonner) Yes. That is the responsive  
6 testimony of James J. Bonner, Jr., and Scott D.  
7 Leuthauser filed on September 1st this year.

8 Q. And also before you you have a 17 page document  
9 dated September 26, 2006 and could one of you  
10 describe that document for the record.

11 A. (Bonner) That's the rebuttal testimony of James  
12 J. Bonner, Jr., and Scott D. Leuthauser.

13 Q. And did you provide exhibits with those  
14 testimonies?

15 A. (Bonner) Yes, we did.

16 Q. And there have been exhibits marked 7 through  
17 17 for identification. Are those the exhibits that  
18 you provided with your testimony?

19 A. (Bonner) Yes, they are.

20 Q. Do you have any corrections or changes to your  
21 prefiled testimony in either the September 1st or  
22 September 26th testimony?

23 A. (Bonner) No, I do not.

24 Q. Mr. Leuthauser?

1 A. (Leuthauser) No, I do not.

2 Q. And was that testimony prepared by you or under  
3 your supervision?

4 A. (Bonner) Yes, it was.

5 (Leuthauser) Yes, it was.

6 Q. And do you adopt that testimony as your  
7 testimony in this proceeding today?

8 A. (Bonner) Yes, I do.

9 (Leuthauser) Yes, I do.

10 Q. And the exhibits associated with that  
11 testimony, were they prepared by you or under your  
12 supervision?

13 A. (Bonner) Yes, they were.

14 (Leuthauser) Yes, they were.

15 Q. And those you adopt as full exhibits to your  
16 testimony today?

17 A. (Bonner) Yes, I do.

18 (Leuthauser) Yes.

19 Q. Any changes or corrections in those exhibits?

20 A. (Bonner) No.

21 (Leuthauser) No.

22 MR. GAVILONDO: With that, Your Honor, I  
23 would like to tender the witnesses for  
24 cross-examination.

1 JUDGE STOCKHOLM: Thank you. The  
2 testimony will be copied into the record as though  
3 given orally and the exhibits have been marked for  
4 identification.

5 (The following is the prefiled testimony  
6 of James J. Bonner, Jr. And Scott D. Leuthauser:)

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Case 01-M-0075 JAMES J. BONNER JR. and SCOTT D. LEUTHAUSER

1           **RESPONSIVE TESTIMONY OF JAMES J. BONNER JR. AND**  
2   **SCOTT D. LEUTHAUSER**  
3

4    **I.     Introduction**

5    Q:    Mr. Bonner, please state your name and business address.

6    A:    My name is James J. Bonner Jr. I am employed by Niagara Mohawk  
7           Power Corporation d/b/a National Grid ("Niagara Mohawk" or  
8           "Company"), and my business address is 300 Erie Blvd West, Syracuse,  
9           NY 13202.

10

11   Q:    Mr. Leuthauser, please state your name and business address.

12   A:    My name is Scott D. Leuthauser. I, too, am employed by Niagara  
13          Mohawk and my business address is also 300 Erie Blvd West, Syracuse,  
14          NY 13202.

15

16   Q:    Mr. Bonner, have you described your educational and professional  
17          background, your responsibilities at Niagara Mohawk, and your prior  
18          testimony before this Commission, in other testimony you offer in this  
19          proceeding?

20   A:    Yes. I provide that information in my testimony as part of a panel with  
21          Lee A. Klosowski on the subject of the deferral of costs associated with  
22          customer service backout credits.

1

2 Q: Mr. Leuthauser, have you described your educational and professional  
3 background, your responsibilities at Niagara Mohawk, and your prior  
4 testimony before this Commission, in other testimony you offer in this  
5 proceeding?

6 A: Yes. I provide that information in my testimony on the subject of the  
7 deferral of costs associated with testing and inspections for stray voltage.

8

9 **II. Background and Summary**

10 Q: What is the purpose of your testimony?

11 A: Our testimony describes and supports Niagara Mohawk's current and  
12 forecast deferral balances for Standby Service Lost Revenue and Disputed  
13 Station Service Revenue, and responds to arguments made by Staff  
14 purporting to show that Niagara Mohawk should not be permitted to  
15 recover these deferral balances. One of Staff's arguments, namely, its  
16 contention that a portion of the Disputed Station Service Revenue is  
17 ineligible for deferral because it was recorded as goodwill, is addressed in  
18 the panel testimony of Mr. Richer and Mr. Molloy.

19

20 Q: Would you summarize your conclusions with respect to Staff's proposed  
21 adjustments to Niagara Mohawk's deferral balances for these lost

1 revenues?

2 A: Certainly. First, Staff's proposed adjustments are unjustified and  
3 inconsistent with the terms of the Standby Service Joint Proposal, the  
4 Merger Rate Plan, and the PowerChoice settlements accepted by the  
5 Commission. Staff's analysis completely ignores the provisions of these  
6 rate settlements, which specifically authorize the deferral of revenue  
7 decreases caused by regulatory changes and explicitly acknowledge the  
8 potential for regulatory changes specifically affecting standby service  
9 revenues. Staff does not contest the Company's position that regulatory  
10 changes affecting the Company's ability to collect revenues through  
11 charges for standby service and station service authorized in its tariff have  
12 occurred. Instead of addressing the applicability of the provisions of the  
13 settlements accepted by the Commission, Staff attempts to substitute for  
14 their specific provisions an implausible interpretation of a legal test that  
15 the Commission has discretion to apply in cases where a utility is  
16 requesting a deferral in the *absence* of an agreement approved by the  
17 Commission specifically authorizing the deferral of costs and revenues in  
18 defined circumstances.

19 Second, Staff's claim that the methodology used to determine the  
20 magnitude of the deferrals is "subjective" and "impossible" to administer  
21 is really a critique of its own methodology: Staff's arguments assume that

1 Niagara Mohawk is using the deferral test urged by Staff instead of that  
2 prescribed by the Merger Rate Plan and PowerChoice rate settlements. In  
3 fact, the deferral mechanisms prescribed by these rate settlements satisfy  
4 all the Commission's rules and policies, and permit clear and precise  
5 determinations of the magnitude of the deferrals.

6 Third, the approach Staff urges here contradicts its past positions  
7 in the first CTC Reset proceeding as well as its positions before FERC  
8 with regard to standby service and station service. Staff's claim that it was  
9 unaware of the standby service and station service issues under  
10 consideration in this case provides no basis for departing from the terms of  
11 the agreements approved by the Commission. This claim, moreover, is  
12 hard to understand in light of Staff's participation in the federal  
13 proceedings that gave rise to the regulatory change that caused the lost  
14 revenues at issue, as well as the specific terms of the Merger Rate Plan  
15 addressing the deferral of standby service revenues.

16 We also rebut a number of issues that Staff raises but upon which  
17 it places less emphasis. The \$19 million in station service revenue lost  
18 before approval of the Merger Rate Plan is not "retroactive ratemaking" as  
19 Staff claims, but is deferrable under the provisions of the PowerChoice  
20 settlement, which predated all of these losses. Staff's claims that use of  
21 the Merger Rate Plan and PowerChoice deferral mechanisms here is

1 inconsistent with how Niagara Mohawk treats deferrals and other financial  
2 transactions elsewhere ignores the fact that Staff's purported examples  
3 either do not arise from regulatory change or are not subject to the  
4 provisions of the Merger Rate Plan deferral mechanisms in the first place.  
5 Staff's claim that part of the station service deferral was discharged in  
6 bankruptcy is simply inaccurate: the generator at issue emerged from  
7 bankruptcy with Niagara Mohawk's station service billing claims intact.

8  
9 Q: Briefly describe the Standby Service Lost Revenue and Disputed Station  
10 Service deferral issues.

11 A: The Standby Service Lost Revenue deferral is made under a mechanism  
12 authorized by the Commission in the Standby Service Rate proceeding<sup>1</sup> to  
13 adjust for the revenue effects of a regulatory change made by the  
14 Commission regarding recovery of standby service charges: specifically,  
15 the change made in 2001 from recovery of standby service charges  
16 rendered under Niagara Mohawk's P.S.C. No. 207 Electricity tariff Rule  
17 No. 12 ("Rule 12") or other applicable P.S.C. No. 207 Electricity service  
18 classification to the new P.S.C. No. 207 Electricity Service Classification

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<sup>1</sup> Case 01-E-1847, *In the Matter of the Compliance Filing of Niagara Mohawk Power Corporation in Response to Opinion No. 01-4 on Standby Service Rates*, "Order Approving Joint Proposal," (June 21, 2002).

1 No. 7 ("SC-7"). This provision supplemented and amended a deferral  
2 provision<sup>2</sup> authorized by the Merger Rate Plan.

3 The Disputed Station Service Revenue is a deferral made under  
4 mechanisms established by the Commission in both the PowerChoice  
5 proceeding and the Merger Rate Plan to adjust for the revenue effects of  
6 "any legislative, court, or regulatory change, which imposes new or  
7 modifies existing obligations or duties." ("Station service" is a commonly  
8 used term for standby service provided to generators.)

9  
10 Q: What was the purpose of these deferral mechanisms?

11 A: As Mr. Reilly discusses in his testimony, the PowerChoice and Merger  
12 Rate Plan rate agreements were complicated, delicately balanced  
13 compromises of numerous interests and factors. They involved major  
14 financial concessions by Niagara Mohawk in return for specific rate relief  
15 provided by the Commission. The essence of the bargain was that Niagara  
16 Mohawk would stabilize its retail rates for an extended period, but, in  
17 order to allow it to do this without presenting undue financial risk to the  
18 Company and its customers, the agreements each included adjustment and  
19 deferral mechanisms to allow for adjustments to the otherwise fixed rates

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<sup>2</sup> The Standby Service Joint Proposal provisions supplemented and amended Merger Joint Proposal Section 1.2.4.17.

1 to account for certain specified events. The deferral mechanisms  
2 applicable to the standby and station service revenue issues provided for  
3 the deferral of the impact of certain statutory, legal, or, regulatory changes  
4 on Niagara Mohawk's costs or revenues. In the case of the mechanism  
5 underlying the Standby Service Lost Revenue deferral, the parties agreed  
6 to adjust for the revenue effects of a regulatory change made to  
7 accommodate a change in the Commission's policy governing standby  
8 service rates. In the case of the mechanism underlying the Disputed  
9 Station Service Revenue deferral, the parties agreed to adjust for the cost  
10 or revenue effects (above a specified threshold) of statutory, court, or  
11 regulatory changes arising after the date of the Merger Rate Plan.

12

13 **III. Basis for Deferrals**

14 Q: Please discuss in more detail the regulatory basis upon which Niagara  
15 Mohawk claims a right to seek recovery of Standby Service Lost Revenue.

16 A: Standby Service Lost Revenue is subject to deferral and recovery under a  
17 settlement agreement reached between Staff, Niagara Mohawk, and other  
18 parties and approved by the Commission in Case No. 01-E-1847 (the  
19 "Standby Service Joint Proposal"). Under this agreement, standby service  
20 revenues lost as a result of the Commission's approval of a change in

1 Niagara Mohawk's tariff to the new SC-7 service classification are to be  
2 deferred and recovered.

3 Section 2 of the Standby Service Joint Proposal addresses the  
4 deferral and rate adjustment for Standby Service Lost Revenue. Section  
5 2.1.1 specifies how the verifiable lost or gained revenue is to be  
6 calculated:

7 Each month, Niagara Mohawk shall calculate the verifiable  
8 lost or gained revenue per customer associated with the  
9 implementation of the Standby Service tariff included in  
10 Attachment 1 [the SC-7 service classification] by  
11 comparing the delivery service billings under the Standby  
12 Service tariff to the delivery service billings that would  
13 have been made by Niagara Mohawk under its superseded  
14 Rule 12 or other applicable tariff in effect prior to the  
15 Effective Date of this Joint Proposal ("Standby Service  
16 Lost Revenue").  
17

18 The section goes on to provide detailed analysis of the various  
19 permutations of the calculation that can occur at various retail and  
20 wholesale generator locations.

21 Section 2.1.2 of the Standby Service Joint Proposal establishes a  
22 special Standby Service Lost Revenue Deferral Account that is to be  
23 adjusted monthly. Section 2.1.3 authorizes the Standby Service Lost  
24 Revenue Rate Adjustment that allows Niagara Mohawk to make a  
25 compliance filing, detailed in Attachment 2 to the Standby Service Joint  
26 Proposal, to adjust delivery rates at the time of the CTC Reset when the



1 sum of the Standby Service Lost Revenue Deferral and the balance in the  
2 major deferral account under Section 1.2.4 of the Merger Joint Proposal is  
3 positive.

4

5 Q: Please briefly describe why these Standby Service Lost Revenue  
6 provisions were negotiated and approved separately from the rest of the  
7 Merger Rate Plan.

8 A: The Standby Service Lost Revenue provisions were put in place to  
9 accommodate a change in the way standby service revenues were  
10 collected under Niagara Mohawk's tariff. These revenues had previously  
11 been charged under Rule 12 of Niagara Mohawk's tariff and/or under  
12 another applicable service classification. The Commission had issued an  
13 order in Case 99-E-1470 on October 26, 2001, adopting new guidelines  
14 for standby rates applicable to all customers with on-site generators in  
15 New York, both retail and wholesale. In response, on November 28,  
16 2001, Niagara Mohawk made a compliance filing in Case 99-E-1470 (later  
17 renumbered Case 01-E-1847 for Niagara Mohawk) submitting its new SC-  
18 7 rate classification for generators.

19 The parties had originally anticipated reflecting the change from  
20 Rule 12 to SC-7 in Section 1.2.4.17 of the Rate Plan, along with similar  
21 provisions allowing deferral of revenue losses associated with changes to

1 Niagara Mohawk tariff Rules 44 and 52. Thus, Section 1.2.4.17 had  
2 originally authorized Niagara Mohawk to include in the Deferral Account:

3 all verifiable losses of revenue associated with  
4 modifications to Rules 12, 44, and 52 after the filing of this  
5 Joint Proposal, including, without limitation, the  
6 implementation of the Standby Order contemplated in  
7 Section 1.2.17.3.2 . . .

8  
9 However, since the Commission had already initiated a separate  
10 proceeding to evaluate its policy for retail standby service rates charged to  
11 generators, it seemed desirable to consider the deferral of lost revenues  
12 associated with this new policy in this separate proceeding as well.

13 Negotiations in this separate standby service proceeding led to a Standby  
14 Service Joint Proposal dated March 12, 2002. Because Section 2.1.4 of  
15 this Standby Service Joint Proposal now supplemented and amended  
16 Section 1.2.4.17 of the Merger Joint Proposal by specifically addressing  
17 the lost revenues resulting from changes from Rule 12 to SC-7, the parties  
18 modified Section 1.2.4.17 to reflect this. As thus modified, the Merger  
19 Joint Proposal now provides as follows:

20 1.2.4.17 Loss of Revenue from Changes to Rules 44 and  
21 52

22  
23 Niagara Mohawk shall include in the Deferral Account all  
24 verifiable losses of revenue associated with modifications  
25 to Rules 44 and 52 after the filing date of this Joint  
26 Proposal. . . but excluding . . . the Actual Annual Standby  
27 Service Lost Revenue incurred under the Joint Proposal  
28 approved by the Commission in Case No. 01-E-1847 using

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1 the methodology shown in Attachment 2, page 5, of that  
2 Joint Proposal.

3  
4 The Commission approved the Joint Proposal and the treatment of  
5 lost revenue in its Order dated June 21, 2002 in Case 01-E-1847. As the  
6 Commission stated in that Order: "The NMPC rate plan contains a lost  
7 revenue deferral mechanism, which subsumes, among other things, all  
8 verifiable losses associated with implementation of the Standby Order."<sup>3</sup>

9  
10 Q: How does Niagara Mohawk calculate Standby Service Lost Revenues for  
11 deferral under the provisions discussed above?

12 A: Pursuant to these provisions, the Company calculates, on a monthly basis,  
13 the lost or gained delivery revenue associated with each customer served  
14 under SC-7 beginning July 1, 2002. The lost or gained revenue is  
15 determined as the sum of the delivery charges and Competitive Transition  
16 Charges ("CTC") that the Company would have charged the customer  
17 under the otherwise applicable service classification absent SC-7 minus  
18 the sum of the actual delivery and CTC charges billed to the customer  
19 under SC-7. (The first part of this calculation is performed differently  
20 based on whether the SC7 customer would have been served under Rule

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<sup>3</sup> Case 01—E-1847, *In the Matter of the Compliance Filing of Niagara Mohawk Power Corporation in Response to Opinion No. 01-4 on Standby Service Rates*, Order Approving Joint Proposal, p. 4 (June 21, 2002).

1 12 prior to removal of that rule, or whether the customer was exempt from  
2 Rule 12.)

3  
4 Q: Does the Merger Rate Plan also authorize Niagara Mohawk to recover  
5 Disputed Station Service Revenue deferrals?

6 A: Yes. Section 1.2.4.3 of the Merger Rate Plan provides that:

7 Unless otherwise provided for in Section 1.2.3.5 [covering  
8 reclassifications of costs that are immediately reflected in  
9 rate adjustments], Niagara Mohawk shall include in the  
10 Deferral Account all of the effects of any legislative, court,  
11 or regulatory change, which imposes new or modifies  
12 existing obligations or duties and which, evaluated  
13 individually, increases or decreases Niagara Mohawk's  
14 revenues or costs from regulated electric operations at an  
15 annual rate of more than \$2.0 million per year.

16  
17 There is a similar provision in the PowerChoice Settlement. Section 2.6.1  
18 of the PowerChoice Settlement provides that: "the following changes in  
19 forecast costs are eligible for deferral: changes in laws, regulations, rules  
20 and accounting that can be substantiated as increasing or decreasing the  
21 cost of doing business (in excess of \$500,000 per change) . . ."

22  
23 Q: How do these provisions authorize recovery of Disputed Station Service  
24 deferrals?

25 A: There has unquestionably been a regulatory change that modifies Niagara  
26 Mohawk's obligations and duties, and has decreased its revenues from

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1 regulated electric operations at an annual rate of more than \$2 million per  
2 year. That change is reflected in a series of FERC orders issued  
3 subsequent to the Commission's approval of the Merger Rate Plan, which  
4 substantially reduced or eliminated the revenues that Niagara Mohawk is  
5 authorized to collect for its provision of standby services to wholesale  
6 generators. These orders for the first time allowed generators  
7 interconnected directly to the Company's transmission system to bypass  
8 Niagara Mohawk's retail standby service charges altogether (except in the  
9 rare case in which a generator has net negative generation over a period of  
10 30 days or more – and in the latter case allows standby service charges to  
11 be levied only for that portion of standby service delivered while the  
12 negative generation condition persists beyond the 30 days). The result of  
13 FERC's regulatory change (which, unfortunately, is binding upon Niagara  
14 Mohawk and the Commission) has been a substantial and continuing loss  
15 of revenue by Niagara Mohawk, because a number of the large wholesale  
16 generators interconnected to its system now no longer pay for the  
17 substantial standby service Niagara Mohawk provides to them.

18

19 Q: Does Staff dispute that there has been a substantial regulatory change  
20 affecting Niagara Mohawk's station service revenues from generators?

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1 A: No. As we explain later, Staff does not dispute that there has been a  
2 substantial regulatory change affecting Niagara Mohawk's station service  
3 revenues from generators. In fact, Staff's testimony completely fails to  
4 address the provisions of the Merger Rate Plan and PowerChoice  
5 settlements authorizing deferred recovery of revenues and costs affected  
6 by regulatory changes.

7  
8 Q: Please describe in more detail the FERC regulatory change that took place  
9 after approval of the Merger Rate Plan.

10 A: The Commission had authorized Niagara Mohawk to charge generators  
11 for station service as part of its retail tariff under rules going back at least  
12 two decades.<sup>4</sup> At the time when the Merger Joint Proposal and Standby  
13 Service Joint Proposal were approved, in January and June 2002,  
14 respectively, Niagara Mohawk provided station power to generator  
15 customers under its general service classifications for industrial end-users,  
16 primarily the P.S.C. No. 207 Electricity Service Classification Nos. 3 and  
17 3A ("SC-3 and SC-3A") service classifications. Those service

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<sup>4</sup> See discussion in Case 94-E-0098, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation for Electric Service*. S.C. 7 *TARIFF FILING*, "Order Denying Requests to Postpone a Tariff Filing," (October 29, 1999), pp. 3-4.

1 classifications measured usage and demand based on 15-minute intervals.<sup>5</sup>  
2 In June 2002, Commission approved Niagara Mohawk's SC-7 rate  
3 classification, which applied the same measurement of net generation over  
4 15 minute intervals.<sup>6</sup> This approach was consistent with the NYISO  
5 market rules in effect at that time (and until April 1, 2003): all withdrawals  
6 of unbundled electric energy from the New York Transmission System  
7 operated by the NYISO to serve retail load in Niagara Mohawk's  
8 Transmission District were subject to the retail delivery rates in Part IV of  
9 the NYISO OATT, which incorporated the delivery rates of Niagara  
10 Mohawk's retail tariff by reference. *See* New York Independent System  
11 Operator, Inc., FERC Electric Tariff Original Volume No. 1 ("NYISO  
12 OATT"), Original Sheet No 201 (Effective Sept. 1, 2000), stating that  
13 "[a]ll retail Transmission Service over the transmission facilities of the  
14 Parties to the ISO/TO Agreement shall be pursuant to this Section." This  
15 rule was applied specifically to station power under a NYISO "Technical  
16 Bulletin," which provided that station service "is rendered pursuant to the  
17 applicable retail tariff." NYISO Revised Technical Bulletin 34, effective  
18 July 17, 2000.

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<sup>5</sup> P.S.C. No. 207 Electricity Service Classification No. 3, Leaf No. 86-A; and P.S.C. No. 207 Electricity Service Classification No. 3A, Leaf Nos. 87-E1 and 87-E2.

<sup>6</sup> Case No. 01-E-1847, *In the Matter of the Compliance Filing of Niagara Mohawk Power Corporation in Response to Opinion No. 01-04 on Standby Service Rates*, 219 P.U.R. 4<sup>th</sup> 457, 2002 N.Y. PUC LEXIS 270 (June 21, 2002), *reh'g denied*, 2002 N.Y. PUC LEXIS 528 (Oct. 4, 2002).

1                   It was not until September 2002 that NYISO for the first time  
2                   proposed a station service rule that permitted 30-day netting, i.e., that  
3                   permitted a generator/customer to avoid paying charges for the delivery of  
4                   station service unless its consumption exceeded its output over a 30-day  
5                   period.<sup>7</sup> Over the strong objections of Niagara Mohawk, Commission,  
6                   and other parties, FERC approved this new rule in November 2002, and it  
7                   went into effect in April 2003 as part of NYISO's Market Administration  
8                   and Control Area Services Tariff.<sup>8</sup> Thus, at the time the Rate Plan and  
9                   Standby Service Rate Plan were filed in early 2002, the established rule  
10                  applied by NYISO and Commission prescribed the quarter-hourly  
11                  measurement of stand by service (effectively corresponding to quarter-  
12                  hourly "netting") in force under service classifications SC-3 and -3A, and  
13                  later under SC-7. FERC's approval of the new station power rules  
14                  authorizing 30-day netting, which it put into effect in April 2003 (and, as  
15                  we will explain, later applied retroactively), clearly constituted a  
16                  regulatory change occurring subsequent to the filing of the Joint Proposal  
17                  in January 2002. All of the lost revenues deferred in the Disputed Station  
18                  Service account at issue here are a direct result of this FERC regulatory  
19                  change.

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<sup>7</sup> *KeySpan-Ravenswood, Inc. v. New York Independent System Operator, Inc.*, 101 FERC ¶ 61,230, P 5 (2002).

<sup>8</sup> *See KeySpan-Ravenswood*, 108 FERC ¶ 61,164 at P 4 (2002); *KeySpan-Ravenswood*, 101 FERC ¶ 61,230 at P 1; NYISO Market Services Tariff Section 4.24



1

2 Q: How does Niagara Mohawk calculate Disputed Station Service revenues  
3 for deferral under the provisions discussed above?

4 A: The basic calculation is straightforward. As in the case of the Standby  
5 Service Lost Revenues, Niagara Mohawk simply compares the delivery  
6 charges and Competitive Transition Charges ("CTC") that the Company  
7 would have charged each customer under SC-7 or other applicable service  
8 classification minus the sum of the actual delivery and CTC charges that  
9 could be billed to the customer under the FERC regulatory change  
10 described above. Although the Commission has not yet addressed how the  
11 FERC-mandated regulatory change will be reflected in the retail rates of  
12 Niagara Mohawk and other New York utilities, for purposes of making the  
13 required forecast of deferrals for this reset period, the Company has  
14 simply assumed that generators will not pay any of the delivery and CTC  
15 charges that are billed in accordance with the existing retail tariff  
16 provisions.

17

18 Q: Given that the FERC regulatory change discussed above was not approved  
19 until November 2002, why is Niagara Mohawk claiming lost revenues  
20 from before this period?

1 A: While FERC's approval of the regulatory change came in November  
2 2002, in subsequent orders FERC put this change into effect as of May  
3 1999.<sup>9</sup> What this means is that revenues actually received from affected  
4 generators going back to this date have had to be credited back to these  
5 generators, and revenues due but not received from affected generators  
6 have now been bypassed.

7

8 **IV. Response to Staff Objections to Standby Service Deferrals**

9 Q: What are Staff's main objections to Niagara Mohawk's requested deferral  
10 recovery?

11 A: Staff does not argue that there was no regulatory change as provided for in  
12 rate plan section 1.2.4.3. Nor does Staff argue that Niagara Mohawk did  
13 not lose revenue as a result of such regulatory change. Likewise, Staff  
14 does not argue either that Niagara Mohawk did not lose revenues as a  
15 result of the change from Rule 12 to SC-7 for recovery of standby rates  
16 under Niagara Mohawk's retail tariff that trigger section 1.2.4.17 of the  
17 Merger Rate Plan.

18 In fact, Staff's main objection to the requested deferral recovery  
19 completely ignores the terms of the Merger Rate Plan: Staff argues that

---

<sup>9</sup> See e.g. *AES Somerset, LLC v. Niagara Mohawk Power Corp.*, 110 FERC ¶ 61,032, P 70 (2005).

1           these lost revenues cannot be deferred – regardless of the provisions of the  
2           Merger Rate Plan approved by the Commission – because revenues from  
3           the provision of station service were not included in the revenue forecasts  
4           underlying the Joint Proposal. Specifically, Staff argues that the deferrals  
5           requested by Niagara Mohawk fail to meet one of the prongs of the  
6           Commission's three-prong test for deferral recovery. Staff testimony, pp.  
7           23:14-24:17. Staff concedes that, even under its analysis, Niagara  
8           Mohawk's deferral request meets the "materiality" and "over-earning"  
9           prongs of the deferral test; according to Staff, the only prong the request  
10          does not meet is the "decremental" prong (which Staff initially refers to as  
11          the "incremental" prong). Staff testimony, pp. 24:18-25:8. Even here,  
12          Staff's argument is very narrow: Staff concedes that the "decremental"  
13          prong of the deferral test is intended to identify situations where a revenue  
14          source has been "lost" or is "nonexistent". Staff testimony, pp. 25:23-  
15          26:16. Yet Staff does not deny that the revenues Niagara Mohawk could  
16          recover through charges for standby service has declined through the  
17          change from Rule 12 to SC-7. Nor does Staff deny that FERC's ruling  
18          prevents Niagara Mohawk from realizing the revenues that would  
19          otherwise result from the application of the delivery and CTC charges in  
20          its retail tariff to generators receiving standby service.

1                   Staff's narrow claim is that none of Niagara Mohawk's generation  
2 plants were sold before 1999, and so "by definition" no charges for station  
3 service provided to them could have been included as "line items" in the  
4 baseline rates that were used to structure the Merger Rate Plan. Staff  
5 testimony, pp. 27:11-24, 58:17-60:24. Specifically, Staff argues that the  
6 lost revenues do not satisfy the "decremental" prong of the Commission's  
7 deferral policy because there is no line item in the baseline revenue  
8 projections against which a "decrement" could be measured, despite the  
9 fact that the lost revenues are real and substantial.

10

11 Q: Is Staff's position correct?

12 A: No. Staff's position is contrary to the terms of the Merger Rate Plan and  
13 the PowerChoice Settlement Agreement and, if accepted, would prevent  
14 those agreements from achieving their clear purpose. Indeed, it is notable  
15 that nowhere in the 48 pages of testimony in which Staff sets out its  
16 position does Staff discuss the provisions of the Merger Rate Plan and  
17 PowerChoice settlements authorizing the recovery of costs or revenues  
18 affected by regulatory changes.

19

1 Q: Why do you believe that Staff's argument is contrary to the terms of the  
2 Merger Rate Plan (including the Standby Service Joint Proposal) and  
3 PowerChoice Settlement Agreement?

4 A: Staff's argument violates the Merger Rate Plan, the Merger Joint Proposal  
5 and PowerChoice Settlement Agreement because it effectively ignores  
6 their existence. As we have shown, the deferrals of lost standby service  
7 revenues are clearly authorized by Section 1.2.4.3 and 1.2.4.17 of the  
8 Merger Rate Plan, and Staff does not argue that they are not. Instead,  
9 Staff relies exclusively on arguments based on general Commission  
10 policies, in this case policies regarding deferrals. However, in the instant  
11 proceeding these general Commission policies – which are applied when  
12 utilities approach the Commission with requests for deferrals in the  
13 absence of any governing rate agreements – have already been interpreted  
14 and applied through the specific terms of the Merger Rate Plan, the  
15 Standby Service Joint Proposal, and the PowerChoice Settlement  
16 Agreement. Just as the Company could not escape its obligations under  
17 one of these agreements by pointing to general ratemaking principles or  
18 policies, Staff cannot rely on its view of general ratemaking principles to  
19 override the negotiated and Commission-approved implementation of  
20 these general ratemaking principles in the specific context of the rate  
21 agreements.

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1           As we have shown above, Section 1.2.4.3 of the Merger Rate Plan  
2           authorizes deferral of lost revenues caused by regulatory changes to the  
3           rules for billing standby service to wholesale generators (also known as  
4           “station service”). There has been a regulatory change that greatly reduces  
5           Niagara Mohawk’s ability to charge wholesale generators for such station  
6           service. This regulatory change has clearly reduced Niagara Mohawk's  
7           revenues because generators have not paid station service bills under the  
8           SC-7 tariff that FERC has ruled inapplicable.

9

10    Q:    Does Staff present a contrary analysis of how the Merger Rate Plan  
11           provisions you discuss apply to station service lost revenues?

12    A:    No. Staff’s testimony does not take issue with any of these propositions,  
13           or indeed, present any analysis of the Merger Rate Plan’s provisions.

14           Similarly, Section 2.1.1 of the Standby Service Joint Proposal is a specific  
15           special case of a Commission policy that changes in standby rates caused  
16           by regulatory change are deferrable and recoverable, in this case allowing  
17           deferral recovery of losses associated with the change in Commission  
18           regulations governing standby service. There clearly has been a change in  
19           the rates resulting from the change from Rule 12 to service classification  
20           SC-7, and this change has clearly affected Niagara Mohawk's revenues.

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1           Again, Staff does not argue otherwise, or undertake any analysis of the  
2           Merger Rate Plan

3                       Staff's testimony offers no analysis of the Merger Rate Plan,  
4           Standby Service Joint Proposal, or PowerChoice Settlement Agreement,  
5           but instead purports to analyze the lost station service revenue deferral as  
6           though they did not exist. Staff treats this case as though Niagara  
7           Mohawk were asking to defer the lost revenues on a blank slate, pursuant  
8           to the Commission's general policies regarding the deferral of such  
9           revenues. However, this case is about the proper implementation of the  
10          Merger Rate Plan, Standby Service Joint Proposal, and PowerChoice  
11          Settlement Agreement. These rate settlements allow the deferral of certain  
12          costs and revenue items as part of complex integrated bargains which  
13          include a stabilization of Niagara Mohawk's delivery rates. Niagara  
14          Mohawk relied on the specific deferral items included in the rate plans as  
15          part of the overall bargain allowing it to agree to the long-term rate  
16          stabilization which it has observed.

17

18    Q:    If Staff's position were correct, would the deferral provisions of the  
19           Standby Service Joint Proposal, the Merger Rate Plan, and the  
20           PowerChoice Settlement Agreement be meaningful?

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1 A: No. If Staff's position were correct there would have been no point at all  
2 in including these provisions in these rate agreements, because Niagara  
3 Mohawk would only be able to defer costs or revenues if such deferral  
4 were permitted under general Commission policy. This makes no sense.  
5 There would have been a little reason for the Commission, Niagara  
6 Mohawk, and the other parties to undertake the time-consuming, tortuous,  
7 and complex negotiations required to formulate and win approval of these  
8 rate settlements if they had intended them to be a dead letter – i.e., if  
9 general rules regarding deferrals were to be applied in any event. The  
10 parties, through their agreements, intended the terms of the rate plans to be  
11 followed over the periods during which they are effective, and the  
12 Commission's acceptance of those agreements made them binding on the  
13 parties to this proceeding, including the Staff. These terms clearly address  
14 both the specific change from Rule 12 to SC-7 and the issue of other  
15 regulatory changes having impacts on Niagara Mohawk's standby  
16 service/station service revenues.

17  
18 Q: Staff's testimony states: "For at least the past twenty years, the  
19 Commission has always set and maintained the . . . three prong test for  
20 determining whether an incurred cost is deferrable . . . This three prong  
21 test is set forth in every Commission order dealing with utility petitions for



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1 deferral accounting . . .” Staff testimony, 23:17-20, 23:24-24:2. Do you  
2 agree with Staff’s assessment?

3 A: No, we do not. Even if the general test for deferral treatment could  
4 properly be used to override or modify the terms of the agreements  
5 approved by the Commission, the Commission has applied that test in a  
6 far more flexible manner than Staff suggests. In fact, Staff itself has  
7 advised the Commission that the three-prong deferral test is

8 considered practice rather than policy because it has  
9 evolved over the years and has been modified depending on  
10 the circumstances. No formal policy on deferred  
11 accounting (excluding income taxes) has ever been issued  
12 by the Commission. However, the guidelines outlined  
13 above have been expressed in various Staff Memorandums  
14 to the Commission.

15  
16 See Case 94-M-0667 Notice, Appendix A at 4, Fn. 3. In fact, the  
17 Commission has exercised discretion to allow the use of deferral  
18 accounting where it believes it is reasonable. The Commission has  
19 confirmed that its guidelines for allowing the use of deferral accounts in  
20 particular cases are just that – guidelines, not formal polices or  
21 regulations. See Case 01-M-1958, *Petition of Consolidated Edison*  
22 *Company of New York, Inc. etc.* (Issued and effective January 30, 2004);  
23 Case No. 01-G-1821, *Petition of Central Hudson Gas & Electric*  
24 *Corporation etc.* (October 25, 2002); Case 29189, *Proceeding on Motion*  
25 *of the Commission as to the Rates and Charges of Rochester Gas and*

1           *Electric Corporation etc.* Opinion No. 86-17(A) (November 3, 1986).  
2           This position has been upheld in the Appellate Division. *Rochester Gas &*  
3           *Electric Corp. v. Public Service Commission*, 135 AA 2d, 4, 12, 523 NYS  
4           2d 201, 205 (3d Dept. Sept. 1987). Finally, when specifically asked in an  
5           IR to “provide any documents in Staff’s possession . . . indicating that the  
6           lost revenue recoveries provided for in the SC-7 settlement or the  
7           Commission’s approval thereof requires a showing that the revenues were  
8           decremental to the forecast used to set rates in order to be eligible for  
9           deferral,” Staff was unable to provide any such documents. (See Exh. \_\_\_\_  
10          (JJB/SDL-1) [Response to IR. No. 391 [NMPC-3], 8/14/06].)

11

12    Q:    Please describe in more detail how Staff’s position contradicts the  
13          provisions of the Merger Rate Plan.

14    A:    As we discussed previously, Section 2.1.1 of the Standby Service Joint  
15          Proposal provides that:

16               Each month, Niagara Mohawk shall calculate the verifiable  
17               lost or gained revenue per customer associated with the  
18               implementation of the Standby Service tariff included in  
19               Attachment 1 [the SC-7 service classification draft tariff  
20               leaves] by comparing the delivery service billings under the  
21               Standby Service tariff to the delivery service billings that  
22               would have been made by Niagara Mohawk under its  
23               superseded Rule 12 or other applicable tariff in effect prior  
24               to the Effective Date of this Joint Proposal (“Standby  
25               Service Lost Revenue”).  
26

1 Section 2.1.3 authorizes a Standby Service Lost Revenue Rate Adjustment  
2 that allows Niagara Mohawk to make a compliance filing to adjust  
3 delivery its rates accordingly at the time of the CTC Reset when the sum  
4 of the Standby Service Lost Revenue Deferral and the balance in the major  
5 deferral account under Section 1.2.4 of the Merger Joint Proposal is  
6 positive. It should be noted that there is no requirement whatsoever in this  
7 provision that the deferrals thus calculated and recovered be decremental  
8 to any "line item" in the baseline cost projections. Rather, the deferrals  
9 are specifically identified as the difference between Niagara Mohawk's  
10 standby service revenues under Rule 12 and its standby service revenues  
11 under the new SC-7 rate classification. (As we discuss below, this is the  
12 "decremental" measure that the Commission has approved for this deferral  
13 mechanism.)

14

15 Q: Is Staff's position consistent with the language of this provision?

16 A: No. Staff's position is directly at odds with the language of the Standby  
17 Service Lost Revenue provision because it would substitute for its terms  
18 the requirement – found nowhere in the provision – that the deferral  
19 revenues in question be decremental to some hypothetical baseline "line  
20 item" that Staff itself points out cannot exist "by definition." If Staff's  
21 position is correct, what is the explanation for the Commission having

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1 approved this Standby Service Lost Revenue rate adjustment in the first  
2 place? In effect, Staff's argument would read this rate agreement out of  
3 existence, and substitute for it new rules that Staff now prefers to the  
4 provision of the agreements it signed in the past.

5

6 Q: Do the Standby Service Lost Revenue deferral provisions in the Standby  
7 Service Joint Proposal clarify the understandings and expectations of the  
8 parties to the Merger Rate Plan?

9 A: Yes. The Standby Service Lost Revenue deferral provisions demonstrate  
10 that Staff, Niagara Mohawk, and the other parties to the rate settlement  
11 were aware that Niagara Mohawk was counting on revenues from the sale  
12 of standby service to generators who acquired the divested Niagara  
13 Mohawk generation assets, and establish that changes in those revenues  
14 were to be eligible for deferral treatment. Yet at the same time, all of  
15 these parties were well aware that neither the baseline cost projections nor  
16 the historical revenue figures on which they were based contained separate  
17 "line items" corresponding to standby service to generators.  
18 Consequently, it cannot be the case that the Commission or the parties to  
19 the rate agreement contemplated the requirement that these lost revenues  
20 be decremental to such "line items."

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1           The parties' recognition that standby service/station service  
2 revenues were eligible to be deferred bolsters Niagara Mohawk's position  
3 regarding the meaning of Section 1.2.4.3 of the Merger Rate Plan, which  
4 was included to address unforeseen regulatory changes. As we discussed  
5 previously, Section 1.2.4.3 provides that

6           Niagara Mohawk shall include in the Deferral Account all  
7 of the effects of any legislative, court, or regulatory change,  
8 which imposes new or modifies existing obligations or  
9 duties and which, evaluated individually, increases or  
10 decreases Niagara Mohawk's revenues or costs from  
11 regulated electric operations . . .

12  
13          Again, there is no requirement that such deferral be decremental to any  
14 "line item" in the baseline cost projections. Again, Staff's argument  
15 would read this provision out of existence, and substitute for it general  
16 Commission deferral policies that would have applied in the event that the  
17 Merger Rate Plan had never existed.

18

19   Q:   Do you believe that Staff's position violates the spirit of the Merger Rate  
20 Plan and PowerChoice Agreement, as well as their express terms?

21   A:   Absolutely. Staff's argument violates the spirit of the Merger Rate Plan  
22 and PowerChoice Agreement because the relevant provisions of both these  
23 rates settlements were intended to neutralize changes in revenues caused  
24 by the identified categories of regulatory change. Staff does not argue that

1 no such revenues were lost, or that Niagara Mohawk's identification of  
2 these revenues double-counts or results in over-earning or is not material.  
3 The ability to defer revenues lost due to legal and regulatory changes  
4 constitutes a significant part of the benefits Niagara Mohawk derived from  
5 the Rate Plan, representing part of the consideration in exchange for which  
6 the Company made significant rate concessions. The ability to defer cost  
7 and revenue changes caused by legal and regulatory changes, moreover,  
8 works both ways, affording significant protection to customers, as well as  
9 the Company.

10

11 Q: Has Staff recognized that it would be unfair to deny Niagara Mohawk the  
12 revenues from standby service and station service?

13 A: Yes. In briefs and pleadings it filed on behalf of the Commission at FERC  
14 and in federal court, Staff itself has recognized that it would be unfair to  
15 deny Niagara Mohawk these lost standby service revenues. For example,  
16 Staff has noted that the stranded costs to be recovered through standby  
17 service rates "are a direct result of the policy of retail competition adopted  
18 by the NYPSC and supposedly favored by FERC," and that "[u]tilities that  
19 advanced the competitive market policies the Commission expressed in  
20 Order No. 888 by divesting their generation plant should not find that their  
21 stranded cost recovery is impaired as a result of that divestiture . . ." Final

1 Brief of NYPSC, filed Feb. 7, 2006 in D.C. Circuit case No. 04-1227 et  
2 al., at II. C., 2006 WL 447816, p. 17; Petition for Rehearing, filed Jan. 22,  
3 2004 in Docket No. EL03-204, pp. 11, 14-15.

4

5 Q: Does your testimony suggest that the Merger Rate Plan or PowerChoice  
6 Settlement Agreement are contrary to the Commission's general  
7 ratemaking policies regarding deferrals?

8 A: No. On the contrary, these rate agreements represent specific  
9 implementations of the Commission's deferral guidelines under the  
10 specific circumstances giving rise to each, explicitly reflected in  
11 contractual language in order to provide certainty and repose to the parties.  
12 Staff has accepted that the deferral regimes in accordance with its own  
13 standards for Standby Service Lost Revenues and Disputed Station  
14 Service Revenues at issue here meet the "materiality" and "not over-  
15 earning" prongs of Commission's standard deferral test.<sup>10</sup> Staff testimony,  
16 pp. 24:19-25:6. While Staff does not appear to appreciate that the Merger  
17 Rate Plan includes provisions that implement that "materiality" and "not  
18 overearning" portions of the standard test, primarily through the

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<sup>10</sup> The Company does not agree with Staff's standards for "materiality" and for "overearnings". In the Company's view, these standards are set forth specifically in the Merger Rate Plan itself—e.g., the "materiality" standard is, in most cases, \$2.0 million per year in costs or lost revenues and "overearnings" is addressed in Section 1.2.5, Earnings Sharing Mechanism, in the Merger Rate Plan.

1           incorporations of deductibles before costs or lost revenues may be  
2           deferred and the earnings sharing mechanism, since Staff does not rely on  
3           these elements of the standard test, we will not address them further.

4                       Staff's failure to recognize that the Merger Rate Plan and  
5           PowerChoice agreement also address how to implement the "incremental"  
6           or "decremental" prong of the standard test in this instance, is, however,  
7           very significant. The rate agreements define specifically the baseline  
8           against which this "decremental" measurement is to be made. (See Exh.  
9           \_\_\_ (JJB/SDL-2) [Response to IR No. 11 [PSC-11 (RAV-4)], 8/3/05].) In  
10          neither of the deferrals we address is this baseline defined as the aggregate  
11          baseline cost projections used to formulate the Merger Rate Plan. In the  
12          case of the Standby Service Lost Revenue deferral mechanism, the  
13          baseline against which revenue changes are to be measured is defined to  
14          be revenues as they would have been under Rule 12. Under the regulatory  
15          change deferral mechanism supporting the Disputed Station Service  
16          Revenues deferral, the baseline against which lost station service revenues  
17          are to be measured is revenues as they would have been in the absence of  
18          the specified regulatory changes. We have described earlier in our  
19          testimony the methodology Niagara Mohawk uses to precisely determine  
20          the magnitude of Standby Service Lost Revenues and Disputed Station  
21          Service lost revenues. In the case of Disputed Station Service, before the



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1 FERC regulatory change, Niagara Mohawk charged standby service at  
2 SC-7 rates times the metered quantities of electricity delivered to the  
3 specified generation plants; after this regulatory change, Niagara Mohawk  
4 is permitted to charge nothing except during periods when a plant has  
5 negative generation for more than 30 days.

6 Thus, the rate agreements at issue here specify how the  
7 Commission's general deferral policies are to be implemented in the  
8 particular circumstances under which these global rates settlements were  
9 made. These specific implementations allow the lost revenues under each  
10 deferral to be measured with precision and cannot be disregarded or  
11 overridden by Staff's reference to general policies that govern deferral  
12 requests made in the absence of governing settlements approved by the  
13 Commission.

14

15 Q: How much of Staff's testimony urging rejection of Niagara Mohawk's  
16 deferrals depends on Staff's argument that the rates settlements should be  
17 ignored?

18 A: Most of Staff's arguments either depend upon or are simply restatements  
19 of its position that its own interpretation of the "three-pronged deferral  
20 test" must be substituted for the explicit provisions of the rates  
21 settlements. For example Staff's argument that Niagara Mohawk violated

1 Commission policy that revisions to a utility's original rate forecasts must  
2 be presented as adjustments to this original presentation (Staff testimony,  
3 pp. 31:14-33:15) depends on the notion that Niagara Mohawk is  
4 attempting to change its baseline revenue forecasts; as the discussion  
5 above makes clear, Niagara Mohawk is seeking to do nothing of the kind.  
6 Staff's argument that Niagara Mohawk is violating Commission policy by  
7 failing to base its rates on a historic test year plus forecasted changes  
8 (Staff testimony, pp. 33:24-34:12) likewise collapses: as discussed above,  
9 the deferral provisions in the rate agreements call for current revenues to  
10 be compared to the specific revenue baselines identified in the provisions  
11 themselves. Similarly, Staff's numerous arguments that Niagara  
12 Mohawk's proposed implementation of the rate settlement provisions  
13 would require comparisons of current revenues to the historic baseline that  
14 are "subjective," "overly complicated," or "impossible to determine" (Staff  
15 testimony, pp. 33:24-34:12, 34:24-37:10, 53:17-54:7) fail because the  
16 baselines against which these revenues must be compared are defined  
17 specifically within each separate provision, as discussed above.  
18  
19 Q: Staff claims that the deferral mechanisms Niagara Mohawk proposes to  
20 apply to Standby Service Lost Revenue and Disputed Station Service

- 1 Revenue are too subjective and complex to be practical, and that Niagara  
2 Mohawk has effectively conceded this. Do you agree?
- 3 A: No, we strongly disagree. Staff spends a great deal of time in its  
4 testimony arguing that Niagara Mohawk's deferral methodologies are "too  
5 complicated," apparently ignoring the fact that Niagara Mohawk has  
6 already calculated and presented precise dollar amounts for each deferral –  
7 calculations that Staff does not challenge. Staff also makes much of a  
8 Niagara Mohawk IR response that it alleges reflects a concession that the  
9 level of sales for station service included in the Merger Rate Plan's  
10 baseline revenue projections "cannot be determined" (Staff testimony, pp.  
11 36:3-39:15), and argues that acceptance of Niagara Mohawk's position  
12 would infect the entire deferral regime established by the Merger Rate  
13 Plan, requiring the same "overly complex" analysis for all of its parts.  
14 Staff testimony, pp. 39:16-44:12. Staff relies heavily on this theme  
15 throughout its testimony.
- 16
- 17 Q: Are Staff's arguments correct?
- 18 A: No. There are at least six distinct flaws in Staff's arguments, each of them  
19 fatal to its position.
- 20

1 Q: What is the first flaw in Staff's arguments that the deferral mechanisms  
2 Niagara Mohawk proposes to apply are too subjective and complex to be  
3 practical?

4 A: As we have discussed above, Staff's arguments presume that the figures  
5 against which standby service and station service revenues must be  
6 measured are "line items" in the baseline revenue projections produced in  
7 1999 to support the Merger Rate Plan. However, as we have also shown,  
8 the actual provisions of the Merger Rate Plan call for the revenues to be  
9 compared to those revenues that would have been realized in the absence  
10 of the specified regulatory changes; as these baseline revenues are well  
11 defined, it is possible to make an exact comparison between them and the  
12 actual revenues resulting from the regulatory changes.

13 In this connection, Staff spends many pages alleging that Niagara  
14 Mohawk is asking for an "evaluation period" to be interposed between the  
15 supposed "test year" (i.e., the 1984-1998 period, in Staff's view) and the  
16 rate year, and arguing that such an "evaluation period" injects imprecision  
17 and subjectivity into the deferrals. See Staff testimony, 35:1-36:2, 38:10-  
18 52:18. Staff is tilting at a straw man of its own construction. An  
19 "evaluation period" of the kind Staff attacks might indeed be necessary if  
20 the deferral mechanisms called for a comparison between current revenues  
21 and "line items" in the Merger Rate Plan's revenue projection baseline.

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1           However, this is the mechanism proposed by Staff, not the one prescribed  
2           by the rate settlements governing the instant deferrals. As we have  
3           discussed, the deferral mechanisms at issue here simply call for actual  
4           revenues to be compared to those that would have existed in the absence  
5           of the specified regulatory changes, a comparison that does not require an  
6           “evaluation period” of the kind Staff’s testimony spends so many pages  
7           excoriating. It is true that Niagara Mohawk has pointed out that it began  
8           billing the divested generators for standby service and station service  
9           between the time the Merger Joint Proposal revenue projection baseline  
10          was formulated in 1999 and the approval of the Merger Rate Plan in 2002.  
11          However, the point of this discussion was simply to point out that standby  
12          service and station service issues were clearly within the contemplation of  
13          the parties to the Merger Rate Plan, and therefore that it cannot be argued  
14          that the Standby Service Lost Revenues and Disputed Station Service  
15          deferrals cannot incorporate them. The parties to the rate agreements then  
16          very sensibly set up a deferral mechanism for such lost revenues allowing  
17          them to be clearly and straightforwardly calculated, not compared to some  
18          “line items” that were never included in the revenue projection baseline in  
19          the first place.  
20

1 Q: What is the second flaw in Staff's arguments that the deferral mechanisms  
2 Niagara Mohawk proposes to apply are too subjective and complex to be  
3 practical?

4 A: The second flaw is that Staff's argument proves too much. In fact, the  
5 baseline revenue projections used by Niagara Mohawk, the Commission,  
6 and the other parties to formulate and approve the Merger Rate Plan are  
7 *aggregate* projections, and do not contain "line items" for *any* separate  
8 revenue sources. Acceptance of Staff's arguments would therefore mean  
9 that none of the revenue deferrals authorized by the Merger Rate Plan may  
10 be allowed, because none of them are decremental to a well defined "line  
11 item" in the baseline revenue projections. Indeed, Staff's analysis on this  
12 issue is not free from confusion. Staff does recognize that the rate plan's  
13 baseline revenue projections are separate and distinct from the annual  
14 revenue figures for the period 1984-1998 used to formulate them.  
15 However, throughout the rest of its testimony, Staff appears to conflate the  
16 two sets of figures: on the one hand the actual Merger Rate Plan baseline  
17 revenue projections, and on the other hand the actual historical revenues  
18 for the period 1984-1998. Presumably, if the parties had intended that  
19 deferral revenues would have to be compared to "line items" in the  
20 baseline revenue projections, they would have included such "line items"  
21 in the baseline revenue projections. The parties did precisely that in other

1 portions of the rate plan, specifying "line items" against which the  
2 deferrals for items such as Pension and OPEB [Other Post-Employment  
3 Benefits] Expense, Economic Development Fund, Site Investigation and  
4 Remediation Costs, and Incremental Expenses Associated with the  
5 Customer Outreach and Education Incentive Program and Competition-  
6 Related and Low Income Incentive Mechanisms would operate. That they  
7 did not do so in the Standby Service Joint Proposal or in connection with  
8 the regulatory change deferral provision, and that the Commission  
9 approved the Merger Rate Plan on this basis, is more evidence that the  
10 baseline cost projections were not intended to work in the way that Staff  
11 alleges.

12  
13 Q: What is the third flaw in Staff's arguments that the deferral mechanisms  
14 Niagara Mohawk proposes to apply are too subjective and complex to be  
15 practical?

16 A: Even accepting for the sake of argument that the existence of "line items"  
17 in the historical source revenues allows us to impute "line items" to the  
18 Merger Rate Plan's baseline revenue projections contained "line items" is  
19 correct, and even assuming further that the historical source revenues did  
20 not contain any standby service or station service "line items," it must also  
21 be recognized that by the time the Merger Rate Plan was being negotiated

1 Niagara Mohawk *had* sold the generation plants at issue here, and was  
2 providing them with, and charging them for station service. The fact that  
3 such sales were taking place was clear from the outset, because the Asset  
4 Sales Agreements, Asset Purchase Agreements, and Interconnection  
5 Agreements entered into between the plant purchasers and Niagara  
6 Mohawk specified that they would do so, and these Agreements were  
7 reviewed by all parties to the proceedings, including Staff. (Exh. \_\_\_\_  
8 (JJB/SDL-3).) Consequently, these station service revenues were  
9 definitely within the knowledge of the parties when the baseline cost  
10 projections underlying the merger rate plan were formulated. Indeed, the  
11 Commission directed these generators to pay for station service in the very  
12 same order in which it also approved the Standby Service Lost Revenues  
13 deferral mechanism. Therefore, if "line items" corresponding to revenue  
14 sources are to be imputed to the baseline cost projections underlying the  
15 Merger Rate Plan, surely standby service and station service revenue  
16 sources must be among those thus imputed.

17

18 Q: What is the fourth flaw in Staff's arguments that the deferral mechanisms  
19 Niagara Mohawk proposes to apply are too subjective and complex to be  
20 practical?



1 A: Adoption of Staff's position – that the historical revenue figures  
2 underlying the baseline cost projections must be ransacked to identify  
3 "line items" against which subsequent deferrals must be compared –  
4 would have wide-ranging effects going far beyond the standby service and  
5 station service area. In particular, there are undoubtedly many "line items"  
6 in the underlying annual revenue figures for the period 1984-1998 for  
7 which Niagara Mohawk has fallen short of its revenue expectations when  
8 compared to revenue projections. If Staff may disaggregate these  
9 historical revenue figures in order to search for areas in which deferrals  
10 authorized by the Merger Rate Plan may be disallowed, there should be  
11 nothing to stop Niagara Mohawk from undertaking a similar search to find  
12 areas in which the underlying "line items" suggest that Niagara Mohawk  
13 should be allowed to *increase* the size of existing deferrals or introduce  
14 new ones. Such an interpretation of the Merger Rate Plan would, of  
15 course, be an invitation to endless controversy and litigation over the  
16 significance of such imputed "line items."

17

18 Q: What is the fifth flaw in Staff's arguments that the deferral mechanisms  
19 Niagara Mohawk proposes to apply are too subjective and complex to be  
20 practical?

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1 A: Staff's testimony repeatedly cites purported Niagara Mohawk statements  
2 that the level of sales for standby service to generators included in the  
3 Merger Rate Plan baseline revenue projections "cannot be determined."  
4 Staff testimony, pp. 37:11-39:15, 53:17-54:7. This is a red herring, as a  
5 review of the IR Response at issue reveals. (See Exh. \_\_\_\_ (JJB/SDL-4)  
6 [Response to IR No. 264 [PSC-209 (RAV-40)], 2/6/06].) As indicated  
7 above, the baseline revenue projections underlying the merger rate plan  
8 are aggregate, company-wide projections, and were never intended to be  
9 disaggregated into "line items." Econometric analysis was used to project  
10 historical annual aggregate revenues into the future based on various  
11 macroeconomic and sociological assumptions. Obviously, such  
12 econometric projections could not separately identify standby service or  
13 station service revenues. Going back to the original historical revenue  
14 figures might yield the ability to perform such a disaggregation, but this  
15 could not be done by looking at the aggregate econometric projections.  
16 Niagara Mohawk's IR responses attempting to explain this point have been  
17 misappropriated in an attempt to discredit the Standby Service Joint  
18 Proposal and Merger Rate Plan's deferral methodology. However, all  
19 Staff's arguments really show is that it has misunderstood both Niagara  
20 Mohawk's IR responses and the mechanism underlying the Merger Rate  
21 Plan.

1

2 Q: What is the sixth flaw in Staff's arguments that the deferral mechanisms  
3 Niagara Mohawk proposes to apply are too subjective and complex to be  
4 practical?

5 A: The sixth flaw is Staff's argument that Niagara Mohawk's position would  
6 require an "impossible," "subjective," or "overly complex" analysis of  
7 "line items" to be imputed to each category of deferral in the Merger Rate  
8 Plan's deferral regime. For one thing, Staff's argument completely  
9 mischaracterizes Niagara Mohawk's position regarding how the standby  
10 service lost revenue and disputed station service deferrals work – as we  
11 have indicated above, the calculation of lost revenues is against revenues  
12 as they would have been in the absence of the regulatory changes, *not* the  
13 1999 baseline revenue projections. For another thing, the Merger Rate  
14 Plan makes each category of deferrals subject to its own determinative  
15 methodology; therefore, contrary to Staff's allegations, there is no basis  
16 for believing that acceptance of the standby service and station service  
17 deferral methodology we have outlined above would have any effect at all  
18 on the rest of the deferral regime.

19

20 Q: What have been the Commission's and Staff's past practice regarding  
21 deferrals of the kind Niagara Mohawk is proposing here?

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1 A: In the only CTC reset proceeding since approval of the Merger Rate Plan,  
2 which took place in 2003, Niagara Mohawk submitted Standby Service  
3 Lost Revenue deferrals identical in form to those it is submitting in this  
4 proceeding.<sup>11</sup> Staff raised no objections to these deferrals in that  
5 proceeding, and the Commission approved them. Thus, Staff's current  
6 position directly contradicts the one it took in the past.

7  
8 Q: But Staff explains this discrepancy by stating that it was not aware of the  
9 Standby Service and Station Service issues until March 2005, and that the  
10 Commission similarly overlooked it in the 2003 CTC proceeding. Staff  
11 testimony, pp. 61:1-62. Do you disagree with Staff's explanation?

12 A: Even if Staff were unaware of the standby service and station service  
13 revenue issues until 2005, as it now claims, that would not present a basis  
14 for disregarding or overriding the terms of the Merger Rate Plan approved  
15 by the Commission. In any event, it is difficult to understand how Staff  
16 could have been unaware of these issues. As we testified earlier, the  
17 Commission had authorized Niagara Mohawk to charge generators for

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<sup>11</sup> Case 01-M-0075, *Joint Proposal of Niagara Mohawk Holding, Inc., Niagara Mohawk Power Corporation, National Grid plc, and National Grid for Approval of Merger and Stock Acquisition*, "Compliance Filing to Update Market Price Forecast and Reset the Competitive Transition Charges in Retail Delivery Rates, Pursuant to Commission Opinion No. 01-6, Issued December 3, 2001," (November 5, 2003), pp. 4-5.

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1 station service for decades before the Merger Rate plan was approved<sup>12</sup>;  
2 furthermore, the fact that Niagara Mohawk was charging the purchasers of  
3 its divested generation plants for station service was established as early as  
4 1999 under the sales agreements and interconnection agreements  
5 associated with these divestitures, which Staff reviewed and the  
6 Commission approved. (See Exh. \_\_\_ (JJB/SDL-3).) The Commission  
7 prescribed guidelines for the design of rates for the sale of station power<sup>13</sup>,  
8 and implemented those guidelines for Niagara Mohawk twice, once in  
9 2002<sup>14</sup> and again in 2003.<sup>15</sup> Moreover, as we also described earlier in our  
10 testimony, there were provisions of the Merger Rate Plan and the Standby  
11 Service Joint Proposal that specifically addressed the potential for deferral  
12 of revenues affected by a change in the rate provisions governing standby  
13 service.

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<sup>12</sup> See discussion in Case 94-E-0098, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation for Electric Service. S.C. 7 TARIFF FILING*, "Order Denying Requests to Postpone a Tariff Filing," (October 29, 1999), pp. 3-4.

<sup>13</sup> Case 99-E-1470, *Proceeding on Motion of the Commission as to the Reasonableness of the Rates, Terms and Conditions for the Provision of Electric Standby Service*, Opinion 01-4, "Opinion and Order Approving Guidelines for the Design of Standby Service Rates," (October 26, 2001)

<sup>14</sup> Case 01-E-1847, *In the Matter of the Compliance Filing of Niagara Mohawk Power Corporation in Response to Opinion No. 01-4 on Standby Service Rates*, "Order Approving Joint Proposal," (June 21, 2002)

<sup>15</sup> Case 03-E-1016, *Niagara Mohawk Power Corporation – Proposed Tariff Revisions to S.C. No. 7 to Provide Unbundled Transmission and Distribution Rates For NY ISO Station Service Customers (filed in Case 01-E-1847)*, "Order Approving Tariff Filing," (November 25, 2003).

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1           In addition, in numerous pleadings before FERC and the courts  
2           dating back significantly before the 2003 CTC proceeding, Staff, on behalf  
3           of the Commission, took an active role in the very proceedings in which  
4           FERC effected the regulatory changes that led to the lost revenues the  
5           Company proposes to treat under the deferral mechanisms. NYISO filed  
6           its proposed 30-day netting proposal in September 2002, well before the  
7           2003 First CTC Reset proceeding. Compliance Filing of New York ISO,  
8           filed Sept. 20, 2002 in EL01-50-000. Arguing against NYISO's proposal  
9           in late 2002, Staff, on behalf of the Commission, noted that these costs  
10          would be charged to other retail customers if they could not be recovered  
11          from wholesale generators:

12                   There is no reason to exempt generators that use delivery  
13                   facilities from the customer and stranded cost charges that  
14                   all other similarly-situated customers must pay. To do  
15                   otherwise is discriminatory and would force other  
16                   ratepayers to subsidize the generator's use of the electric  
17                   system.

18  
19          Protest of Tariff Filing, filed Oct. 11, 2002 in Docket No. EL01-50-002, p.  
20          11. Clearly, at this time both Staff and the Commission were fully  
21          cognizant both that NYISO's new rule would drastically reduce New York  
22          transmission owners' ability to charge generators for standby service, and  
23          that in such a case these charges would devolve to other New York  
24          ratepayers.

1           Indeed, in the proceeding addressing Niagara Mohawk's proposed  
2 changes to SC-7 to comply with the NYISO's Market Services Tariff  
3 station power provisions, the Commission showed by its discussion that,  
4 far from "overlooking" this issue as Staff alleges, it was fully aware of it.  
5 Observing that standby service charges to wholesale generators were an  
6 appropriate part of the charges Niagara Mohawk should recover under its  
7 retail tariff, the Commission noted:

8           Niagara Mohawk has accurately tariffed the CTC  
9 applicable to wholesale generators. In developing the CTC  
10 applicable to all transmission-level standby service  
11 customers, the utility met the Opinion No. 01-4 guidelines  
12 for proportional application of the CTC to the various  
13 standby service rate components.

14                   \* \* \*

15  
16  
17           Disregarding the provision and consumption of these  
18 delivery and energy services [by generators for standby  
19 service] would have pernicious consequences. Niagara  
20 Mohawk remains the provider of last resort to the  
21 wholesale generators, and it must arrange for the purchase  
22 and delivery of the energy from NYISO markets that a  
23 wholesale generator consumes when not operating. Only a  
24 financially-healthy utility that is fully paid for incurring  
25 these burdens can be expected to reliably meet those  
26 obligations.

27  
28           Niagara Mohawk's standby service rates are specifically  
29 designed to preserve its financial health and its ability to  
30 supply the delivery and energy services that wholesale  
31 generators need when their generation equipment is not  
32 operating. In particular, the CTC imposed on all  
33 customers, including wholesale generators under the

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1 standby services tariff, enabled Niagara Mohawk to avoid  
2 bankruptcy by providing for recovery of its stranded costs.

3  
4 *Re Niagara Mohawk Power Corporation*, Case 03-E-1016 (November 25,  
5 2003) slip op., pp. 8-9, 2003 Westlaw 22799508 (NYPSC). In this same  
6 time period, the Staff argued strongly to FERC that it would be unfair to  
7 prohibit Niagara Mohawk from recovering the very standby service and  
8 station service revenues at issue in the instant case:

9 Imposing the costs of Trial Staff's rate exemptions on the  
10 utility is equally unfair. Niagara Mohawk remains the  
11 provider of last resort to the wholesale generators, and it  
12 must arrange for the purchase and delivery of the energy  
13 from NYISO market that a wholesale generator consumes  
14 when not operating. Only a financially-healthy utility that  
15 is fully paid for incurring these burdens can be expected to  
16 reliably meet those obligations. As explained in the  
17 NYPSC Order Approving Tariff, exempting wholesale  
18 generators from stranded cost charges could raise questions  
19 about its financial health, redounding the detriment of both  
20 the wholesale generators and all customers.

21  
22 [NYPSC] Motion for Late Intervention, Motion to Lodge Decision, and  
23 Reply Brief, filed Dec. 5, 2003 in Docket No. EL03-27, pp. 12-14.

24 The Commission's rulings on standby service proposals, as well as  
25 Staff's active participation in the FERC proceedings that created the  
26 regulatory change that allows the deferral of lost Station Service  
27 Revenues, and, especially, its acknowledgement that FERC's rulings  
28 could cause costs to be shifted to other customers, make it difficult for us  
29 to understand Staff's claim that it was unaware of this issue. In any event,



1 as we said earlier, it is even more difficult to understand how such a claim,  
2 even if accepted, could justify disregard of the provisions of the Merger  
3 Rate Plan and other agreements approved by the Commission.

4

5 Q: Staff points out that approximately \$19 million of the Disputed Station  
6 Service lost revenues are attributable to the period before the Merger Rate  
7 Plan was approved. Staff argues that this \$19 million cannot be  
8 considered decremental with respect to the Merger Joint Proposal baseline  
9 revenue projections (Staff testimony, pp. 51:14-53:3), and that Niagara  
10 Mohawk is asking the Commission to engage in retroactive ratemaking by  
11 requesting recovery of this \$19 million deferral. Staff testimony, p. 34:13-  
12 23. Do you agree with Staff's argument?

13 A: No, we do not. Niagara Mohawk is not requesting recovery of the \$19  
14 million deferral accrued before the Merger Rate Plan was approved under  
15 the provisions of the Merger Joint Proposal. Rather, for this portion of the  
16 Disputed Station Service deferral Niagara Mohawk is relying on deferral  
17 provisions of the PowerChoice Settlement Agreement, which came into  
18 effect before the \$19 million in Disputed Station Service lost revenues  
19 began to accrue. As we have discussed previously, Section 2.6.1 of the  
20 PowerChoice Settlement provides that "the following changes in forecast  
21 costs are eligible for deferral: changes in laws, regulations, rules and

1 accounting that can be substantiated as increasing or decreasing the cost of  
2 doing business (in excess of \$500,000 per change) . . .” The station  
3 service revenues from Niagara Mohawk’s divested generation was  
4 considered in the PowerChoice settlement, which expressly recognized  
5 that a standby rate tariff would apply to the divested generators. Section  
6 4.11.4.2 of the PowerChoice Settlement (Vol.1, pp. 62-63), entitled “New  
7 Subscribers and Existing S.C. No. 7 Customers Following Divestiture of  
8 the Company’s Fossil and Hydro Assets,” required Niagara Mohawk to  
9 file new tariff leaves which would apply to the sold units following  
10 divestiture. Given the Commission’s concern in that case, expressed in  
11 discussing the standby rate, that “the CTC remains manageable, and does  
12 not become too large a burden for any group of customers” (Opinion 98-8,  
13 p. 42), it is evident that the deferrals related to regulatory changes  
14 authorized in Section 2.6.1 applies to such changes in respect to station  
15 service. (*See also* Exh. \_\_\_ (JJB/SDL-5) [Response to IR No. 12 [PSC-12  
16 (RAV-4)], 8/3/05].) Clearly, the \$19 million in Disputed Station Service  
17 lost revenues qualify for deferral under this provision, using the same  
18 reasoning set forth previously in my testimony with respect to the  
19 provisions of the Merger Joint Proposal. This is not retroactive  
20 ratemaking, as Staff alleges; all of the \$19 million in disputed Station

1 service lost revenues identified by Staff were lost subsequent to the  
2 approval of the PowerChoice settlement.

3

4 Q: In an apparent attempt to discredit the reasoning behind and calculation of  
5 Niagara Mohawk's Standby Service Lost Revenue and Disputed Station  
6 Service deferrals, Staff contends that Niagara Mohawk is not using similar  
7 reasoning or calculations to justify or quantify other proposed deferrals,  
8 and has not used a similar methodology in other proceedings and  
9 situations that Staff characterizes as analogous to this one. Staff  
10 testimony, pp. 44:13-51:13, 62:2-64:17. Do you find Staff's argument  
11 persuasive?

12 A: No, we do not. Staff appears to be laboring under the impression that  
13 Niagara Mohawk is prescribing the reasoning and methodology behind the  
14 Standby Service Lost Revenue and Disputed Station Service deferrals for  
15 all ratemaking circumstances that it encounters. Nothing could be further  
16 from the truth. The Merger Joint Proposal, Standby Service Joint  
17 Proposal, and PowerChoice deferral mechanisms under which the Standby  
18 Service and Disputed Station Service lost revenues are calculated specify  
19 that revenues lost as a result of regulatory changes may be deferred. The  
20 other deferrals and situations that Staff alleges are "analogous" do not  
21 share this same mechanism. Niagara Mohawk does not allege, for

1           example, that changes in revenues due to changes in sales volumes that are  
2           not caused by regulatory changes are deferrable. Furthermore, in  
3           proceedings and situations outside a deferral context, Niagara Mohawk  
4           does not claim that anything similar to the regulatory change deferral  
5           mechanism applies. Thus, Niagara Mohawk's position on generation  
6           stranded cost deferrals and CSBC deferrals in this proceeding are not  
7           inconsistent with its position on standby service and station service  
8           deferrals because the latter, but not the former, were the result of  
9           regulatory changes; Niagara Mohawk's positions on the Town of Marcy  
10          property tax refund, or on "First Through the Meter" contracts (see Staff  
11          testimony at pp. 44:13-51:13, 62:2-64:17) are not inconsistent with its  
12          positions on the standby service and station service deferrals, because the  
13          latter, but not the former, are governed by Section 2 of the Standby  
14          Service Joint Proposal and Section 1.2.4.3 of the Merger Joint Proposal,  
15          respectively. Thus, statements like Staff's allegation that the "situation"  
16          of certain "First Through the Meter" contracts between Niagara Mohawk  
17          and some NYPA customers "is identical to that involving station service  
18          lost revenues" (Staff testimony, p. 64:10-11) are egregiously incorrect.  
19          Staff's attempts to discredit Niagara Mohawk's Standby Service and  
20          Disputed Station Service lost revenue deferrals by comparing them with

1 other, clearly distinguishable, deferrals and non-deferral situations are  
2 completely unpersuasive.

3

4 Q: Staff claims that Niagara Mohawk has been unable to locate executed  
5 Form Gs for 17 of its generator standby service customers. Staff  
6 testimony, p. 65:5-19. Is Staff correct? Does this have a bearing on the  
7 deferrals at issue here?

8 A: Staff's factual representation is not quite accurate. Staff is apparently  
9 referring to the fact that Niagara Mohawk has been unable to locate  
10 informational forms designated "Form Gf" for certain of its generator  
11 standby service customers. "Form Gf" is distinct from the "Form G" that  
12 Staff mentions. "Form Gf" was used in connection with the transition to  
13 the SC-7 tariff of some of Niagara Mohawk's generator standby  
14 customers; however, it was not a condition of receiving service, and,  
15 unlike "Form G," is not mentioned in Niagara Mohawk's tariff. Thus,  
16 there is no tariff requirement in the first place that these forms be  
17 completed. Also, Staff does not dispute that any of the generators for  
18 whom "Form Gfs" are missing took the standby service recorded by  
19 Niagara Mohawk, or that the lost revenues associated with them are  
20 otherwise than represented by Niagara Mohawk. Thus, Niagara

1 Mohawk's inability to locate these forms has absolutely no bearing on the  
2 deferrals at issue here.

3

4 Q: Staff argues that at least one of the Niagara Mohawk generator station  
5 service customers whose lost revenues are included in the Disputed  
6 Station Service deferral has declared bankruptcy. Staff argues that  
7 "[t]here are no provisions in the Merger Joint Proposal which would make  
8 the Company whole on lost revenues due to bankruptcies, even if the  
9 revenues were determined to be decremental. Uncollectible expense  
10 allowances are included in base rates and cover losses due to  
11 bankruptcies." Staff testimony, pages 66:12-67:6. Do you agree with  
12 Staff's analysis?

13 A: No, we do not. Staff's testimony apparently refers to the NRG companies  
14 that own the Huntley, Dunkirk, and Oswego generation plants. However,  
15 while these companies did go into bankruptcy, they subsequently emerged  
16 from bankruptcy with Niagara Mohawk's station service claims intact.  
17 Thus, for these companies as well as the other wholesale generators,  
18 Niagara Mohawk's station service losses resulted from FERC's regulatory  
19 change to the station service rules rather than from bankruptcy or some  
20 other cause.

21

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1 V. Conclusion

2 Q: Thank you. I have no further questions at this time.

1                                   **REBUTTAL TESTIMONY OF**  
2                                   **JAMES J. BONNER JR. AND SCOTT D. LEUTHAUSER**  
3

4   **I.    Introduction**

5   Q:    Mr. Bonner, please state your name and business address.

6   A:    My name is James J. Bonner Jr. My business address and credentials were  
7           set forth in our responsive testimony, filed in this proceeding on  
8           September 1, 2006.

9  
10   Q:    Mr. Leuthauser, please state your name and business address.

11   A:    My name is Scott D. Leuthauser. My business address and credentials,  
12           too, were set forth in our responsive testimony, filed in this proceeding on  
13           September 1, 2006.

14  
15   Q:    What is the purpose of your rebuttal testimony?

16   A:    We will respond briefly to certain assertions regarding the disputed station  
17           service lost revenue and standby service lost revenue deferrals made by  
18           Staff witnesses Denise A. Gerbsch and Robert A. Visalli (the "Staff  
19           Panel") in their Responsive Testimony filed on September 19, 2006. We  
20           note that, due to the limited time available, and because we fully described  
21           the basis for the deferral in our earlier testimony, we are not responding to  
22           every point made in the Staff Panel testimony. Our silence should not be



1 construed as agreement with the arguments presented by the Staff Panel  
2 that we do not address. We also note that, in this rebuttal testimony, we  
3 will use defined terms and acronyms with the meanings defined in our  
4 responsive testimony.

5

6 Q: Do you sponsor any exhibits?

7 A: Yes, we are sponsoring six exhibits. Exhibit \_\_\_\_\_ (JJB/SDL-6) is a copy  
8 of the Company's Response to Information Request ("IR") No. 404 (PSC-  
9 340 Visalli (RAV-127)), which addresses the Merger Rate Plan Deferral  
10 Account Provisions. Exhibit \_\_\_\_\_ (JJB/SDL-7) contains excerpts of the  
11 electric sales forecast workpapers from Volume 1 of the Financial  
12 Forecast and Supporting Workpapers filed in support of the Merger Rate  
13 Plan Joint Proposal in this proceeding in January 2001. Exhibit \_\_\_\_\_  
14 (JJB/SDL-8) is a copy of the Company's Response to IR No. 264 (PSC-  
15 209 Visalli (RAV-40)), which addresses the annual sales comparison that  
16 was included in the Merger Rate Plan Joint Proposal. Exhibit \_\_\_\_  
17 (JJB/SDL-9) is a copy of the Standby Service Joint Proposal submitted by  
18 the Company, Staff, Multiple Intervenors, and others on March 12, 2002  
19 in Case 01-E-1847. Exhibit \_\_\_\_ (JJB/SDL-10) is a copy of Staff's  
20 Statement in Support of the Standby Service Joint Proposal, dated March  
21 26, 2002. Exhibit \_\_\_\_ (JJB/SDL-11) is a copy of the Company's

1 Statement in Support of Standby Service Joint Proposal, dated March 25,  
2 2002.

3

4 **II. Response to Selected Staff Assertions**

5 Q: Do you have any comments on the Staff Panel's contention (made on page  
6 24, line 8 – page 25, line 20) that the deferral of disputed station service  
7 lost revenues is somehow improper because the Company did not convene  
8 a meeting as they allege is required by Section 1.2.4.3.1 of the Merger  
9 Rate Plan?

10 A: Yes. As we explained in our earlier testimony, the deferral of disputed  
11 station service lost revenues is clearly authorized by Section 1.2.4.3 of the  
12 Merger Rate Plan, which provides for the deferral of “all of the effects of  
13 any legislative, court, or regulatory change, which imposes new or  
14 modifies existing obligations or duties and which, evaluated individually,  
15 increases or decreases Niagara Mohawk's revenues or costs” by more than  
16 the \$2 million annual threshold. We also explained that the Staff Panel  
17 did not take issue with the fact that the orders of the Commission, the  
18 FERC and the courts that constrain the Company's ability to collect the  
19 charges for standby service authorized by its tariff at the time of the  
20 Merger Rate Plan constitute legal or regulatory changes within the scope

1 of this provision. In its rebuttal testimony, the Staff Panel again concedes  
2 that a legal or regulatory change has taken place.

3 However, the Staff Panel raises a new argument. It now contends  
4 that another provision, Section 1.2.4.3.1 of the Merger Rate Plan, bars the  
5 Company from deferring disputed station service lost revenues. This  
6 provision provides:

7 To the extent that the actions of FERC, the New York ISO,  
8 or any other agency having authority over how costs or  
9 revenues are allocated to or away from the distribution or  
10 transmission function, materially alter the existing  
11 ratemaking and/or cost responsibility for retail electric  
12 customers, interested parties will reconvene and negotiate  
13 in good faith to resolve the impact on electricity delivery  
14 rates, if any.  
15

16 The Staff Panel argues that this provision prohibits the deferral of disputed  
17 station service lost revenues because Niagara Mohawk did not convene a  
18 meeting to negotiate over the impact of the FERC rulings on station  
19 service on delivery rates.

20 The Staff Panel's new argument is wrong. First, Section 1.2.4.3.1  
21 does not limit the deferrals allowable under Section 1.2.4.3. Rather, it  
22 provides an option for alternative treatment of the impact of regulatory  
23 decisions that reclassify the Company's costs, which are also addressed in  
24 Section 1.2.3.5 of the Merger Joint Proposal. Second, the regulatory and  
25 court rulings that limit Niagara Mohawk's recovery of charges for the

1 delivery of standby service do not reclassify costs between the distribution  
2 and transmission functions, and so do not come within the requirements of  
3 Section 1.2.4.3.1.

4

5 Q: Why do you say that Section 1.2.4.3.1 does not limit deferrals under  
6 Section 1.2.4.3?

7 A: Our statement that Section 1.2.4.3.1 does not limit the eligibility of costs  
8 or revenues affected by legal or regulatory change for deferral under  
9 Section 1.2.4.3 is based on what the language of the two provisions says.  
10 Section 1.2.4.3 provides for the deferral of costs and revenues affected by  
11 a legal or regulatory change, and does not require the parties first to  
12 conduct negotiations under Section 1.2.4.3.1 before those costs or lost  
13 revenues may be deferred. Staff's attempt to read such a prerequisite into  
14 Section 1.2.4.3 would turn the provision into a dead letter, effectively  
15 allowing the Company to defer the cost or revenue impact of legal or  
16 regulatory changes only if the other parties first agree. Treating Section  
17 1.2.4.3 as an agreement-to-attempt-to-agree on deferrals is clearly  
18 inconsistent with its language and purpose.

19

20 Q: If Section 1.2.4.3.1 does not limit deferrals under Section 1.2.4.3, what  
21 does it do?

1 A: Section 1.2.4.3.1 simply provides an alternative remedy to deferrals for the  
2 impact of regulatory decisions that “materially alter” the allocation of  
3 costs between the transmission and distribution functions. As such, the  
4 provision relates back to Section 1.2.3.5 of the Merger Joint Proposal,  
5 which allows a prospective rate change to reflect the impact of such  
6 reallocation decisions. This provision was included in the Merger Rate  
7 Plan to deal with the possibility that an event such as a spin-off of Niagara  
8 Mohawk’s transmission facilities or a change in the classification of  
9 facilities between transmission and distribution might increase the extent  
10 of FERC jurisdiction over the Company’s delivery facilities. In that event,  
11 it would make sense for the parties to reconvene to consider how and  
12 whether electric delivery rates might be affected, since such events would  
13 normally affect delivery rate design generally. Doing so would afford  
14 them the opportunity to decide if any compensating adjustments are  
15 required to ensure that the combined delivery rate (transmission plus  
16 distribution) would remain at the agreed-upon level after the spin-off or  
17 other event.

18 Moreover, Section 1.2.4.3 allows for such reclassification  
19 decisions to be addressed through prospective adjustments under Section  
20 1.2.3.5, rather than through deferrals. It does so by providing for the  
21 deferral of the cost and revenue impact of legal and regulatory changes

1            “[u]nless otherwise provided for in Section 1.2.3.5.” This shows that all  
2            of the sections were designed to work together: a regulatory decision  
3            affecting the allocation of costs between the transmission and distribution  
4            functions that results in a prospective adjustment to delivery rates under  
5            Section 1.2.3.5, following discussions held under Section 1.2.4.3.1, would  
6            not also result in deferrals under Section 1.2.4.3.

7

8    Q:    Please explain why the regulatory changes that create the disputed station  
9            service lost revenues are not within Section 1.2.4.3.1’s requirement for  
10            renegotiation.

11    A:    The regulatory and court decisions affecting station service revenues are  
12            not the kind of facility cost allocation decisions that are covered by the  
13            language or intent of Section 1.2.4.3.1 and Section 1.2.3.5. Facilities have  
14            not been shifted between the transmission and distribution function or  
15            transferred to another corporate entity. Instead, FERC has required the  
16            use of a monthly netting to determine when standby service is provided  
17            and to measure the quantity of that service, and its decisions have been  
18            upheld by the reviewing court. This is not a facility cost allocation  
19            decision that is the subject of this provision.

20

1 Q: Has the Company held any meetings with the Parties on the standby  
2 service issue?

3 A: Yes. As we explained in our previous testimony (on page 9), on  
4 November 28, 2001, the Company made a compliance filing to implement  
5 the Commission's guidelines for standby rates to generators. That filing  
6 was followed by numerous meetings among substantially the same parties  
7 who participated in the negotiations leading to the Merger Joint Proposal,  
8 which produced the Standby Service Joint Proposal accepted by the  
9 Commission on June 21, 2002 in Case No. 01-E-1847. A copy of the  
10 Joint Proposal the Company, Staff, Multiple Intervenors, and others  
11 submitted in Case 01-E-1847 on March 12, 2002, is attached as Exhibit  
12 \_\_\_ (JJB/SDL-9). In addition, we have attached copies of the Staff's  
13 Statement in Support of Joint Proposal, dated March 26, 2002, and the  
14 Company's Statement in Support of Joint Proposal, dated March 25, 2002,  
15 as Exhibit \_\_\_ (JJB/SDL-10) and Exhibit \_\_\_ (JJB/SDL-11), respectively.

16 The discussions leading to the Standby Service Joint Proposal  
17 addressed all aspects of rate design and cost allocation for standby service  
18 rates. As a result of those discussions, the Parties agreed on cost  
19 allocation issues associated with the change in standby service rates, but  
20 continued to rely on the Merger Rate Plan (primarily Section 1.2.4.17,  
21 discussed in our earlier testimony) to deal with the deferral of revenues

1           lost as a result of the change. Therefore, for the cost allocation issues  
2           associated with the Standby Lost Revenue Settlement, Niagara Mohawk  
3           has satisfied fully any obligations to hold meetings with the Parties under  
4           Section 1.2.4.3.1. In its initial filing in this Second CTC Reset  
5           proceeding, the Company expressed its willingness to hold similar  
6           meetings to address the disputed station service revenues, even though  
7           there is no cost allocation issue involved (*see* Second CTC Reset  
8           Compliance (July 29, 2005), Attachment 6 at page 49 of 71, footnote 11),  
9           but such consultations are not a prerequisite for deferrals under Section  
10          1.2.4.3.

11

12    Q:    Do you have any comments on the Staff Panel's parsing of the language of  
13          Section 1.2.4.3.1 on page 25 of its rebuttal testimony?

14    A:    Yes. The Staff Panel says that the reference in Section 1.2.4.3.1 to  
15          "electricity delivery rates, if any" supports its view that any deferral under  
16          Section 1.2.4.3 must be measured by the impact of regulatory change on  
17          those rates, rather than on the revenues the Company would have realized  
18          without the regulatory change. The difference between the two  
19          possibilities Staff is comparing is difficult to see: when a legal or  
20          regulatory change limits the Company's ability to charge delivery rates  
21          authorized in its tariff – as Staff concedes to be true in the case of station



1 service – that change impacts both the rates themselves and the revenues  
2 the Company could have collected but for the change. If Staff is trying to  
3 say that the language of Section 1.2.4.3.1 supports its view that the effect  
4 of a legal or regulatory change on the Company’s revenue must be  
5 compared to a line item in the sales forecast submitted with the Merger  
6 Rate Plan, we must disagree. There is no reference to that forecast or its  
7 components in Section 1.2.4.3.1.

8 Moreover, there is an additional, more basic problem with Staff’s  
9 argument: it is parsing the wrong section of the Merger Rate Plan. Section  
10 1.2.4.3 of the Rate Plan, not Section 1.2.4.3.1, authorizes the deferral of  
11 the cost and revenue impacts of legal and regulatory changes. The plain  
12 language of Section 1.2.4.3 makes it clear that “all of the effects” of a  
13 legal or regulatory change on “Niagara Mohawk’s revenues . . . from  
14 regulated electric operations” may be deferred if the annual impact is  
15 greater than \$2 million. The obvious way to measure the effect of a  
16 regulatory change on the Company’s revenues is to compare the revenues  
17 the Company is permitted to collect after the change with those it could  
18 have collected if the change had not occurred.

19 If anything, Section 1.2.4.3.1 supports this straightforward reading  
20 of Section 1.2.4.3. Any discussions under Section 1.2.4.3.1 of the impact  
21 of decisions affecting cost allocation would, as we have discussed, be

1 directed toward implementing Section 1.2.3.5, which requires any  
2 prospective rate change associated with a reclassification to be  
3 implemented in a revenue neutral manner and specifically bars any under-  
4 recovery of electric delivery revenues as a result of the reclassification  
5 decision. Section 1.2.4.3.1 therefore does not contemplate the massive  
6 disallowance the Staff Panel is advocating in this case.

7  
8 Q: Do you have any comments on the Staff Panel's assertions on page 12,  
9 line 11 – page 13, line 18, that this plain reading of Section 1.2.4.3 will  
10 open the door to “staggering” problems, including hundreds of millions of  
11 dollars of new deferrals?

12 A: Yes. Staff's concerns are groundless. Staff's parade of horrible  
13 consequences is based on a misrepresentation of the Company's position.  
14 We did not testify that the cost of service submitted to support the Merger  
15 Rate Plan rates has no relevance to the operation of any of the deferral  
16 mechanisms included in the Joint Proposal. To the contrary, both we and  
17 Mr. Reilly explicitly noted that there were numerous deferral provisions  
18 that specifically authorized the deferral only of changes in an element of  
19 Niagara Mohawk's cost of service, as compared with a specified baseline  
20 derived from the Merger Rate Plan cost of service (see our responsive  
21 testimony at page 38, line 18 – page 39, line 11, and Mr. Reilly's

1 responsive testimony at page 22, lines 3-7). But Section 1.2.4.3,  
2 authorizing the deferral of the cost and revenue impact of legal and  
3 regulatory changes, is not one of them. In an information request response  
4 (IR No. 404 (PSC-340 Visalli (RAV-127)) submitted on September 12,  
5 2006, the Company described how different categories of deferrals would  
6 be determined under the Merger Rate Plan. A copy of this response is  
7 included as an exhibit to our rebuttal testimony. See Exhibit \_\_  
8 (JJB/SDL-6). As that exhibit demonstrates, there is no requirement in  
9 Section 1.2.4.3 that the impact of a legal or regulatory change on the  
10 Company's revenues from a particular service classification must be  
11 measured against the original forecast for revenues from that same service  
12 classification. Such a requirement is unnecessary to ensure that the  
13 amounts eligible for deferral under Section 1.2.4.3 can be readily  
14 identified and audited by comparison of the revenues the Company is  
15 authorized to collect before and after the legal or regulatory change.  
16 Implementing Section 1.2.4.3 in accordance with the terms agreed upon  
17 among the parties and approved by the Commission therefore will not  
18 have the widespread dire consequences hypothesized by Staff.

19

20 Q: Do you have any comments on the Staff Panel's statement on page 21,  
21 lines 11-15, that Staff was not aware until March 2005 "that station

1 service related revenues were not built into the Merger Joint Proposal

2 rates”?

3 A: Yes. We find this statement curious because the basis for the sales  
4 forecast underlying the Merger Rate Plan rates was fully disclosed in the  
5 negotiations and was described in the workpapers filed with the Merger  
6 Joint Proposal. The workpapers supporting the sales forecast were  
7 included as pages 60-145 of Volume 1 of the Financial Forecast and  
8 Supporting Workpapers filed in support of the Merger Rate Plan Joint  
9 Proposal in this proceeding in January 2001. We have included excerpts  
10 from those workpapers in Exhibit \_\_\_ (JJB/SDL-7). Page 69 of the  
11 workpapers (page 1 of the exhibit) summarizes the overall sales forecast  
12 by customer class; pages 107-108 of the workpapers (pages 2 and 3 of the  
13 exhibit) show the breakdown by customer class, including unregulated  
14 generators receiving standby service and other large commercial and  
15 industrial customers.

16 There was, therefore, ample information available to Staff showing  
17 the basis of the sales forecast well before March 2005. Moreover,  
18 contrary to the Staff Panel’s assertion (on page 19, lines 8-15), the fact  
19 that the sales forecast did not include a separate forecast of sales of  
20 standby service or permit the identification of the portion of overall sales  
21 attributable to standby service customers neither undermines the basis for

1 the deferrals of lost station service revenues nor renders Niagara

2 Mohawk's rates excessive if it recovers those deferrals.

3

4 Q: Why is that?

5 A: As the Company has consistently explained in its testimony and responses  
6 to information requests, the forecasts for sales to large commercial and  
7 industrial customers, including standby service customers, were based on  
8 econometric techniques, not customer-by-customer projections. (We have  
9 attached as Exhibit \_\_\_ (JJB/SDL-8) our response to IR No. 264 (PSC-209  
10 Visalli (RAV-40)) which discusses this point in greater detail.) Therefore,  
11 accepting for purposes of discussion Staff's position that a line-item-by-  
12 line-item comparison of revenues is required for a deferral, the overall  
13 level of sales to customers in the large commercial and industrial classes,  
14 rather than the level of sales to customers within those classes (such as  
15 standby service to generators), is what is significant for purposes of  
16 determining whether a loss of revenues from a legal or regulatory change  
17 represents a reduction compared to what the Company expected to receive  
18 from that class under the Merger Rate Plan rates. In other words, even  
19 under Staff's approach, its assertion that any standby service revenues the  
20 Company might receive after the Rate Plan took effect would constitute a  
21 windfall because they were unaccounted for in the forecast, and so would

1           deferral of the effects of a regulatory change curtailing those revenues,  
2           must be tested by comparing forecasted sales to all large commercial and  
3           industrial customers with actual sales to those customers.

4

5   Q:    Did you perform such a comparison?

6   A:    Yes, as part of our response to IR No. 264 (PSC-209 Visalli (RAV-40)),  
7           we compared actual and forecast sales to large commercial and industrial  
8           customers before and after the Rate Plan took effect. The comparison,  
9           included in Exhibit \_\_ (JJB-SDL-8), shows that actual sales to large  
10          commercial and industrial customers were less than forecast sales both  
11          before and after the Rate Plan (through 2004). Had the regulatory  
12          changes limiting the Company's ability to charge for standby service not  
13          taken place, standby service sales would only partially have offset the  
14          shortfall in sales to the large commercial and industrial classes taken  
15          together as a whole. They would not have constituted a windfall such that  
16          the impact of the regulatory changes on the Company's revenues should  
17          be excluded from Section 1.2.4.3 of the Merger Joint Proposal.

18

19   Q:    Are you saying that Niagara Mohawk is entitled to defer the impact of the  
20          shortfall in sales to large commercial and industrial customers, as  
21          compared to the forecast?

1 A: No. As we have made clear, only the revenue impact of a legal or  
2 regulatory change is eligible for deferral under Section 1.2.4.3. We  
3 present this comparison only to show that Staff's insistence on a  
4 comparison to sales forecast line items does not support its position.

5  
6 Q: Does your comparison between forecast and actual revenues to large  
7 commercial and industrial customers bear on any other argument made in  
8 the Staff Panel's responsive testimony?

9 A: We think so. On page 23 of its responsive testimony, the Staff Panel  
10 argues that allowing the deferral of lost station service revenues would  
11 cause Niagara Mohawk's electric delivery rates to exceed just and  
12 reasonable rates. Mr. Reilly discusses a number of reasons why this is  
13 incorrect in his rebuttal testimony. Since the revenues that Niagara  
14 Mohawk could have realized from standby service sales but for the  
15 regulatory changes we have discussed would only make up for a portion of  
16 the shortfall in sales to large commercial and industrial customers, as  
17 compared with the sales forecast for this class in the Merger Rate Plan,  
18 deferral of these lost revenues cannot cause Niagara Mohawk's rates to  
19 exceed the levels contemplated in the Rate Plan.

20

21

Case 01-M-0075

JAMES J. BONNER JR. and SCOTT D. LEUTHAUSER

1 III. Conclusion

2 Q: Thank you. I have no further questions at this time.



1 JUDGE STOCKHOLM: Cross-examination.

2 MS. ASSAF: Thank you, Your Honor.

3 CROSS EXAMINATION

4 BY MS. ASSAF:

5 Q. Good afternoon, panel.

6 A. (Bonner) Good afternoon.

7 Q. I did review your credentials, but does either  
8 of you possess a degree in economics?

9 A. (Bonner) No, I do not.

10 (Leuthauser) Just a master's in business  
11 administration with further economics courses.

12 Q. Who developed the company's econometric model?

13 A. (Bonner) That's Mr. Jerry S. Mann.

14 Q. Is Mr. Mann still employed by the company?

15 A. (Bonner) He is.

16 Q. Could you turn to page three of your September  
17 1st testimony, lines 12 through 18. And there you  
18 state instead of addressing the applicability of the  
19 provisions of the settlements accepted by the  
20 Commission, staff attempts to substitute for their  
21 specific provisions an implausible interpretation of  
22 a legal test that the Commission has discretion to  
23 apply in cases where a utility is requesting  
24 deferral in the absence of an agreement approved by

1 the Commission specifically authorizing the deferral  
2 of costs and revenues in defined circumstances.

3 Is that correct?

4 A. (Bonner) That's what it says.

5 Q. Is it your position the merger Joint Proposal  
6 stands on its own and that all other Commission  
7 orders, rules, regulations, policies and procedures  
8 are not applicable unless specifically referenced in  
9 the merger Joint Proposal?

10 A. (Bonner) No. I don't believe that's our  
11 testimony. What we are saying here is that the  
12 merger Joint Proposal should be given the primary  
13 weight because it is in effect a manifestation of  
14 those Commission policies and procedures applicable  
15 in this specific instance.

16 Q. But the other Commission rules or policies  
17 should also be used or may be used at points in  
18 implementing and interpreting the merger Joint  
19 Proposal or the actions the company has taken  
20 pursuant to it?

21 A. (Bonner) The Commission has broad authority to  
22 review all the provisions of the merger Joint  
23 Proposal and how it works. As Mr. Reilly testified  
24 earlier, section 3.5 would confer the authority on

1 Commission if it found the total arrangement to be  
2 totally unjust and totally unreasonable.

3 Q. Page four, lines three through four of your  
4 testimony, you state that the deferral mechanisms  
5 satisfy all the Commission rules and policies; is  
6 that correct?

7 A. (Bonner) We believe that is the case, yes.

8 Q. Are you familiar with the Commission's three  
9 prong test for determining whether a cost or revenue  
10 is deferral?

11 A. (Bonner) Mr. Visalli and Ms. Gerbsch were kind  
12 enough in their testimony to outline in great  
13 detail.

14 Q. They were clear?

15 A. (Bonner) Yes, they were.

16 Q. Does the station service lost revenue meet the  
17 Commission's three prong test for determining  
18 whether a cost or revenue is deferral?

19 A. (Bonner) It does for the very same reasons Mr.  
20 Reilly gave this morning. Certainly in terms of  
21 materiality addressed in the rate plan's \$2 million  
22 threshold associated with this deferral. In terms  
23 of the company's overearning right now it is  
24 unaudited. The company submitted reports saying

1 it's well below its allowed rate of return. It's  
2 8.69 percent, as I recall.

3 And the last one is incremental or  
4 decremental. The definition of incremental and  
5 decremental was provided for in the merger rate plan  
6 itself.

7 Q. Assume for the purpose of this question that  
8 there were no revenues for station service factored  
9 into the determination of rates for the merger Joint  
10 Proposal. Do you think it reasonable for ratepayers  
11 to pay for revenues that are later lost to the  
12 company that were never factored into the rates?

13 A. (Bonner) Assuming the hypothetical at the  
14 moment, I would have issues with what you need to  
15 take into account in addition to the specific  
16 customers you are identifying. Station power  
17 customers is not a defined class. They are even  
18 within rates and current rates part of SC-7 group  
19 which includes people who take partial requirements.

20 There are other customers under service  
21 classification number 7 who take partial  
22 requirements service who are not station power  
23 customers. So, but particularly at the time the  
24 merger Joint Proposal was being formed, current

1 service class number 7 did not exist. It was  
2 created after the merger Joint Proposal was signed,  
3 almost coincidentally at about the same time. The  
4 Commission had not yet even approved the merger  
5 Joint Proposal.

6 So, during the period of time during the  
7 build up for the merger Joint Proposal, customers  
8 who were taking station power were in other service  
9 classification, principally service classification  
10 number 3 and service classification number 3A.

11 So, to work out--to get to your point of  
12 your question is is there a gain or a loss in the  
13 service classifications for which these customers  
14 are a part, well, there are customers who were  
15 added, in this particular case the station power  
16 customers, but other customers who are lost. So,  
17 you have to take into account the movement of the  
18 entire class in order to determine whether or not  
19 the rates on which the--which are based off the  
20 sales to the class as an entire aggregate group are  
21 still just and reasonable.

22 Q. My question was a bit more--let me ask it more  
23 generally. Under normal deferral accounting from a  
24 ratemaking perspective, if no revenues are built

1       into rates can there be any lost revenues?

2       A.       (Bonner) The revenues, the real question is  
3       were the revenues built into rates. For example,  
4       let's try a different class. Say, for example, that  
5       we have sales to steel mills encompassed in SC-3A  
6       service classification. Now, the steel industry has  
7       generally been in decline, so those customers over  
8       periods of time probably have less sales than what  
9       was in the historical period used as a basis to come  
10      up with a forecast.

11             In addition, pharmaceuticals are a growth  
12      business. Now we are having additional customers  
13      and additional load coming from this. So, in terms  
14      for the purpose of the overall service  
15      classification, the loss in the steel mills is  
16      offset by the gain in pharmaceuticals.

17             And you mentioned Mr. Mann. The forecast  
18      isn't built up from customer by customer basis.  
19      It's built up on econometric basis using as degree  
20      of granularity the service class and all of its  
21      members as a whole.

22      Q.       Putting aside the granularity statement, I am  
23      not sure what that is, I am asking a very basic  
24      ratemaking question. If there were no revenues

1 built into rates for whatever item it is, could  
2 there be lost revenues from the ratemaking  
3 standpoint?

4 A. (Bonner) Sure. In the case--depends on your  
5 reference point. Lost revenue would mean that at  
6 one point in time you are receiving a stream of  
7 money and are no longer receiving that same stream.

8 Q. But the premise of the question is there was no  
9 revenues built into rates.

10 A. (Bonner) If there were no revenues built into  
11 rates at all of course you cannot have a lost  
12 revenue.

13 Q. On page 28 of your testimony, lines 14 through  
14 17, you state that all of these parties were well  
15 aware that neither the baseline cost projections nor  
16 the historical revenue figures on which they were  
17 based contain separate line items corresponding to  
18 standby service to generators; is that correct?

19 A. (Bonner) Yes.

20 Q. Did you canvass each of the parties to  
21 determine their level of awareness?

22 A. (Bonner) No. I based that statement on the  
23 materials the company had provided in the course of  
24 the proceeding.

1 Q. So, you were making an inference? You don't  
2 know for a fact whether people did or didn't  
3 understand?

4 A. (Bonner) We provided the information within the  
5 appropriate terms that were distributed at the time  
6 and their--for example, in the same forecasting  
7 section you can actually see what was in certainly  
8 the long range forecast, so making the presumption  
9 people actually read the material they were  
10 provided. But, no, I didn't canvass them.

11 Q. Thank you. Turn to page 51, lines 19 through  
12 21.

13 A. (Bonner) Yes, I am there.

14 Q. You suggest here that other deferrals don't  
15 share the same mechanism of station service; is that  
16 correct?

17 A. (Bonner) Yes.

18 Q. And the mechanism you are referring to is the  
19 company's interpretation of what is the baseline for  
20 clause 1.2.4.3 of the merger Joint Proposal?

21 A. (Bonner) Yes, that is correct.

22 Q. Could you look at merger Joint Proposal clause  
23 1.2.4.2.1.

24 MR. GAVILONDO: Your Honor, if I may provide



1 the witness with a copy.

2 JUDGE STOCKHOLM: Absolutely, sure.

3 BY MS. ASSAF:

4 Q. Page 17.

5 A. (Bonner) Yes, the section references to  
6 existing deferral balance. I am sorry. Externally  
7 imposed accounting changes.

8 Q. Would the baseline for a sales tax audit be the  
9 amount you actually paid in sales tax or the amount  
10 built into the merger Joint Proposal rates for sales  
11 tax based on that provision there, 1.2.4.2.1.

12 A. (Bonner) I believe this provision is intended  
13 to convey the difference between the costs of  
14 revenues with and without the change. That is shown  
15 also in Exhibit 12, page four.

16 Q. I just want to run through a hypothetical with  
17 you so I understand what we are saying here. If the  
18 merger Joint Proposal rates were based on an annual  
19 New York sales tax allowance of \$6 million and you  
20 only paid \$3.5 million in a given year, but on audit  
21 New York State found that you underpaid by 2.5  
22 million, how much if any in deferrals do you believe  
23 would be allowed on clause--

24 A. (Bonner) Would you restate it one more time.

1 Q. Sure, absolutely. If the merger Joint Proposal  
2 rates were based on an annual New York State sales  
3 tax allowance of 6 million, and you made 3.5 million  
4 in a year, but on audit New York State found that  
5 you underpaid by 2.5 million, how much if any in  
6 deferrals would you be allowed under that clause?

7 A. (Bonner) I would say none because there wasn't  
8 a regulatory change in that provision. There was no  
9 tax or accounting changes. Seems to be an  
10 underpayment.

11 Q. Could you please turn to exhibit what is now  
12 marked as exhibit 10. JJB/SDL 4.

13 A. (Bonner) I have it.

14 Q. If you could turn to the table that's page four  
15 of four.

16 A. (Bonner) I have it in front of me.

17 Q. Actually, I just want to clarify for the record  
18 because I am not sure everybody followed this  
19 through. Is it correct that this table two had the  
20 actual and the forecast amounts reversed and that  
21 was corrected in JJB/SDL 8?

22 A. (Bonner) Yes.

23 Q. Other than having to flip those numbers, every  
24 other number on the two tables is the same?

1 A. (Bonner) Correct. The one attached to JJB/SDL  
2 4 had the incorrect attachment.

3 Q. I guess we will work off Exhibit 14 then. On  
4 page four of that exhibit, the sheet we were looking  
5 at, you show a comparison of actual versus forecast  
6 sales for SC-3 and SC-3A; is that correct?

7 A. (Bonner) Yes.

8 Q. Could you explain why you are making that  
9 comparison?

10 A. (Bonner) The comparison I was attempting to do  
11 here was to show the sales in these two  
12 classifications before the merger rate plan took  
13 effect, which is table number one, compared against  
14 the forecasts at that time and then what they were  
15 immediately after the merger Joint Proposal took  
16 effect in the first three years of it from 2002 to  
17 2004.

18 At the time, station service customers as  
19 well as all standby service customers were in  
20 the--at least up until--sorry. Let me back that up  
21 again. Up until 2002 station service customers as  
22 well as all other standby customers were actually  
23 served under the company's other service  
24 classifications, principally SC-3 and SC-3, and

1 accounts for the majority of the usage and the  
2 revenue.

3 Commencing with 2002, beginning in July of  
4 that year, the Commission had approved and made  
5 effective SC-7. In fact, the SC-7 sales, although  
6 it is not labeled here, are actually included in the  
7 figures for 2002 through 2004. So they are actually  
8 the sum of three numbers.

9 Q. So, what are the three numbers?

10 A. (Bonner) The three numbers would have been the  
11 SC-3 and the SC-3A classes independently, but within  
12 those the customers whose parent class SC-7 works  
13 off the notion that the price you pay is referenced  
14 back to the otherwise applicable service  
15 classification if you were a full requirements  
16 customer.

17 So, we have SC-7s whose parent class is  
18 SC-3, SC-7s whose parent class is SC-3A, and SC-7  
19 customers whose parent class is SC-2D. What we did  
20 with the SC-7 sales was, to make sure the comparison  
21 was completely fair, we added them back into the  
22 otherwise applicable service class.

23 So, the SC-3 line beginning in 2002 midway  
24 in the year included the sum of SC-3 customers as

1 well as SC-7 customers whose parent class was SC-3.

2 Q. Did the MJP, the merger Joint Proposal  
3 forecasted levels you have shown on that table  
4 assume any level of migration for SC-12 and Power  
5 for Jobs customers and SC-11 customers?

6 A. (Bonner) Those particular service classes in  
7 combination with SC-3 and 3A do work in conjunction  
8 with each other. Customers can become eligible for  
9 service class 11 or 12 contracts. At that point  
10 they are no longer in their parent class and now are  
11 reported under the SC-11 or 12 category. So,  
12 customers do migrate in and out.

13 The same thing is true for customers that  
14 receive allocations of NYPA power for Power for Jobs  
15 power allocation, which changes the way they are  
16 built.

17 Q. You did assume some level of migration?

18 A. In the forecast that underlies all of this Mr.  
19 Mann does take into account those sorts of  
20 variables.

21 Q. Do you know if more or less SC-3 and SC-3A  
22 customers actually migrated to SC-11, SC-12, PFJ or  
23 SC-7 than the company forecasted in 2002 on table  
24 two?

1 A. (Bonner) I don't know that at this point. It  
2 is something that I could find out. I just don't  
3 know the answer at this point.

4 Q. If we just focus in on 2002, table two. If the  
5 actual SC-11, SC-12 and PFJ sales turned out to be  
6 617 gigawatts more than forecasted, would you agree  
7 that rather than this negative variance that you  
8 show of 617 gigawatt hours on the table that company  
9 would not have any sales variables for SC-3 and  
10 SC-3A customers in total?

11 A. (Bonner) I would need to see the analysis  
12 before I could reach that conclusion.

13 Q. I assumed it was simply math, but I am making  
14 an assumption. The assumption is the sales turned  
15 out to be 617 gigawatt hours more than forecast, so  
16 if there was more built in there are you still  
17 uncomfortable with that analysis, that assumption?

18 A. (Bonner) Yes, because it doesn't seem to ring  
19 true to me. I believe that the aggregation once--if  
20 you were to take into account things like the SC-3,  
21 3As, add in the sevens, put in all of the various  
22 NYPA products and the 11s and 12s, I believe we are  
23 under forecast. That's why I am challenging that,  
24 your conclusion.

1 Q. I am going to try one more time. I was just  
2 trying to set forth a hypothetical which I think is  
3 strictly math. That is, if the actual SC-11, 12 and  
4 PFJ sales turned out to be higher than you assumed  
5 so there's a level of migration, correct, to  
6 classes?

7 A. (Bonner) We have to put it in a different  
8 fashion. We have a sales forecast which has values  
9 for all of those varied components for each of the  
10 years.

11 Q. Right, for purpose of then this table--if the  
12 sales had turned out to be 617 gigawatt hours more  
13 than forecasted from the merger Joint Proposal,  
14 would there then be sort of a loss, no negative  
15 variance?

16 A. (Bonner) Assuming for the sake of argument,  
17 subject to check, had everything worked out, things  
18 would be more or less right on track, yes.

19 Q. Thank you. Can there be any valid comparisons  
20 made or conclusions drawn from your table two about  
21 actual versus forecasted sales for all the SC-3 and  
22 3A customers as defined as those customers who  
23 stayed in SC-3 and 3A plus those who migrated to  
24 other service classes?

1 A. (Bonner) I think you have to try that one more  
2 time.

3 Q. I'm trying to determine when you are looking at  
4 table two whether or not we can make any comparisons  
5 about actual versus forecasted sales, which is the  
6 comparison you are trying to make here, for all SC-3  
7 and 3A customers if all means SC-3, SC-3A and those  
8 customers who migrated to other service classes?

9 A. (Bonner) The missing ingredient in the whole  
10 discussion was the other customers and where did  
11 they go, but migrations are also normal events. I  
12 mean customers do, for example, the difference  
13 between the company's different service  
14 classifications for general service customers are  
15 based largely upon size.

16 SC-2D would be for customers less than 100  
17 kilowatts in size. SC-3 would be for customers  
18 between 100 and 2000 kilowatts, and SC-3A would be  
19 between--for customers whose load is between--in  
20 excess of 2000 kilowatts.

21 So, as customers shrink, that is lose load,  
22 and they do for a variety of reasons, which is why  
23 you normally have to look at this group as an  
24 aggregate sum, but for the purpose of what we were



1           trying to do here I think the comparison is valid.

2                   The real question is because when you change  
3           service class you also change the price that you  
4           pay. What we are coming down to is the notion of  
5           revenue. The prices on average for SC-3A customer  
6           are lower than SC-3, and SC-2Ds pay even more. The  
7           migrations really don't affect the viability of the  
8           analysis.

9                   What I was trying to demonstrate here we  
10          were either at or below the forecasted levels and  
11          that was the amount of money the company was  
12          receiving from these customers.

13                   MS. ASSAF: Your Honor, I would like to mark  
14          for identification a document dated October 28, 2005  
15          to a Mr. Liu of staff submitted by Mr. Fletcher. It  
16          is also identified as Niagara Mohawk Power  
17          Corporation PSC 151.

18                   JUDGE STOCKHOLM: The document as you  
19          described is marked for identification as Exhibit 18.

20                   (Exhibit 18 marked for identification.)

21          Q.        Do you have copies, gentlemen?

22          A.        (Bonner) Yes, we do.

23          Q.        If I could ask you to turn to the attachment to  
24          PSC 151, page one.

- 1 A. (Bonner) Yes.
- 2 Q. Let me ask first, the respondent for this IR  
3 was Mr. Mann; is that correct?
- 4 A. (Bonner) Yes, it is.
- 5 Q. And the first sentence on page one of five says  
6 that, as a general comment, but with specific regard  
7 to items one, two and three, the forecast of classes  
8 SC-3, SC-3A, SC-7, SC-11, SC-12 and NYPA (R&E, EDP  
9 and PD) should not be done in isolation due to the  
10 large volumes affected by interclass migrations; is  
11 that correct?
- 12 A. (Bonner) That's what it says.
- 13 Q. Do you agree with Mr. Mann's statement in  
14 general?
- 15 A. (Bonner) Yes. There is, from his point of view  
16 as a sales forecaster there is a great deal of  
17 difficulty in understanding where the sales trends  
18 are going if you look at the rate classes in  
19 isolation.
- 20 Q. I'm trying to find an exhibit that's already  
21 been marked here. I apologize. JJB/SDL 7, which I  
22 believe is Exhibit 13.
- 23 A. (Bonner) I have it.
- 24 Q. If you look on page three of three, I guess.

1 A. (Bonner) Yes.

2 Q. Where you show the June 1999 sales forecast.  
3 You show 30 gigawatt hours for unregulated  
4 generators; is that correct?

5 A. (Bonner) That is correct.

6 Q. Is the term unregulated generators the same as  
7 station service customers as we are currently using  
8 the term?

9 A. (Bonner) No, it was a different set. It  
10 referred to unregulated generators, mostly  
11 independent power producers, that existed in 1999  
12 and served under the earlier version of SC-7 before  
13 it was terminated later that year.

14 Q. So you have unregulated generators, we are also  
15 discussing here the generators of the divested  
16 plants, correct, when we discuss station service?

17 A. (Bonner) Today we are, yes.

18 Q. These unregulated generators, are they still a  
19 subset of your station service customers?

20 A. (Bonner) They should be but I am going to let  
21 Mr. Leuthauser elaborate on it. He's more familiar  
22 with the events at that time.

23 (Leuthauser) These customers were the  
24 customers that were independent power producers

1 under the previous SC-7 which was terminated in  
2 Power Choice. We then re-implemented SC-7 under  
3 the Commission's SC-7 program in around the merger  
4 time frame. That has a new set of applicability  
5 different than this old SC-7. May or may not  
6 include that. Depends on the applicability  
7 requirements.

8 Q. May or may not include them?

9 A. (Leuthauser) The application of the initial  
10 SC-7 before Power Choice was a different  
11 applicability than the rules for the current SC-7.

12 (Bonner) I am more familiar with the new SC-7.  
13 The wholesale generators at least in July of 2002  
14 when the modern incarnation of SC-7 commenced, it  
15 consisted of customers who were served then under  
16 SC-3 or SC-3A who were wholesale generators, and  
17 served at the subtransmission or transmission  
18 voltage level. That was the qualifications cited at  
19 that time.

20 What Mr. Leuthauser is referring to is the  
21 qualifications to be an SC-7 prior to 1999 and prior  
22 was a completely different set. Now, more than  
23 likely, there are certainly customers in common  
24 between the two, but without knowing what's behind

1 those specific numbers I couldn't tell you if they  
2 are still there today.

3 Q. Does the 30 gigawatt hours in 1999 represent  
4 what was then the company's total forecast sales to  
5 unregulated generators?

6 A. (Bonner) No. I don't believe so, and I think  
7 Mr. Leuthauser can elaborate on that.

8 (Leuthauser) The 30 gigawatt hours  
9 represents the year ending 1999. The amount of  
10 sales to the independent power producers did  
11 qualify for the SC-7 at that point in time.

12 Q. So there may have been more unregulated  
13 generators, more gigawatt hour sales included in the  
14 sales forecast that aren't represented by this 30?

15 A. (Leuthauser) Yes. Take, for example, the  
16 company had 96 hydro independent power producers,  
17 none in the unregulated generator lines. Those  
18 customers would have been otherwise applicable  
19 service categories such as SC-2D.

20 Q. No way to identify them separately, they were  
21 part of another class?

22 A. (Leuthauser) Correct.

23 Q. In doing the May 2000 sales forecast could you  
24 have rerun the May 2000 sales forecast used to set

1 rates for the merger Joint Proposal and removed the  
2 actual sales from the unregulated generators for the  
3 years 1974 through 1998 to determine exactly how  
4 much in each year of the merger Joint Proposal there  
5 was for station service customers?

6 A. (Bonner) I would have to consult with Mr. Mann  
7 to find out whether or not that could be done.

8 Q. If you could turn to page three of your  
9 rebuttal testimony, lines five through nine. You  
10 were asked a question about a meeting that you said  
11 staff suggests the company was supposed to convene  
12 as required by section 1.2.4.3.1 of the merger Joint  
13 Proposal; is that correct?

14 A. (Bonner) Yes.

15 Q. Is it your position that this meeting was not a  
16 requirement of the merger Joint Proposal?

17 A. (Bonner) No. It's our comment that holding the  
18 meeting wasn't a pre-condition in order to seek  
19 recovery of the deferral amount attributable to  
20 section 1.2.4.3.

21 Q. Did the company request such a meeting on the  
22 issue of station service lost revenues?

23 A. (Bonner) Not that I am aware of.

24 Q. If you turn to page four, line 16 and 17, where

1       you state that the staff panel is arguing that the  
2       provision prohibits the deferral of the disputed  
3       station service lost revenues because NIMO didn't  
4       convene a meeting.

5       A.       Yes.

6       Q.       Could you point out in staff's testimony where  
7       it makes the argument that this provision prohibits  
8       the deferral of disputed station service lost  
9       revenues?

10      A.       (Bonner) I believe this question is addressing  
11      staff's rebuttal testimony on pages 24 and 25.

12      Q.       Where does it say that we are suggesting that  
13      that provision prohibits the deferral of disputed  
14      station service lost revenues because NIMO didn't  
15      convene a meeting?

16               Panel, if I could direct your attention to  
17      line 20, beginning on line 20, page 24, isn't it  
18      correct the staff panel was simply addressing Mr.  
19      Reilly's position that the company accurately and  
20      faithfully implemented the deferral mechanisms in  
21      the merger Joint Proposal?

22      A.       (Bonner) Yes. That's what it states.

23      Q.       So there was no suggestion by staff that that  
24      provision prohibited the deferral of disputed

1 station service?

2 A. (Bonner) In that section there does not seem to  
3 be any reference that directly addresses that point.

4 Q. Can you turn to page 13 of your rebuttal  
5 testimony, lines 12 through 15. Hang on a second.  
6 I think I have the wrong reference. Right  
7 reference.

8 At lines 12 through 15 you state at page 69  
9 of the work papers summarizes the overall sales  
10 forecast by customer class. Pages 107 to 108 of the  
11 work papers, pages two and three of the exhibit,  
12 show the breakdown by customer class, including  
13 unregulated generators receiving standby service; is  
14 that correct?

15 A. (Bonner) Yeah.

16 MR. GAVILONDO: I missed the reference. I  
17 thought I was in the right place.

18 MS. ASSAF: This is in the panel's rebuttal  
19 testimony at page 13, lines 12 through 15.

20 MR. GAVILONDO: Thank you.

21 A. (Bonner) Yes.

22 MS. ASSAF: Could we take a five-minute  
23 recess?

24 JUDGE STOCKHOLM: Yeah, let's make it ten.



1 (Recess taken.)

2 JUDGE STOCKHOLM: Ms. Assaf.

3 MS. ASSAF: Thank you, Your Honor.

4 BY MS. ASSAF:

5 Q. Panel, staff asked on May 5, 2005, IR PSC 21,  
6 and followed that up approximately nine months later  
7 on February 7, 2006, IR 264, and I believe both of  
8 them are in staff's exhibit SP-5. The level of  
9 station service built into the merger Joint Proposal  
10 forecast, that's what the questions were on.

11 Did you approach Mr. Mann to provide an  
12 answer since it was his econometric model used in  
13 the merger Joint Proposal? When staff asked the two  
14 particular IRs on the level of station service sales  
15 built into the merger Joint Proposal did you  
16 approach Mr. Mann to provide the answers?

17 A. (Bonner) I personally did not. I don't know  
18 whether he was approached. My role in the IR  
19 process was usually to answer a question. I wasn't  
20 administering the program.

21 Q. Mr. Leuthauser, do you know if you asked him  
22 these questions?

23 A. (Leuthauser) Nothing to add.

24 JUDGE STOCKHOLM: Who did answer the

1 question, counselor?

2 MS. ASSAF: That's what I am looking for,  
3 Your Honor.

4 JUDGE STOCKHOLM: Okay.

5 MR. BONNER: What were the numbers again?

6 MS. ASSAF: PSC 21 and PSC 264.

7 MR. JAFFE: 264 is also in the record.

8 MS. ASSAF: The respondent was Mr. Bonner.

9 JUDGE STOCKHOLM: Thank you.

10 MR. BONNER: And I was responding on  
11 behalf of 21, so, let me take a look at 264. No.  
12 I believe that was in Niagara Mohawk's information  
13 request number 264. Ms. Assaf.

14 BY MS. ASSAF:

15 Q. Excuse me?

16 A. (Bonner) Was the number 264 the PSC number?

17 Q. Yes.

18 MR. JAFFE: Disregard my helpful comment.

19 JUDGE STOCKHOLM: Disregarded.

20 MS. ASSAF: Mr. Bonner responded to 264.

21 JUDGE STOCKHOLM: Is there an outstanding  
22 question? Given the confusion can we start again  
23 with the question perhaps.

24 BY MS. ASSAF:

1 Q. Is it correct, panel, that the company was not  
2 metering station service use at each of its  
3 generating stations prior to divesting them?

4 A. (Bonner) I am going to let Mr. Leuthauser  
5 field the question.

6 (Leuthauser) Correct. Not being billed.  
7 May have been metering depending on which station.

8 Q. They weren't being billed and the meters would  
9 have been installed maybe on some, maybe not on  
10 others?

11 A. (Leuthauser) That is correct.

12 Q. So, without the meters or because you weren't  
13 billing them, did you have data available to even  
14 make a production about how much station service  
15 usage there was?

16 A. (Leuthauser) No.

17 Q. Did you attempt to find out if there had been  
18 any engineering studies on the generating stations  
19 that might provide some insight as to the level of  
20 station service usage at each plant?

21 A. (Leuthauser) No.

22 MS. ASSAF: Your Honor, I would like to mark  
23 with the next exhibit number a document,  
24 multiple-page document, entitled New York State and

1 region report prepared for New York Power Pool  
2 prepared by RFA. It's dated February 1999.

3 JUDGE STOCKHOLM: Marked as exhibit 19.

4 (Exhibit 19 marked for identification.)

5 Q. Panel, just for clarification, this was the  
6 sales work papers, part of them, for the merger  
7 Joint Proposal, just so you know what this is.

8 JUDGE STOCKHOLM: Just for the record, this  
9 says prepared by RFA. Who is RFA or what is RFA?

10 MS. ASSAF: Your Honor, I am not entirely  
11 certain. Perhaps the company would know.

12 JUDGE STOCKHOLM: Gentlemen, do you know?

13 MR. BONNER: It predates my involvement  
14 since it's 1999. Maybe Mr. Leuthauser knows.

15 MR. LEUTHAUSER: There were various advisory  
16 committees to the planning committee to the New York  
17 Power Pool. RFA was likely one of those planning  
18 subcommittees to the New York Power Pool.

19 JUDGE STOCKHOLM: Okay.

20 BY MS. ASSAF:

21 Q. In the electric sales portion of the supporting  
22 work papers, the exhibit we just gave you, there is  
23 a detailed description of the economy in the  
24 company's service territory; is that correct?

1 A. (Bonner) Yes, there are several.

2 Q. And those pages--you may need to take a  
3 minute--those pages show where specific pockets of  
4 growth were likely to occur; is that correct?

5 A. (Bonner) I believe those issues are addressed  
6 in each of the relevant sections.

7 Q. And the level of detail on those pages is quite  
8 extensive; would you agree?

9 A. (Bonner) Not being an economist I really  
10 don't have a capacity to render a professional  
11 opinion, but as an engineer there seems to be quite  
12 a bit of information here, yes.

13 Q. I recognize you haven't had a lot of time to  
14 digest this. Do you know if there is any mention of  
15 station service customers in any of these pages?

16 MR. GAVILONDO: Your Honor, may I indicate  
17 this is an excerpt from the report. We don't really  
18 know who authored this report. My report begins at  
19 page 75 it appears. I don't know what else is in  
20 this report. This is the first time I have seen it.  
21 I am not sure if the witness has seen it before.

22 MS. ASSAF: This is the company's work  
23 papers from the merger Joint Proposal.

24 MR. GAVILONDO: I have not seen this report.

1 I am not sure if this is an entire report and what  
2 might be reflected in the rest of the report.

3 MR. BONNER: I do believe it is an excerpt.

4 JUDGE STOCKHOLM: One of the problems that I  
5 have in looking at it is that there are two page  
6 numbering systems on each page. One indicates  
7 February 1999 RFA page two, page three, page four,  
8 etc., and the other begins with cover page as page  
9 75.

10 MS. ASSAF: Right. That is the page number  
11 where this document was located in the work papers,  
12 Your Honor, in the company's work papers.

13 JUDGE STOCKHOLM: Okay. In the company's  
14 work papers supporting?

15 MS. ASSAF: The merger Joint Proposal.

16 JUDGE STOCKHOLM: The merger Joint Proposal.  
17 Does this document appear in the Commission files in  
18 any place? Isn't it an exhibit in the case? Was it  
19 filed with the merger Joint Proposal? What I am  
20 trying to do is confirm this document so somebody  
21 that is not here or one of our lawyers that has to  
22 defend a Commission opinion or whatever can figure  
23 out where this document came from.

24 MS. ASSAF: Your Honor, work papers

1 sometimes are and sometimes aren't in the record.  
2 To be honest with you I am not entirely certain.

3 JUDGE STOCKHOLM: It's going to be difficult  
4 to ask these witnesses many questions on this  
5 document that are going to require their knowledge  
6 of the whole document.

7 MS. ASSAF: That was my last question  
8 actually, Your Honor.

9 JUDGE STOCKHOLM: Can I suggest that you put  
10 your question subject to check?

11 MS. ASSAF: Certainly.

12 BY MS. ASSAF:

13 Q. Panel, would you take subject to check that  
14 within this document there is no mention of station  
15 service customers from divested plants in the  
16 document?

17 A. (Bonner) We can take that subject to check.

18 MS. ASSAF: Your Honor, if I could just for  
19 a moment, we have an outstanding IR request that is  
20 applicable to the line of cross that I have just  
21 conducted. The request went in October 2nd so it  
22 went in yesterday, and I know that staff has actually  
23 asked this question of Mr. Mann and he has provided  
24 some information.

1           We have not gotten it formally so I wasn't  
2           sure whether or not--and I would like to introduce it  
3           or at least have an exhibit number held for this  
4           information once it comes in.

5           JUDGE STOCKHOLM: After we conclude these  
6           hearings if there is anything--I have made requests  
7           for information and staff's made requests and I am  
8           sure other requests as we go along. Any party that  
9           wants supplemental information in the record should  
10          provide me and the parties obviously with a copy and  
11          make that a formal request and I will consider that  
12          after the hearings are done.

13          MS. ASSAF: Thank you, Your Honor.

14          BY MS. ASSAF:

15          Q. Panel, earlier when I was crossing Mr. Reilly I  
16          asked him a series of questions that he said might  
17          be better addressed by Mr. Bonner and  
18          Mr. Leuthauser. Can the company show how much  
19          station service revenues were reflected in a line  
20          item in the historic sales forecast submitted as  
21          part of the support for the base delivery rates in  
22          the merger Joint Proposal?

23          A. (Bonner) There's no separately identifiable  
24          categories for station power sales in the forecast,



1 the May 2000 forecast, which underlies the merger  
2 rate plan.

3 Q. Mr. Reilly suggested--this is page 20 of his  
4 testimony, lines four through seven.

5 JUDGE STOCKHOLM: Initial or rebuttal?

6 MS. ASSAF: Initial.

7 JUDGE STOCKHOLM: What's the page reference  
8 again?

9 MS. ASSAF: Page 20, lines four through  
10 seven.

11 Q. If you look at those lines do you know what Mr.  
12 Reilly meant by the historic sales forecast was  
13 submitted as part of support for the base delivery  
14 rates in the merger Joint Proposal?

15 A. (Bonner) Yes, I believe I do.

16 Q. And that would be--what other parts would there  
17 be?

18 A. (Bonner) I am seeing if we can back up. What  
19 was the specific question again?

20 Q. Okay. The first question was simply to  
21 understand if you understood what Mr. Reilly's point  
22 was?

23 A. (Bonner) Yes, I think I do.

24 Q. If we focus on the section that says it was

1 submitted as part of the support, I am curious as to  
2 what else was submitted to support the base electric  
3 rates.

4 A. (Bonner) The basic support for most of the  
5 stuff that's in the merger Joint Proposal outside  
6 the merger Joint Proposal and its direct attachments  
7 in the company's submission in January of 2001 was a  
8 two volume set of supporting work papers which  
9 include the financial forecasts which I believe you  
10 have characterized that Exhibit 18 was taken from.

11 Q. So, is it the company's position that the  
12 merger rate plan revenue forecast includes some  
13 unknown or undefinable amounts for station service  
14 revenues in each of the ten years?

15 A. (Bonner) To the extent that station service  
16 revenues, the station service revenues, to the  
17 extent that station service customers were either  
18 forecasted to be in it or what were part of  
19 the--then included in the then existing service  
20 classifications, they have to be in there.

21 Q. They have to be in there, but we don't know how  
22 much is in there for them?

23 A. (Bonner) True. Nor would I know how much  
24 belonged to the metals or plastics machine industry

1 or machine tools or retailing. The forecast is  
2 built as a service class level.

3 Q. These questions relate to the Power Choice  
4 settlement, and I am wondering whether or not it's  
5 the company's position that the Power Choice  
6 settlement was also a black box as far as station  
7 service revenues were concerned?

8 A. (Bonner) I was not there at the time of the  
9 Power Choice settlement, but from what I have been  
10 able to review it's my understanding it was.  
11 Mr. Leuthauser may be able to add to that.

12 (Leuthauser) Yes, I would.

13 Q. You believe there was some black box concept  
14 involved?

15 A. (Leuthauser) That is correct.

16 Q. There was no line item for the station service  
17 revenues?

18 A. (Leuthauser) Correct.

19 Q. And under that concept the station service lost  
20 revenues would have been deferrable under clause  
21 2.6.1 of the Power Choice settlement. Do you have a  
22 copy of it, gentlemen?

23 A. (Leuthauser) The clause is referenced in our  
24 testimony.

1 Q. You have that clause, okay.

2 JUDGE STOCKHOLM: Can you give me that  
3 reference when you find that?

4 MR. LEUTHAUSER: On page 49 of our  
5 September 1st testimony, on line 20, through page  
6 50, line two.

7 MS. ASSAF: Could we give the panel--we have  
8 the copy of the Power Choice settlement section.

9 JUDGE STOCKHOLM: Absolutely.

10 BY MS. ASSAF:

11 Q. That section is entitled cost categories  
12 eligible for deferrals; is that correct?

13 A. (Leuthauser) Yes.

14 (Bonner) That's the title, yes.

15 Q. There it states that changes in laws,  
16 regulations, rules and accounting that can be  
17 substantiated as increasing or decreasing the cost  
18 of doing business in excess of \$500,000 per change  
19 are eligible for deferral; is that correct?

20 A. (Leuthauser) Correct.

21 Q. Where in that clause does it say anything about  
22 changes in laws, regulations, rules and accounting  
23 that impact revenues?

24 A. (Leuthauser) It's the cost of doing business.

1 JUDGE STOCKHOLM: You are equating a  
2 decrease in revenues would be the same as increase in  
3 the cost of doing business?

4 MR. LEUTHAUSER: Yes. When cost of service  
5 is developed, cost of service and revenue  
6 requirements become one and the same. If you lose  
7 payment on revenues from one, cost of doing business  
8 elsewhere is affected.

9 BY MS. ASSAF:

10 Q. I'm looking here at section 1.2.4.3 of the  
11 merger Joint Proposal. In this section, gentlemen,  
12 it's similar language except here we talk about a  
13 regulatory change which imposes new or modified  
14 existing obligations or duties and which value  
15 individually increases or decreases Niagara Mohawk's  
16 revenues or costs for regulated electric operations  
17 Power Choice only indicated costs.

18 A. (Leuthauser) Of doing business.

19 Q. And you equate two to be the same thing?

20 A. (Leuthauser) As previously answered, yes.

21 Q. So the fact that clause refers only to the cost  
22 of doing business you still interpret it both ways,  
23 that the cost of doing business means revenues or  
24 costs, however you want to define it?

1 A. (Leuthauser) As previously described.

2 Q. Is there a cost of service underlying the  
3 merger Joint Proposal for all ten years?

4 A. (Bonner) Yes, there is.

5 MS. ASSAF: Thank you. That's all I have.

6 JUDGE STOCKHOLM: Thank you. Can I go back  
7 though just for a second to the Power Choice  
8 settlement agreement, \$19 million that was discussed  
9 just a minute ago. Is there a provision in the  
10 merger Joint Proposal that allows you under the terms  
11 of the merger Joint Proposal to defer amounts that  
12 were, or to continue to carry deferred amounts that  
13 came from an earlier provision from an earlier rate  
14 plan?

15 MR. BONNER: I do not recall any specific  
16 provisions, but the triggering event in this  
17 particular case, Your Honor, actually during the  
18 merger rate plan period and the action of the FERC's  
19 order, carried it back retroactively into the Power  
20 Choice period in 1999.

21 JUDGE STOCKHOLM: Thank you. If in fact  
22 there is a provision in the merger Joint Proposal  
23 that addresses this issue I would appreciate the  
24 company advising me.

1 MR. BONNER: Well, Your Honor--

2 MR. GAVILONDO: If I may, for clarification,  
3 there is a section which refers to existing deferral  
4 balance. I am not sure if that necessarily  
5 encompasses the \$19 million issue that you just  
6 referenced, but there is a section 1.2.4.1 referring  
7 to existing deferral balance.

8 JUDGE STOCKHOLM: Thank you, counselor. If  
9 there is anything else you find, let me know.

10 Mr. Mager.

11 CROSS EXAMINATION

12 BY MR. MAGER:

13 Q. Mr. Leuthauser, can you identify any PSC  
14 decision you are relying upon for your position that  
15 an increase in the cost of business is the same as  
16 decline in revenues?

17 A. (Leuthauser) No.

18 MR. MAGER: And can I go off the record a  
19 second?

20 JUDGE STOCKHOLM: You may. Off the record.

21 (Discussion held off the record.)

22 JUDGE STOCKHOLM: Back on the record.

23 BY MR. MAGER:

24 Q. Panel, have you had a chance to review section

1 1.2.4.1 of the merger Joint Proposal?

2 A. (Bonner) I certainly have read the provisions  
3 right here and now, Mr. Mager.

4 Q. To your knowledge, does that provision  
5 authorize the company to recover \$19 million in  
6 station power lost revenues under the Power Choice  
7 settlement?

8 A. (Bonner) without further study, Mr. Mager, I  
9 can't answer that question.

10 Q. The existing deferral balance referred to there  
11 is a reference there shown on attachment 11 to the  
12 Joint Proposal. Do you see that?

13 A. (Bonner) Yes, I do.

14 Q. Does attachment 11 have anything to do with  
15 station power?

16 A. (Bonner) Do you have a copy of attachment 11  
17 with you? I do not.

18 Q. Yes, I do.

19 JUDGE STOCKHOLM: Could we take it subject  
20 to check or--

21 MR. MAGER: I would rather just make sure I  
22 am reading it the same way he is.

23 JUDGE STOCKHOLM: Okay, that's fine.

24 MR. BONNER: Would you repeat your question.



1 Q. Does attachment 11 authorize the recovery of  
2 station power loss revenues?

3 A. (Bonner) I don't find any line item with that  
4 title on attachment 11.

5 Q. There are other line items referring to other  
6 deferrals, correct?

7 A. (Bonner) Yes, there are.

8 Q. With respect to FERC's rulings on station  
9 power, am I correct that FERC has determined how the  
10 company may bill for station power service?

11 A. (Bonner) In effect, yes.

12 Q. And is it a FERC jurisdictional rate?

13 A. (Bonner) FERC is asserting jurisdiction over  
14 those customers who apply for and who are awarded  
15 station power from the New York Independent System  
16 Operator.

17 Q. And is it a cost based rate?

18 A. (Bonner) I don't know.

19 Q. If it's not a cost based rate how did FERC  
20 decide what the company may charge for that service?

21 A. (Bonner) It isn't the company that's charging  
22 for the service in this particular instance. What  
23 FERC was dictating was what the New York ISO would  
24 charge for the service and then claiming that the

1           only person that can do that was the New York ISO.

2           Q.       And so does the company receive any station  
3           power revenues currently?

4           A.       (Bonner) Yes. We receive service from  
5           customers who have not applied to the New York ISO  
6           or who were ineligible for it. Station power is a  
7           generic term referring to the provision of  
8           electricity to a merchant generator plant, a  
9           wholesale generator in the business of selling  
10          electricity for a profit.

11          Q.       Let me just back track to make sure I  
12          understand. Certain wholesale generators are  
13          subject to station power rates that are recovered  
14          from the New York ISO?

15          A.       (Bonner) There is a number of customers who  
16          have applied to the ISO and given ISO station power.

17          Q.       With respect to those customers, the company  
18          did not receive any revenues?

19          A.       (Bonner) To the best of my knowledge we  
20          received nothing.

21          Q.       And with respect to other wholesale generators,  
22          what revenues does the company receive?

23          A.       (Bonner) Normally for most generators but not  
24          exclusively, it's principally in SC-7 as well, just

1 under a different provision.

2 Q. And so with respect to the wholesale generators  
3 that receive station power, FERC has determined that  
4 that service is actually provided by the New York  
5 ISO and not Niagara Mohawk?

6 A. (Bonner) To the extent the service is provided  
7 at all, a lot of what FERC addresses is whether or  
8 not any service whatsoever is being applied at least  
9 in terms of delivery services from the local  
10 utility.

11 Q. So, your deferral petition here seeks recovery  
12 of lost revenues related to a service Niagara Mohawk  
13 did not provide?

14 A. (Bonner) That's what FERC alleged. The State  
15 of New York has a very different opinion on that and  
16 they so ruled when they issued their order in case  
17 03-E-1016.

18 Q. How much is the company seeking to recover for  
19 services it has not provided?

20 A. (Bonner) The company is seeking to recover the  
21 amount of money for the services it believed it did  
22 provide and under state jurisdictional tariff shown  
23 in attachment seven of the July 29th filing in this  
24 proceeding.

1 Q. Let's just throw a number out, could be an  
2 approximate. How much is the company's claim for  
3 station power service?

4 A. (Bonner) Station power service is buried in  
5 three deferrals, the largest of which is distributed  
6 station service, which is the amount principally  
7 under SC-7 special provision J, but not all NYISO  
8 station power customers are subject to special  
9 provision J of SC-7. That one was forecasted by the  
10 end of 2007 to be approximately \$72 million.

11 Q. What are the other two components of station  
12 power service that you are seeking recovery of?

13 A. (Bonner) In addition, part of the standby  
14 service lost revenue adjustments are sales to  
15 station power customers. That's the difference  
16 between standard tariff rates and what they would  
17 pay under SC-7. I don't have a number. I have the  
18 total SC-7, but it's most of it for the purpose of  
19 this discussion as approximate, although not the  
20 exact answer, that would be about \$7 million. That  
21 would be the sum of the standby service lost revenue  
22 reduced by the standby service lost revenue offset.

23 And then the last piece is that these  
24 customers were also receiving customer service

1 backout credits, and there is an amount of money  
2 associated with that, too. I believe staff  
3 estimated something, subject to check, of  
4 approximately about \$1.6 million.

5 Q. Let's leave that piece out for the moment. And  
6 excluding customer service backout credits, the  
7 proposed deferrals relating to the provision of  
8 standby service is approximately 79 million, 72  
9 million plus an approximate seven million?

10 A. (Bonner) That's the right ballpark.

11 Q. And under FERC decisional law Niagara Mohawk  
12 has not provided any station power service dating  
13 back to 1999, correct?

14 A. (Bonner) On the decision that they have  
15 rendered in the three cases that they adjudicated,  
16 which was for Constellation, Nine Mile, AES Somerset  
17 and the NRG companies.

18 Q. And can you point me to a New York PSC decision  
19 where a utility has ever recovered lost revenues for  
20 a service that it did not provide?

21 A. (Bonner) We are providing a service under New  
22 York State law. It is FERC that deemed no delivery  
23 services have been provided.

24 Q. Doesn't FERC's decision control in this

1 instance?

2 A. (Bonner) That's why we are seeking recovery of  
3 the lost revenues.

4 JUDGE STOCKHOLM: Can I interrupt just a  
5 quick second, counsel. FERC has exercised  
6 jurisdiction here because they see this as a  
7 wholesale transaction? That is your understanding?

8 MR. BONNER: I think it is more involved  
9 than that. They were working through what they  
10 believed is the right measurement period over which  
11 a service that's being provided would be measured.  
12 Normal retail service tariffs incorporate a number  
13 of different cost or charge elements.

14 For example, most rate classes have customer  
15 charges which are paid monthly just for the  
16 privilege of being hooked up to the network. In  
17 addition, for large commercial and industrial  
18 customers we level a type of capacity charge that  
19 represents the costs of the T&D system as well as  
20 part of our stranded costs recovered through that.

21 Now, the measurement for demand, the rates  
22 for almost all of Niagara Mohawk service, the only  
23 exceptions are those associated with NYPA, is over a  
24 15-minute period. What FERC ruled on was that the

1 appropriate measurement interval for the purpose of  
2 delivery service for station power should be  
3 30 days.

4 So the generator could be actually drawing  
5 power from the network for a week or two, provided  
6 their total output was in excess of power for over a  
7 30 day period, and no money would be owed to the  
8 serving entity.

9 JUDGE STOCKHOLM: Okay, but if I understand  
10 this correctly, and correct me if I am wrong, FERC  
11 has said you can't charge that or if you are going  
12 to charge it you have to calculate it the way we  
13 say?

14 MR. BONNER: That is correct.

15 JUDGE STOCKHOLM: Are you aware of any  
16 circumstances where the company has recovered a  
17 shortfall due to FERC established rates through a  
18 state Commission through the New York State  
19 Commission retail rate setting?

20 MR. BONNER: I am sorry. Would you repeat  
21 the question, please.

22 JUDGE STOCKHOLM: Sure. My question, and I  
23 will describe my concern and then you can address it  
24 as you see fit. My concern is that it looks like,

1 based on this line of cross-examination at least,  
2 that FERC has said we have jurisdiction over this  
3 rate, at least to some extent. We are going to  
4 dictate what you are going to be able to do and not  
5 going to be able to do. And according to the  
6 company's testimony that leaves them with revenue  
7 shortfall.

8 My question is has a revenue shortfall that  
9 has resulted from rates that FERC exercises  
10 jurisdiction over ever been applied to retail  
11 customers in New York?

12 MR. BONNER: Yes, actually. We have one of  
13 our adjustment clauses that is a recognition of the  
14 difference between wholesale revenues received and  
15 an allowance that was incorporated in the merger  
16 rate plan, called the transmission revenue  
17 adjustment clause under rule 23, PSC 207 electricity  
18 tariff.

19 JUDGE STOCKHOLM: So, this may be a little  
20 flip, but to the extent that FERC doesn't allow you  
21 to recover your costs the State of New York has to?

22 MR. BONNER: The way the merger rate plan  
23 rates were developed in this particular instance it  
24 was under the assumption we would be recovering



1 these delivery service costs from wholesale  
2 customers in accordance with the Commission  
3 guidelines program 98, case 99-E-1470, then that was  
4 specifically implemented for Niagara Mohawk in case  
5 01-E-1847, which approved SC-7.

6 Now, in those decisions, the Commission said  
7 because the generators were--no services were really  
8 being provided to them, that provision of delivery  
9 services to wholesale generators was a state  
10 jurisdictional service, that they were part of the  
11 rates and they should be charged.

12 So, that's what the company's expectations  
13 were. This works in concert with the provisions in  
14 the merger Joint Proposal regarding an essentially  
15 regulatory change or one regulatory jurisdiction has  
16 now basically claimed jurisdiction in one area that  
17 was formerly governed by another. And that's the  
18 provision under which we are seeking the money.

19 JUDGE STOCKHOLM: I understand much better  
20 now. I am sorry, Mr. Mager.

21 MR. MAGER: That's okay.

22 BY MR. MAGER:

23 Q. With respect to that other example you  
24 provided, the transmission revenue adjustment,

1 that's the compensation the company receives for  
2 providing transmission service, correct?

3 A. (Bonner) Yes. They are transmission services,  
4 right.

5 Q. And with respect to station power, it's FERC's  
6 holding that the company is not providing a service,  
7 correct?

8 A. (Bonner) It is FERC's holding, not the  
9 company's, nor the state's, that we are not  
10 providing a service.

11 (Leuthauser) We established a forecast for  
12 transmission wheeling, represents what the company  
13 would receive for services under the wholesale  
14 tariff for transmission service. To the degree  
15 that went down, the wholesale transmission service  
16 went down, and we provided less services as would  
17 happen under the New York ISO. Changed how we  
18 collect revenues. Under transmission wheeling  
19 agreements there is a true up to the actual  
20 forecast.

21 Q. And I don't disagree with any of that. I guess  
22 the distinction I am trying to draw with respect to  
23 the transmission revenue adjustment applies to a  
24 shortfall in revenues for service the company is

1 providing, whereas I believe under at least FERC  
2 decisional law this issue, meaning the station  
3 service issue, the company is seeking lost revenues  
4 for a service it's not produced?

5 A. (Bonner) Again, from the standpoint of this  
6 particular application it has no bearing, and it's  
7 actually FERC's sole delivery rates that's the case.  
8 I have not heard the State of New York concur with  
9 it and certainly National Grid does not agree.

10 Q. Well, notwithstanding that National Grid and  
11 the PSC's decision in the litigation, is the company  
12 able to recover station service revenues from  
13 station service customers?

14 A. (Bonner) Again, the term you are using is the  
15 disputed station service, the ones now buying from  
16 the ISO. The answer is the company is seeking  
17 recovery from that under the regulatory change  
18 provisions of the merger Joint Proposal.

19 Q. You are not seeking it from them?

20 A. (Bonner) No, because I can't. If FERC upheld,  
21 I can't bill them for it, so the revenue shortfall  
22 is being collected from everyone else. I would  
23 prefer to collect it from them.

24 Q. So would we.

1 A. (Bonner) Right at the moment I seem to be  
2 barred.

3 Q. I guess that's the point I am making is that  
4 right now, absent some change in the law, the rule  
5 of law for this issue is that Niagara Mohawk is not  
6 providing a service that it's seeking compensation  
7 for, isn't that correct, from the customers  
8 purportedly receiving this service?

9 A. (Bonner) Yes. That's the current state of  
10 affairs, yes.

11 Q. Now, to the extent the ISO recovers station  
12 service revenues, are you aware how that rate is  
13 calculated?

14 A. (Bonner) I am aware in sort of the broadest  
15 sense because the wholesale transactions don't come  
16 under my--I am not responsible for them. That's a  
17 different department at National Grid. I am aware  
18 of generally what the basic rules are in terms of  
19 how a customer applies for it, and but I am very  
20 unclear as to exactly what revenues we may or may  
21 not receive directly in the transmission side that  
22 might be re-rated to the provisions of this service.

23 Q. Are you aware generally how the ISO provides  
24 station service?

1 A. (Bonner) No, I am not.

2 Q. And so at this point are you aware how or  
3 whether Niagara Mohawk could be compensated from the  
4 ISO?

5 A. (Bonner) No. I have been asking those  
6 questions. To the best of my knowledge we have not  
7 received any money that's related to this.

8 JUDGE STOCKHOLM: What does ISO do with the  
9 money?

10 MR. BONNER: That's a good question. I  
11 assume to actually run its own operations and cover  
12 those costs that are jurisdictional to it.

13 JUDGE STOCKHOLM: Okay. And if it lost  
14 revenues where would the shortfall to cover the ISO  
15 costs come from?

16 MR. BONNER: They would probably raise the  
17 rates. No. I am not sure if they have any specific  
18 regulatory change provisions or other recovery  
19 mechanisms. I am not familiar with ISO billing or  
20 the ISO tariff in any detail.

21 MR. LEUTHAUSER: Through rate schedule one  
22 of the FERC tariff. Through anybody that buys power  
23 through the New York ISO.

24 JUDGE STOCKHOLM: That's where they get

1 income?

2 MR. LEUTHAUSER: That's where they get their  
3 money to run the operations of the securities, all  
4 through rate schedule one of the FERC tariff.

5 JUDGE STOCKHOLM: That includes the charges  
6 we are talking about here?

7 MR. LEUTHAUSER: No. I think how they are  
8 working--they pay the generators who supplied  
9 electricity and collect money from those generators  
10 that consumed electricity and net things out. To  
11 the degree there is imbalance, they go to rate  
12 schedule one if the ISO has shortfalls in their  
13 revenue requirement.

14 JUDGE STOCKHOLM: Okay. And rate schedule  
15 one charges who, end users? Transmission owners?  
16 Where does that money come from?

17 MR. LEUTHAUSER: Transmission owners. Based  
18 upon load usage.

19 JUDGE STOCKHOLM: Then let me see if I can  
20 draw the circle and tell me where I don't have this  
21 right. You don't get the revenues now because FERC  
22 says you can't have them, but ISO does get the  
23 revenues now because FERC says they can have them.

24 Once the ISO gets the revenues and they put

1 it in their pool of money used to cover their costs,  
2 the amount that they then charge under tariff one to  
3 the transmission owners goes down; am I right about  
4 that?

5 MR. LEUTHAUSER: On a 30 day netting, to the  
6 degree a generator serves more electricity than  
7 generated, it's a very, very low probability in the  
8 first instance. In most instances no payments for  
9 the service.

10 JUDGE STOCKHOLM: Pays nobody for that  
11 service under those circumstances?

12 MR. LEUTHAUSER: That is correct.

13 JUDGE STOCKHOLM: Assuming that the  
14 generators are in a position to be billed by the ISO,  
15 then the ISO gets money, that money offsets its--I  
16 don't know if revenue requirement is the offset, the  
17 revenue requirement.

18 MR. LEUTHAUSER: I don't believe the ISO has  
19 any charges for any of the wires, only selling the  
20 energy that it bought and energy it resold on 30 day  
21 netting. So, to the degree a generator  
22 consumed--some generator had to generate it so the  
23 money went out net sum gain.

24 JUDGE STOCKHOLM: Money goes to the ISO and

1 the ISO doesn't--costs are not supported by these  
2 amounts?

3 MR. LEUTHAUSER: That is correct.

4 JUDGE STOCKHOLM: I think I understand  
5 better. Mr. Mager.

6 BY MR. MAGER:

7 Q. Do you recall a line of questioning with  
8 respect to section 1.2.4.3.1 of the merger Joint  
9 Proposal entitled material regulatory changes?

10 A. (Bonner) Yes, I do.

11 Q. Am I correct that the company believes this  
12 change is applicable with respect to this station  
13 service issue?

14 A. (Bonner) Could you restate that question, Mr.  
15 Mager.

16 Q. Does the company believe that this provision of  
17 the merger Joint Proposal governs its proposed  
18 recovery of station service lost revenues?

19 A. (Bonner) No, we do not.

20 Q. And do you believe it's inapplicable?

21 A. (Bonner) The section to which you are referring  
22 was designed around an event. That's a little bit  
23 different than what we are talking about here. This  
24 had to do with that more broader context.



1           Give you an illustration that I remember  
2           being part of the discussion. Let's try the example  
3           that--say that right now our transmission and  
4           delivery rates are one component, they are combined  
5           together. We don't separate transmission from  
6           distribution. Say somewhere along the line  
7           hypothetically FERC were to decide it wanted and was  
8           able to support this through the courts and/or  
9           Congress that it had just simply sole jurisdiction  
10          over what's called transmission facilities, and  
11          those facilities just happened to correspond with  
12          our definition of what we think transmission costs  
13          are, to make the math work out easier.

14                 In such a case--and then they decided to  
15          work out their own rate setting process and come up  
16          with a series of prices now applicable for  
17          transmission service and residual piece for  
18          distribution service.

19                 Under those circumstances, this provision  
20          1.2.3.1 would be voided because it's around cost  
21          allocation.

22          Q.       Has the company claimed that station service  
23          loss revenues are deferrable under clause 1.2.4.3.1  
24          as part of its CTC reset filing? Let me draw your

1 attention to page 49 of attachment six and seven.

2 A. (Bonner) We do mention it there, yes.

3 Q. Can you describe the reference so the record is  
4 clear.

5 A. (Bonner) Sure. The actual statement on page 49  
6 of attachment six and seven to the July 29, 2005  
7 filing in this case reads as follows: These lost  
8 revenues includable in the deferral account pursuant  
9 to section 1.2.4.3 and 1.2.4.3.1 of the rate plan.

10 Q. Let me stop you there, Mr. Bonner. A minute  
11 ago I thought you said that provision was  
12 inapplicable here and now you are reading from your  
13 filing saying that the lost revenues are includable  
14 in the deferral account pursuant to that section; am  
15 I correct?

16 A. (Bonner) No. No. Let me clarify the  
17 statement. In order to be able to defer it I need  
18 to only meet the requirements of section 1.2.4.3.

19 Now, there are two ways of accomplishing the  
20 task. One is to put the thing in the deferral  
21 account. Another way would be to actually try and  
22 work out a current revenue recovery if the thing  
23 arose to that level, and covered under section  
24 1.2.4.3.1, but it's an either/or proposition, not

1 both.

2 One doesn't necessarily--you can't collect  
3 it twice. You can only collect it once. And only  
4 one of the two provisions can be used. We believe  
5 that section 1.2.4.3 dictates the deferability and  
6 recovery in that manner.

7 Q. That is a unilateral decision for the company  
8 to make. I mean 1.2.4.3.1 is not limited to Niagara  
9 Mohawk, is it?

10 A. (Bonner) I am not sure I understand your  
11 question. It does mention, the provision does  
12 mention the terms FERC and the New York ISO and  
13 other agencies having authority about how costs and  
14 revenues are allocated to and away from distribution  
15 and transmission function. That isn't what we are  
16 discussing.

17 Q. I am talking about how interested parties will  
18 reconvene, not limited to Niagara Mohawk.

19 A. (Bonner) The interested party of one is not  
20 very many parties. Interested parties meant others,  
21 but the pertinent part was referencing how costs are  
22 allocated to and why the transmission or  
23 distribution function--

24 Q. The fact alone that you want recovery under a

1 different provision of the Joint Proposal doesn't  
2 render 1.2.4.3.1 null and void, does it?

3 A. (Bonner) No. I didn't testify that it did.  
4 One covers cost allocation. The other one refers to  
5 revenue recovery.

6 Q. I believe you testified that there has been  
7 meetings scheduled or requested under 1.2.4.3.1?

8 A. (Bonner) There have been no meetings so far as  
9 I am aware.

10 Q. To the extent there were meetings and a  
11 resolution could not be agreed upon, what would  
12 happen then?

13 A. (Bonner) At that point, in terms of a cost  
14 allocation question? I would presume that the  
15 company would petition the Commission with its own  
16 proposal.

17 Q. Now, going back a second, at the time--  
18 withdrawn. FERC's decision with respect to station  
19 power lost revenues was made retroactive to 1999,  
20 correct? Some point in '99?

21 A. (Bonner) Yeah, for the specific customers that  
22 I had previously identified, yes. It varied by  
23 individual customer, went back basically to the time  
24 that the new owners took ownership and started

1 running the plant. The plant--these were former  
2 utility plants.

3 Q. So at least according to FERC at the time  
4 that--at the time the Joint Proposal became  
5 effective and before that, the company was not  
6 entitled to any station power revenues as it's  
7 requesting here?

8 A. (Bonner) It made that determination after the  
9 merger Joint Proposal. It did that in 2003. We  
10 received the earliest of those orders in November of  
11 2003 and that was for Constellation, Nine Mile and  
12 AES Somerset, and almost a full year later before we  
13 received the order in for the NRG companies, which  
14 was November of 2004.

15 Q. Now, with respect to the recovery of any  
16 standby service related loss revenues, the  
17 Commission has the authority to rule as it sees fit  
18 on any deferral requests in order to achieve just  
19 and reasonable rates?

20 A. (Bonner) The Commission has a broad authority  
21 to make sure rates are just and reasonable. To the  
22 extent that involves deferrals, it's within the  
23 province to do that.

24 Q. There is language to that effect in the standby

1 Joint Proposal, correct?

2 JUDGE STOCKHOLM: What do you mean standby  
3 Joint Proposal?

4 MR. MAGER: Your Honor, there was a Joint  
5 Proposal on standby service filed subsequent to the  
6 merger Joint Proposal. I was referring to that  
7 document.

8 MR. BONNER: It's one of the exhibits. I  
9 was about to identify that.

10 JUDGE STOCKHOLM: Thank you.

11 MR. BONNER: Exhibit number 9. The exhibit  
12 number is number 15.

13 BY MR. MAGER:

14 Q. Specifically section 3.5 of that document  
15 discusses the Commission's authority and its ability  
16 to modify rates in order to make sure that just and  
17 reasonable rates are achieved.

18 A. (Bonner) Yes. That's what it says, Mr. Mager.  
19 That's on page 29 of exhibit 15.

20 Q. And the preceding paragraph discusses the  
21 dispute resolution provisions under that; does it  
22 not?

23 A. (Bonner) Yes, it does.

24 Q. And those provisions require that the parties

1 would promptly convene a conference and attempt to  
2 resolve any disagreement, if such disagreement is  
3 not resolved the petition would be filed with the  
4 Commission?

5 A. (Bonner) That's what it says.

6 Q. Was any technical conference promptly convened  
7 on this deferral request?

8 A. (Bonner) This deferral request only governs  
9 the--this Joint Proposal covers only that portion of  
10 the station power issue that's covered under standby  
11 service as opposed to distributed station service.  
12 There are two different pieces to it.

13 I wasn't aware there was a disagreement over  
14 the interpretation so no conference would be  
15 required.

16 Q. It's your understanding there is no  
17 disagreement?

18 A. (Bonner) Not over the interpretation of the  
19 standby service Joint Proposal. The dispute has  
20 been over the distributed station service portion.  
21 And staff to be thorough needed to examine the three  
22 different places where distributed station service,  
23 customers' monies associated with them, were  
24 covered. One portion of it was in the standby

1 service proposal, a small one, but it was there  
2 nevertheless.

3 MR. MAGER: I have nothing further, Your  
4 Honor. Thank you.

5 JUDGE STOCKHOLM: Anybody else have  
6 anything before we go to the company for redirect?  
7 Hearing nothing, Mr. Gavilondo.

8 MR. GAVILONDO: Thank you, Your Honor. We  
9 do have some redirect.

10 JUDGE STOCKHOLM: Please proceed.  
11 Counselor, you can approach the witness if you  
12 want.

13 REDIRECT EXAMINATION

14 BY MR. GAVILONDO:

15 Q. Panel, in Attorney Assaf's questioning there  
16 was a question regarding revenues received from  
17 station service customers; do you recall that?

18 A. (Bonner) Yes.

19 Q. Prior to the FERC orders that have been  
20 mentioned throughout the discussion today, was the  
21 company receiving revenues or entitled to receive  
22 revenues from those station service customers?

23 A. (Bonner) Yes, we were and we did.

24 Q. And after the FERC's decisions that were



1           referenced in your testimony, did the company  
2           receive or has the company been receiving any  
3           revenues from those customers?

4           A.       (Bonner) From all the customers who have  
5           applied for NYISO station service we have not been  
6           receiving any revenue.

7           Q.       Thank you. Also, staff in its  
8           cross-examination introduced an exhibit number 18,  
9           which is an IR number 198. Do you recall that?

10          A.       (Bonner) Yes, I do.

11          Q.       Now, in Exhibit 18, on I believe what looks  
12          like attachment to the exhibit pages one of five,  
13          there is discussion about a number of rate classes  
14          that are reflected that forecast I believe rate  
15          class SC-3, SC-3A, SC-7, SC-11, SC-12 and NYPA. Do  
16          you see that?

17          A.       (Bonner) Yes, I do.

18          Q.       Now, in preparing for your testimony today did  
19          you have an opportunity to review what's now been  
20          marked for identification as Exhibit 18 in this  
21          proceeding prior to appearing today?

22          A.       (Bonner) Yes, I did.

23          Q.       Did you have any further analysis with respect  
24          to what's reflected in exhibit 19, in particular the

1 forecasts and the actual revenues received from the  
2 service classes indicated on this--looks like page  
3 one of five of attachment PSC 151?

4 A. (Bonner) Yes, I did.

5 MR. GAVILONDO: Your Honor, I provided the  
6 witnesses a copy of a one page exhibit that the  
7 reporter has marked as Exhibit 20 and I would ask  
8 Mr. Bonner if you would describe what this exhibit  
9 reflects.

10 A. (Bonner) Yes, I will. The exhibit is an update  
11 of the figure two graph that was included on the  
12 attachment to IR number 198 prepared by Mr. Mann.  
13 In his original exhibit, what I was demonstrating  
14 here was a 12-month moving annual average for those  
15 combined classes that you mentioned, SC-3, SC-3A,  
16 SC-7, SC-11, SC-12, and the NYPA Power programs from  
17 January 2002 to a little past July of 2005.

18 I did a further analysis of comparing those  
19 actuals to going back to the sales or the forecast  
20 to kilowatt hours essentially that were in the  
21 merger rate plan work papers that staff has referred  
22 to on a couple of cases today in volume 1. It's in  
23 the electric revenue section that underly all the  
24 rates that were approved in the merger rate plan.

1           And I did the same computations adding just  
2           those service classes SC-3, SC-3A. SC-7 did not  
3           exist at that time so that number was zero. SC-11,  
4           SC-12 and the same three NYPA power programs. And  
5           then simply did the same 12-month moving annual  
6           average, and that's reflected in the line with the  
7           squares that is straight and slopes, showing the  
8           merger rate plan forecast and the predicted growth  
9           at that time.

10          Q.       If I might just--referring to page two of  
11           attachment to Exhibit 18, it's not numbered but it's  
12           PSC 151, page two of five. The update you are  
13           referring to is an update of this chart plus a  
14           superimposed line reflecting the merger rate plan  
15           forecast for those aggregate classes?

16          A.       (Bonner) That is correct. As can be seen by  
17           looking at the graph, the merger rate plan forecast  
18           was predicted to be higher than has actually been  
19           the case since the merger rate plan.

20          Q.       Mr. Bonner, with respect to the actual numbers  
21           here, are deliveries associated with the distributed  
22           station service customers that have been discussed,  
23           are they reflected in the actual line here?

24          A.       (Bonner) The answer is yes.

1 MR. GAVILONDO: I have no further questions.

2 MR. MAGER: Just on that?

3 JUDGE STOCKHOLM: I will go first. Then I  
4 will let you go. In looking at this chart that's  
5 been marked for identification Exhibit 20, I notice  
6 this chart starts on January or maybe February of  
7 2002; is that correct?

8 MR. BONNER: It starts on February 2002.

9 JUDGE STOCKHOLM: And that's the first month  
10 under the rate plan?

11 MR. BONNER: No. Actually it does turn out  
12 to be coincidentally the same, but that isn't why the  
13 chart begins at that date. If I can refer you back  
14 to IR number 198, and you go to the first page marked  
15 attachment PSC 151 page one, you will find a scatter  
16 diagram and the scatter plot is actually the input  
17 for the moving average plot, and that was a chart  
18 beginning with the months beginning from March of  
19 2001.

20 So, to produce the first point, the 12-month  
21 average is the sum of March of 2001 through February  
22 of 2002. That's a 12-month period. That's why it  
23 begins on February 2002.

24 JUDGE STOCKHOLM: I see. It's slightly

1 different, but nevertheless I guess my question is  
2 the same. There appears to be something in the range  
3 of five to seven percent deviation between the  
4 forecast on a 12 month rolling average I recognize,  
5 but the forecast--I mean the actuals on 12-month  
6 rolling average, there is what appears to me to be a  
7 huge difference in the very first year of the plan.

8 MR. BONNER: Yes.

9 JUDGE STOCKHOLM: That wasn't all that great  
10 an estimate. Do I correctly conclude that the  
11 forecast was not all that accurate?

12 MR. BONNER: Well, certainly hindsight being  
13 20/20.

14 JUDGE STOCKHOLM: Of course it is. I  
15 understand that.

16 MR. BONNER: I suspect that I would need Mr.  
17 Mann, who is much more acquainted with the relative  
18 accuracies. Don't forget the scale here is a bit  
19 exaggerated. We don't begin at a base of zero.  
20 We're beginning at a base of 17,000.

21 The variation is important to analyze. When  
22 you are looking at it it's a bit more exaggerated.  
23 As a total percentage it really probably isn't that  
24 far off. We do have swings in sales for a variety of

1 reasons.

2 JUDGE STOCKHOLM: Still looks to me like  
3 five to six to seven percent. Is there a reason the  
4 12-month moving average actual appears to be biased  
5 low all the way through, and it seems to be a  
6 relatively flat line as compared to the increase in  
7 line. Why are these lines so different?

8 MR. BONNER: I would have to defer to Mr.  
9 Mann to give me a more thorough explanation of the  
10 actuals. The forecast is going to be a smooth shape.  
11 You remove all variations. So, there is normal  
12 variations.

13 The forecast line removes a lot of the  
14 normal noise that occurs in actual data.

15 JUDGE STOCKHOLM: I understand the  
16 difference in the variations. What I don't  
17 understand is an estimate that is not biased over a  
18 period of time being both low and high.

19 MR. BONNER: Right, but we are looking only  
20 so far at what we see right now today over a four  
21 year span. When Mr. Mann was trying to produce his  
22 projections, trying for ten years, using whatever the  
23 available information was at the time, anecdotally  
24 told me the period of time he was doing the forecast

1 the economy was at one of its peaks, so you don't  
2 find a great deal of data that would suggest there is  
3 a recession going on or there's going to be a  
4 decline.

5 I believe that might be part of what caused  
6 the thing to be flat. What happens is if you draw  
7 between the point as opposed to the declining slopes,  
8 part of the problems in the merger rate plan, the key  
9 point is an inclining number is what's been used to  
10 set rates.

11 JUDGE STOCKHOLM: I am sorry, Mr. Mager. Go  
12 ahead.

13 RE CROSS EXAMINATION

14 BY MR. MAGER:

15 Q. Just building upon what Mr. Bonner said about  
16 the scale being a little confusing, just so the  
17 record is clear I'm focusing on the very first  
18 entry, roughly February '02. Would you agree that  
19 there is roughly a 500 gigawatt hour difference  
20 between the forecast and actual?

21 A. (Bonner) Approximately that, yes.

22 Q. Would you also accept, subject to check, that a  
23 500 gigawatt per hour variance of a forecast of  
24 approximately 18,700 gigawatt hours is a difference

1 of roughly 2.7 percent?

2 A. (Bonner) I will accept it subject to check.

3 JUDGE STOCKHOLM: Thank you for being more  
4 accurate with that, counselor. I appreciate that.

5 Q. Your last response to Mr. Gavilondo's question  
6 in terms of what did you say with respect to whether  
7 these numbers include the disputed standby service,  
8 can you go over that again?

9 A. (Bonner) Sure. The graph, looking at the  
10 actual lines, the blue line, are the sum of the  
11 various classes we have been talking about, SC-3,  
12 SC-3A, SC-7, SC-11 and 12, and the NYPA Power  
13 programs. Mr. Mann's input data source is the  
14 company's billing system, not the cash receipts,  
15 just what we rendered for bills.

16 Despite the fact of the FERC rulings, we  
17 continue to issue the bills to these customers  
18 despite the fact they are not paying for them. So,  
19 at least a portion if not all of the station sales.  
20 And the only one I have a question about are the  
21 three plants that were subject to their own  
22 individual FERC orders are in those numbers or  
23 unless Mr. Mann deliberately excluded. I am not  
24 aware he did.



1 Q. With respect to the forecast, there is no  
2 specific figure attributable to forecasted station  
3 service?

4 A. (Bonner) That is correct.

5 MR. MAGER: I have nothing further on this  
6 chart.

7 JUDGE STOCKHOLM: Staff?

8 RE-CROSS EXAMINATION

9 BY MS. ASSAF:

10 Q. Panel, who is at risk for the sales forecast  
11 variables under the merger Joint Proposal,  
12 ratepayers or stockholders?

13 A. (Bonner) In general the stockholders are.

14 MS. ASSAF: Thank you.

15 JUDGE STOCKHOLM: If the challenge is to the  
16 FERC rulings in this area--this is more a legal  
17 question. I am not really asking you, gentlemen. If  
18 the challenges to the FERC order are successful, does  
19 that mean that the company can go back and collect  
20 all these bills that witnesses said were being sent  
21 out but not being paid?

22 MR. JAFFE: Your Honor, as I have the  
23 dubious honor of being counsel of record for the  
24 company in this, first, just to make sure, there is

1 one point of clarification. FERC has prevailed in  
2 terms of getting a ruling in its favor by the DC  
3 Circuit confirming its rulings against the position  
4 both of the company and the New York PSC. Both the  
5 New York PSC and the New York transmission owners  
6 including the company have filed requests for  
7 rehearing and rehearing en banc, which the court is  
8 considering, so you know where it is.

9 I think the short answer to your question is  
10 in the event we are lucky in prevailing at that stage  
11 and that finally sticks, we would take the position  
12 all the outstanding bills need to be paid.

13 I would note that some of the generators,  
14 there is litigation pending in state court where the  
15 generators are not even willing to pay the bills that  
16 under 30 day netting they owe. So, the ability to  
17 bill and getting the money are not coincident,  
18 unfortunately.

19 JUDGE STOCKHOLM: That I do understand.  
20 Thank you. I appreciate that. Anything further for  
21 these witnesses? If not, gentlemen, you are excused  
22 and thank you for your time.

23 (Witnesses excused.)

24 How long do we really have for

1 Mr. Leuthauser? Is it five minutes? That's what I  
2 have written down here.

3 MS. ASSAF: It really shouldn't be more than  
4 five minutes.

5 JUDGE STOCKHOLM: Mr. Leuthauser, you are  
6 still under oath.

7 MR. GAVILONDO: Thank you, Your Honor.

8 DIRECT EXAMINATION

9 BY MR. GAVILONDO:

10 Q. Mr. Leuthauser, you have before you a copy of a  
11 document dated September 1, 2006 entitled responsive  
12 testimony of Scott G. Leuthauser, 23 pages long.  
13 Can you please describe that for the record.

14 A. Yes. That's my responsive testimony submitted  
15 on September 1st.

16 Q. And you also have before you I believe a copy  
17 of a document dated September 26, 2006 and that is  
18 eight pages long entitled rebuttal testimony of  
19 Scott D. Leuthauser. Do you have that testimony and  
20 can you describe it for the record?

21 A. I do. That is my rebuttal testimony submitted  
22 on September 26th.

23 Q. Thank you. Mr. Leuthauser, did you prepare any  
24 exhibits in connection with your responsive

1 testimony of September 1st and your rebuttal  
2 testimony of September 26th?

3 A. Yes, I did.

4 MR. GAVILONDO: I would like the record to  
5 reflect that exhibits have been marked for  
6 identification Exhibit 21 through 26 consecutively.

7 Q. Mr. Leuthauser, were those exhibits associated  
8 with the testimony that you have just described?

9 A. Yes.

10 Q. And Mr. Leuthauser, was the testimony dated  
11 September 1st and the testimony dated September 26th  
12 prepared by you or under your supervision?

13 A. Yes.

14 Q. And do you have any corrections to that  
15 testimony?

16 A. Yes, I do.

17 Q. And where?

18 A. Page ten of the responsive testimony, line--

19 Q. Testimony dated September 1st?

20 A. Line 18, reads negotiated with the labor union  
21 to temporarily re-hire eight six, the eight should  
22 be stricken. Page ten, line 18.

23 Q. Which testimony?

24 A. Responsive, the first one, September 1st.

1 JUDGE STOCKHOLM: Page ten, line 19.

2 Q. Page 12, line five. Just for clarification,  
3 that is again the September 1st testimony, line five  
4 on page 12 of that testimony, the word eight, second  
5 to last word should be stricken; is that correct?

6 A. That is correct.

7 Q. Do you have any other changes or corrections to  
8 your testimony?

9 A. No, I do not.

10 Q. With that change, do you adopt the testimony of  
11 September 1st and the testimony of September 26th as  
12 your testimony in this proceeding?

13 A. Yes, I do.

14 Q. And the exhibits that have been marked 21  
15 through 26 consecutive, were those prepared by you  
16 or under your supervision?

17 A. Yes, they were.

18 Q. Do you have any changes or corrections to those  
19 exhibits?

20 A. No, I do not.

21 MR. GAVILONDO: Thank you, Your Honor. At  
22 this point I would tender the witness for  
23 cross-examination.

24 (Exhibits 21 through 26 marked for

1  
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identification.)

(The following is the prefiled testimony of  
Scott D. Leuthauser:)

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1           **RESPONSIVE TESTIMONY OF SCOTT D. LEUTHAUSER**

2

3    Q:    Please state your name and business address for the record.

4    A:    My name is Scott D. Leuthauser. I am employed by Niagara Mohawk  
5           Power Corporation d/b/a National Grid ("National Grid" or "Company"),  
6           and my business address is 300 Erie Blvd. West, Syracuse, NY 13202.

7

8    Q:    What is your educational background?

9    A:    I am a licensed engineer in New York State. I graduated from Clarkson  
10           University in 1986 with a Bachelor of Science in Mechanical Engineering.  
11           In 1989, I received a Masters of Business Administration from University  
12           at Buffalo and in 2004 received a Masters Certificate in Power Systems  
13           Management from Worcester Polytechnic Institute.

14

15   Q:    In what capacity are you employed at National Grid?

16   A:    I am Vice President Distribution Investment Management. In that  
17           capacity I am responsible for the supervision of professionals who provide  
18           engineering budgets and prioritized work-plans for National Grid's  
19           electric distribution systems. In addition I have responsibility for the  
20           supervision of the stray voltage testing program, which we also refer to as  
21           the elevated voltage testing program, and the facilities inspection

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1 programs.

2

3 Q: Please summarize your professional experience.

4 A: I joined National Grid in 1986 as a Junior Engineer in Fossil Generation.

5 In 1987 I was transferred to the C.R. Huntley Steam Station where I

6 served as the station performance engineer and Assistant Station Shift

7 Supervisor. In 1990 I was transferred to work as a Senior Fuel Supply

8 Analyst. In 1993 I became a Senior Supply Planner in Supply Planning

9 and shortly thereafter was promoted to Manager of Supply Planning. In

10 1997 I became Manager Supply (Power) Contracts, then, in 1998 was

11 promoted to Director of Energy Transactions (power contracts, rates, and

12 load research). In 2002, I was promoted to Vice President Distribution

13 Planning & Engineering and in 2005, to my current position.

14

15 Q: Have you previously testified before the Commission?

16 A: Yes, I have previously testified in proceedings pertaining to Long Run

17 Avoided Costs, several rate case proceedings including supporting

18 testimony to PowerChoice, the Merger Rate Plan, and Standby Service

19 Rates, and most recently, I submitted testimony (attached hereto as Exhibit

20 \_\_\_ (SDL-1)) in connection with the Company's March 2006, "Petition

21 for Rate Relief" in Case 04-M-0159, seeking recovery of costs incurred to



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1           implement stray voltage testing and facilities inspection programs (the  
2           “Petition”).

3

4    Q:    What is the purpose of your testimony in this proceeding?

5    A:    My testimony rebuts arguments made by Staff of the Department of Public  
6           Service witnesses Denise A. Gerbsch and Robert A. Visalli (“Staff”)  
7           proposing adjustments to the deferral associated with the Company’s  
8           efforts related to implement the new elevated voltage testing and facilities  
9           inspection programs mandated by the Commission's Safety Orders issued  
10          on January 5, 2005 and July 21, 2005 in Case No. 04-M-0159 (the “Safety  
11          Orders”).

12

13   Q:    What exhibits are you sponsoring in support of your testimony?

14   A:    I am sponsoring Exhibit \_\_\_ (SDL-1), which consists of the testimony I  
15          submitted in support of the Company’s March 2006 Petition which also  
16          includes embedded exhibits. I am also sponsoring Exhibit \_\_\_ (SDL-2),  
17          which contains an example of the data validation summary the Company  
18          completes electronically to check contractor invoices, which are paid on a  
19          unitized basis, prior to payment. All of these exhibits were prepared by  
20          me or under my supervision and direction.

21

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1 Q: Please describe generally what the arguments by Staff you will address  
2 concerning elevated voltage and facilities inspection?

3 A: First, Staff states that the costs of compliance with the Safety Order are  
4 not eligible for deferral because the uniform safety standards imposed by  
5 the Safety Orders were not necessarily new requirements that would cause  
6 the utilities to incur incremental costs beyond the amounts already  
7 reflected in rates (Staff at p. 200 line 11). Second, Staff proposes an  
8 adjustment to the Company's deferral to exclude any costs associated with  
9 internal employees (Staff at p. 205 line 15) arguing that the costs of such  
10 employees are included in base rates before the merger and therefore are  
11 not "incremental." Third, Staff proposes an adjustment to the Company's  
12 deferral to exclude any labor overheads associated with such employees,  
13 arguing: (i) the employees should be excluded in the first instance; and (ii)  
14 that labor overheads are not incremental. Fourth, Staff expressed a lack of  
15 confidence in Company contractor invoice controls, referencing an invoice  
16 that included a charge of \$76.99 for a software contractor's travel  
17 expenses. I will explain in my testimony that all of these Staff contentions  
18 are unfounded.

19

20 Q: Turning to the first issue, do you concur with Staff's position that the  
21 uniform safety standards imposed by the Safety Orders are not necessarily

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1 new requirements that would cause the Company to incur incremental  
2 costs?

3 A: No. In fact, Staff's position disregards the statements of the Commission  
4 itself. The Commission explicitly acknowledged in the Safety Orders that  
5 the "stray voltage testing programs are new requirements." (July 21, 2005  
6 Safety Order at p. 17).

7

8 Q: Are you saying that before the Safety Orders were issued, the Company  
9 had no obligation to provide safe service?

10 A: Not at all. Prior to the issuance of the Safety Orders, National Grid and  
11 the other electric corporations in New York were obligated by Public  
12 Service law Section 65 (1) to provide "safe and adequate" facilities. Prior  
13 to the issuance of the Safety Orders, however, there was no explicit  
14 standard requiring the Company to conduct stray voltage testing and  
15 inspections to satisfy this pre-existing obligation. The Company's  
16 judgment was that the pre-existing inspection programs and maintenance  
17 protocols that were in place prior to the Safety Orders were sufficient to  
18 comply with Section 65 (1) of the Public Service Law. (See Exh. \_\_\_\_  
19 (SDL-1) at 4-5; Petition at p. 5.) In the Safety Orders, the Commission for  
20 the first time specified that utilities' obligations under the Public Service  
21 Law included "conducting stray voltage testing and inspections." July 21,

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1           2005 Safety Order at pp. 16-17.

2

3    Q:    Does the Company anticipate undertaking new or expanded activities to  
4           comply with the Safety Orders?

5    A:    Yes. As described in the Company's Petition (Petition at p. 4) and my  
6           testimony in support of the Petition (*see* Exh. \_\_\_ (SDL-1) at 5-6), the  
7           incremental testing and inspection activities National Grid anticipated to  
8           comply with the Safety Orders included the following:

9

10           • Incremental inspections of 20% of Underground facilities each  
11           year, including:

12

- Conventional Underground facilities;

13

- Underground networks with approximately 12,300

14

handholes, 15,455 manholes, 325 junction, 18,590

15

transformers, 104 ratio banks, 1,177 switchgears, 1,774

16

vaults;

17

- Approximately 3761 miles of URD facilities; and

18

- UCD

19

• Incremental inspections of 20% of approximately 62,000 street  
20           light standards each year.

21

• Stray voltage testing each year of all Overhead Distribution

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- 1 facilities covering approximately 35,000 circuit miles with  
2 1,200,000 poles;
- 3 • Stray voltage testing each year of all Overhead Transmission  
4 facilities covering approximately 9,800 circuit miles with  
5 103,000 structures;
  - 6 • Stray voltage testing each year of all Underground facilities,  
7 including:
    - 8 - Conventional Underground facilities;
    - 9 - UG networks including approximately 12,300 handholes,  
10 15,455 manholes, 325 junction, 18,590 transformers, 104  
11 ratio banks, 1,177 switchgears, 1,774 vaults;
    - 12 - Approximately 3761 miles of URD facilities;
    - 13 - UCD;
  - 14 • Stray voltage testing each year of all of the approximately  
15 62,000 street lighting standards, along with municipally owned  
16 street light facilities;
  - 17 • Stray voltage testing each year of all substation fences for  
18 approximately 803 substations; and
  - 19 • Development and implementation of a Quality Assurance  
20 Program.
- 21

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1 Q: Does the Company propose to defer all electric inspection activities as  
2 resulting from incremental requirements imposed by the Safety Orders?

3 A: No. Prior to the Safety Orders, the Company's pre-existing electric  
4 inspection programs included annual visual inspections of 20% per year of  
5 our overhead electric transmission and distribution systems. The purpose  
6 of the visual inspections was to verify that each item inspected is  
7 constructed in accordance with standards and is in a safe, operable, and  
8 reliable condition. Any observed deficiencies are recorded and prioritized  
9 for repair. The Company has not proposed to defer the costs of these pre-  
10 existing inspection programs, but only the new or expanded programs it  
11 will undertake to comply with the new requirements of the Safety Orders.

12  
13 Q: Turning to Staff's proposed adjustments, do you concur with Staff's first  
14 proposed adjustment, relating to costs of internal labor?

15 A: No. Staff's first proposed adjustment would completely disallow internal  
16 labor costs on the ground that these costs do not represent incremental  
17 expense to implement the programs that respond to the Safety Orders.  
18 Staff's position is flawed. It disregards the fact that the Company will  
19 implement the new and expanded inspection and testing programs through  
20 a combination of (i) additional employees hired to support the programs;  
21 (ii) existing employees who contribute to completing these incremental

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1 inspections and testing as part of their duties, but not their sole duties; (iii)  
2 existing employees who are trained to conduct these incremental  
3 inspections and testing, and who otherwise would have been displaced;  
4 (iv) existing employees whose previous positions were shifted to  
5 contractors; and (iv) former Company employees who were rehired.

6

7 Q: How did the Company define the incremental testing and inspection  
8 activities associated with the new requirements of the Safety Orders?

9 A: As I discuss in detail in my testimony in Exhibit \_\_\_ (SDL-1), the  
10 Company identified the incremental tasks, which I described above, and  
11 tracked the costs of employees that worked on these incremental tasks. As  
12 I mentioned earlier, the costs of performing the Company's pre-existing  
13 inspection program were not included. Staff's contention (Staff at p. 203)  
14 that the Company instructed employees to charge time to the incremental  
15 program regardless of whether the expense was incremental or not is  
16 simply wrong.

17

18 Q: Can you describe the method proposed to determine the deferral for 2005?

19 A: The Company defines incremental to be the activity-based itemized costs  
20 associated with the incremental activities as opposed to the total cost  
21 minus the baseline. The work associated with the Safety Orders did not

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1           displace any other existing work on inspections or repair of the electric  
2           system. As such, the costs included in the deferral as incremental include:  
3           (i) contractor costs; (ii) first line internal employees; (iii) manager and  
4           supervisors explicitly hired for compliance with the program; and/or (iv)  
5           internal and external work to develop new software systems to comply  
6           with the Safety Orders. Each of the aforementioned resources' time (and  
7           materials) is for work on incremental tasks required to comply with the  
8           new requirements imposed by the Safety Orders.

9  
10    Q:    In what areas has the Company hired additional employees to complete  
11           these incremental tasks required to comply with the Safety Orders.

12    A:    First, the Company has hired new employees to conduct underground  
13           inspections. To complete the inspection of the conventional underground,  
14           i.e., underground network systems and systems accessible through  
15           manholes and duct systems, requires a highly skilled and trained cable  
16           splicer. This skill-set has limited availability through contracting, given  
17           the extreme unique specialty to the utility market and limited locations.  
18           To complete the underground inspections the Company did in fact post for  
19           and hire eight additional employees. The Company identified that it hired  
20           additional employees for this purpose in its response to IR PSC-247(DAG-  
21           15) and PSC-292(DAG-31).



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1

2

3 Q: Are the new employees the only ones who perform underground  
4 inspections?

5 A: No. Given the nature of a "cable splicer" workload, it would not have  
6 been optimal to use only the new employees to perform those inspections.  
7 Instead, it was more efficient to utilize other qualified splicers to conduct  
8 the underground inspections on a part time basis. As Staff notes, this  
9 results in numerous employees charging some work to this activity, but  
10 this does not make the activity any less incremental.

11

12 Q: Where did the Company transfer additional internal employees to the  
13 incremental activities and back-fill their previous positions with  
14 contractors?

15 A: The Company made a conscious decision for efficiency savings to transfer  
16 and train nineteen employees, including two Supervisors from the former  
17 "Locating Department" into the inspection department to complete the  
18 additional inspection and testing work. The Company subsequently has  
19 contracted with a vendor for the "locating" function formerly provided by  
20 these employees. This transfer of existing employees to perform the  
21 incremental work was described in the response to IR PSC-247(DAG-15)

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1 and PSC-292(DAG-31).

2

3 Q: Where did the Company re-hire employees that were laid off?

4 A: To complete the incremental inspection of street lighting facilities, the  
5 Company negotiated with the labor union to temporarily re-hire ~~eight~~ <sup>9</sup> six  
6 employees that were previously laid-off. The negotiation and resulting  
7 compensation packages for such employees was such that the internal  
8 employees would meet or beat the contractor price that was obtained from  
9 competitive bid. Here the Company and labor union negotiated to a  
10 common resolution providing employment opportunity and cost savings.  
11 There is no basis for Staff's proposal to exclude these costs from deferral  
12 because the Company chose to hire incremental internal laid-off  
13 employees as opposed to contractors. The rehiring of laid-off former  
14 employees to perform the incremental work was described in the response  
15 to IR PSC-90(DAG-3).

16

17 Q: What do you mean when you referred to the Company's use of internal  
18 employees that would have been displaced through the efficiency gains  
19 and savings embedded in the rate plan?

20 A: In general, the merger rate plan embedded efficiency gains and allocated a  
21 portion of those savings to ratepayers. Across the system the Company

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1 has accomplished those savings in various forms and degrees. As a result  
2 employee counts have been reduced in certain areas. The implementation  
3 of the incremental tasks required to implement the Safety Orders provided  
4 the opportunity for select employees to retain certain jobs and permitted  
5 the Company to reduce reductions that otherwise would have occurred  
6 through attrition or other steps. Even though these tasks are performed by  
7 multiple individuals, absent the stray voltage testing and inspection  
8 programs, the Company would have been able to eliminate an additional  
9 12 or more full time equivalent (FTE) employees (e.g., which could have  
10 included workers re-assigned from the Location Department in connection  
11 with the out-sourcing of that function). The Company chose to utilize  
12 internal labor for some of these incremental tasks, which globally  
13 contributes to fewer lay-offs and attrition. In choosing this option, the  
14 Company should not be penalized for seeking to perform incremental  
15 testing and inspection activities with former and/or existing employees as  
16 opposed to utilizing contractors.

17

18 Q: Turning to Staff's proposed adjustment for labor overheads, please  
19 describe what Staff is proposing.

20 A: Staff has proposed excluding labor overheads – fringe benefits, payroll  
21 taxes, and time not worked (p. 306 line 10), apparently for the following

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1 reasons: (i) because Staff proposes exclusion of internal labor in the first  
2 case and by definition would exclude the overheads of such employees,  
3 and (ii) Staff argues these overheads are already included in the revenue  
4 requirement, and (iii) the Company excludes overheads when calculating  
5 the deferral for storms and as such the same practice should apply here.

6

7 Q: Do you agree with the Staff proposed adjustment regarding recovery of  
8 overhead expenses?

9 A: No. Staff's first two reasons are simply elaborations of Staff's position  
10 that internal employees are "non-incremental," even when they are  
11 engaged in incremental activities to comply with the new requirements of  
12 the Safety Orders. I have described why the expenses for these employees  
13 are incremental and not in base rates. Because these employee expenses  
14 are incremental, the associated overheads are also incremental. Staff's  
15 suggestion that these overheads be treated like those for employees  
16 working overtime on storms is also incorrect. Employees who work  
17 overtime on storm response do so on a temporary basis. In contrast,  
18 assignment of an employee's time to the incremental inspection and stray  
19 voltage testing programs is a regular (albeit new) assignment. The  
20 employees supporting storms are on the property regardless of the  
21 occurrence of storms, i.e., they are here to work daily on the system

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1 infrastructure. Employees performing incremental inspection and testing  
2 activities do such work as a regular part of their jobs, and not as a  
3 temporary or emergency activity to respond to a storm. Indeed,  
4 employees assigned to work on implementation of the Safety Orders could  
5 actually be called upon to respond to a storm. Staff's analogy between  
6 those employees and those who are responding to a storm simply is inapt.  
7 Since work on incremental inspections and stray voltage testing is regular  
8 work, clearly distinguishable from temporary overtime to respond to a  
9 storm emergency, overheads associated with incremental inspection and  
10 stray voltage testing activities should be recoverable along with the  
11 incremental internal labor costs.

12

13 Q: Are there any adjustments required to your labor overheads associated  
14 with the stray voltage programs?

15 A: Yes. Pension/OPEB should be excluded from the incremental labor  
16 overheads associated with the stray voltage programs because that item is  
17 addressed in the deferrals separately. There have been 3 entries to defer  
18 stray voltage costs (December 2005, March 2006, and June 2006). Even  
19 though we excluded pension/OPEB in the December 2005 and March  
20 2006 entries, we will need to make an adjustment to correct an error  
21 discovered with the June 2006 deferral to remove this item.

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1

2

3 Q: Do you agree with Staff's assertion that there is little, if any, Company  
4 review and approval of costs that are includable in the deferral accounts as  
5 it relates to stray voltage?

6 A: No. There are several controls affecting the review and approval of  
7 contractor expenses incurred to implement the Safety Orders, including:  
8 (i) definition, employee training and tracking of incremental versus non-  
9 incremental tasks; (ii) identification of only certain qualifying  
10 employees'/departments' time; (iii) electronic review and approval of  
11 invoices; and (iv) audits of the adequacy of oversight of outside vendors.  
12 As I explained in my testimony supporting the Petition, the Company  
13 established a Maintenance Inspection and Assessment Department  
14 ("MI&A") under one manager to effectuate the Safety Standards. The  
15 Company identified which tasks are incremental and which were not. The  
16 employees in MI&A were trained on accounting for each of the accounts  
17 (i.e., which account numbers are associated with each task) and enter their  
18 time accordingly. In the calculation of the deferral, the employees in the  
19 MI&A Department are charged to the deferral account. In the event a  
20 non-MI&A employee (aside from UG Cable Splicers) charges to these  
21 accounts, the charges are excluded from the deferral. As for approval of

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1 contractor invoices, the Company utilizes an enterprise resource program,  
2 namely Peoplesoft, to track invoices. For each of the contractors and  
3 software vendors supporting the Safety Standards, the Company has  
4 established a Purchase Order specific to each contractor. Invoices are  
5 mailed to the Company Accounts Payable department, which scans the  
6 invoice into the system against the P.O. The Peoplesoft system,  
7 automatically and electronically sends the invoice to the respective  
8 "owner", in this case the Manager of MI&A. The respective owner is  
9 responsible for reviewing each and every invoice for accuracy and  
10 correctness against the actual work completed by the contractor. The  
11 invoice is not paid until such time as the Manager MI&A approves such  
12 invoice. The majority of contractor activity on incremental inspection and  
13 stray voltage testing is done on a unit cost basis, which minimizes the risk  
14 associated with the contractors' specific travel and expense item charges  
15 (i.e., this shifts responsibility for tracking, handling and documentation of  
16 its expenses to the contractor).

17 The attached Exhibit \_\_\_ (SDL-2) illustrates an example of the  
18 data validation summary the Company completes electronically to check  
19 contractor invoices, for unit tests prior to payment. An accuracy check  
20 and process is in place to validate the number of units tested for Stray  
21 Voltage (i.e., the basis for unit pricing) done through the Company's

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1 software algorithm. First, the procedure requires the contractor to verify  
2 that they are at the correct location of the facility to be tested by  
3 electronically triggering the longitude and latitude measurements through  
4 their Global Positioning System (GPS). The GPS locating assures the  
5 contract worker is where they are supposed to be.

6 The computer program for records was designed to validate  
7 contractor information based on the rules established in a data document  
8 which was provided to prospective contractors in the bid process. Within  
9 the program there is a validation routine that determines if data is accepted  
10 or rejected (i.e. completeness of the data entries). Accepted data will  
11 include both billable records and non billable records.

12 The records are split up as follows: (i) **Source File name** – naming  
13 convention established for files the contractor submits to the Company;  
14 (ii) **Billing Date** – the month / year that the file is submitted; (iii) **New**  
15 **Preload Inspections** – records that the contractor returns to the Company  
16 that are originally provided to the contractor as locations to test, and that  
17 the contractor is allowed to bill. This includes completed tests and  
18 inaccessible location without a completed test (these are billable); (iv)  
19 **New Non-preload Inspections** – records that the contractor returns for  
20 equipment they found such as municipal street lights, that were not  
21 originally provided to the contractor (these are billable); (v) **Modified**



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1           **Inspections** - records that the contractor returns with corrected info other  
2           than date/time (these are not billable); (vi) **Outdated Inspections** -  
3           records that the contractor send with a date older than 1 month, which the  
4           Company does not accept (these are not billable); (vii) **Updated**  
5           **Inspections** – records that the contractor sends with a date newer than the  
6           current record (these are not billable); (viii) **Old Inspections** – records  
7           that the contractor send with a date older then the current inspection in the  
8           system (these are not billable); (ix) **Billable Updated Inspections** -  
9           records that the contractor sends that have been tested by the Company,  
10          where the contractor date is newer than the Company tester date (these are  
11          billable); (x) **Billable Old Inspections** – records that the contractor sends  
12          that have been tested by the Company, where the contractor date is before  
13          the Company tester date (these are billable); (xi) **Duplicate Inspections** –  
14          records that the contractor sends that have the exact same date, time, and  
15          all other info (these are not billable); (xii) **Rejected Inspections** – records  
16          that the contractor sends that are rejected due to validation errors within  
17          each record (these are not billable); (xiii) **Date Processed** – date the file  
18          was logged into the database.

19                   Company personnel compare the invoice to the Process File Log to  
20                   insure the Company is only paying for the appropriate data, and compares

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1 the invoice to the completion summary report to insure we are charging  
2 the proper accounts (transmission and distribution, Stray Voltage, etc).

3

4 Q: Staff found an expense charge for \$76.99 for a meal, T-shirts and gift  
5 packs. Can you provide additional detail regarding this charge?

6 A: Unlike the unit cost work associated with the majority of contractor work  
7 on the Safety Orders, the computerized system developed to effectuate the  
8 programs was developed by a contracted software vendor,  
9 "ComutaPole," whose travel expenses are reimbursed in accordance with  
10 the contract with the vendor. As such the software vendor would have  
11 been permitted to charge his meals while traveling on business for the  
12 Company. With regard to this specific invoice item, the sundry items (T-  
13 shirts and gift packages) were submitted along with the contractor's  
14 detailed seventeen page invoice for software services rendered. The  
15 invoice total was \$24,475.25 for services and travel expenses. With  
16 regard to controls, the contract does not permit anything beyond  
17 reasonable business and travel expenses, and this charge should have been  
18 excluded. In the first instance, we would expect the contractor to follow  
19 the terms of the contract and refrain from submitting such charges. The  
20 Manager of MI&A reviewed the invoice but missed the sundry items  
21 (which should have been excluded) that were included in the backup

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1 documents submitted with the invoice. We discussed this with the  
2 contractor, and the contractor indicated that the receipt for the sundry  
3 items was mistakenly billed to the Company and has been reversed.

4 Q: Staff indicated that it had performed a "cursory review" of the invoices.  
5 Have you been able to perform a more thorough review of the invoices  
6 from the contractor in question to determine whether the improper  
7 booking was a one-time mistaken oversight on the Company's part?

8 A: Yes. We have reviewed all of the invoices from ComputaPole for the  
9 period April 2004 through present (including review of ComputaPole  
10 invoices submitted prior to implementation of the stray voltage testing and  
11 inspection programs). With the exception of the invoice highlighted by  
12 Staff, the Company did not identify any invoices or charges that violate  
13 the Company's contract and travel expense procedures. Thus, out of the  
14 overall ComputaPole invoices, we have been able to locate only one  
15 aberrant charge, i.e., the one highlighted by Staff. In this light, it is clear  
16 that the arguably inappropriate charges (i.e., the \$76.99 receipt) are a  
17 negligible fraction of the \$2,615,983 in contractor costs. This one-time  
18 oversight hardly constitutes evidence of lax oversight and unreliable  
19 record-keeping.

20

21 Q: Staff asserts that "for the sole purpose of determining which deferrals are

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1 being recovered over the period April 1, 2006 – December 31, 2007, we  
2 have eliminated 50% of the Company's forecasted amounts to serve as a  
3 proxy for what a full audit would uncover." Do you agree that this is an  
4 appropriate and justified adjustment to the forecasted deferral?

5 A: No. Staff's proposed 50% adjustment is completely arbitrary and  
6 unjustified. Staff provides no basis for the proposed adjustment.  
7 Certainly, the fact that Staff has not completed a full audit of deferrals  
8 proposed through December 31, 2007 does not justify elimination of one-  
9 half of the forecasted deferral. Staff was provided detail regarding costs  
10 the Company has incurred to implement the programs, and conduct testing  
11 through the first testing cycle. This detail provides the foundation upon  
12 which the Company's forecasted deferral was developed. Given that the  
13 costs to implement and continue the programs have been established, no  
14 such speculative adjustments should be made to the Company's forecasted  
15 deferrals for stray voltage related expenses. With regard to the two  
16 specific issues raised by Staff involving internal labor and associated  
17 overheads, I have addressed in my testimony above why it is appropriate  
18 to defer expenses associated with incremental internal labor and associated  
19 overhead expenses. Conversely, Staff provides no evidence or supporting  
20 rationale that would justify the proposed complete disallowance of internal  
21 labor costs and associated overheads, or the proposed 50% adjustment to

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1 the forecasted deferral.

2

3 Q: Has the Commission permitted other utilities to recover incremental costs  
4 associated with implementing the Safety Orders?

5 A: Yes. The Commission has authorized other utilities in New York to  
6 recover costs to implement the Safety Orders (see, e.g., Central Hudson's  
7 joint proposal in Case Nos. 05-E-0934 and 05-G-0935, authorizing the  
8 company to defer costs associated with stray voltage in the amounts of  
9 \$2.2 million, \$2.25 million and \$2.3 million in rate plan years 2007, 2008  
10 and 2009 respectively; and Consolidated Edison's joint proposal in Case  
11 No. 04-E-0572, authorizing ConEd to include approximately \$21 million  
12 in estimated program costs in their revenue requirement, and authorization  
13 to address any variation between proposed and actual costs in their  
14 deferral account); and most recently the Commission approved reserve  
15 accounting for NYSEG in the amount of \$5 million for 2007.

16

17 Q: Thank you. I have no further questions at this time.

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**REBUTTAL TESTIMONY OF  
SCOTT D. LEUTHAUSER**

**I. Introduction**

Q: Please state your name and business address for the record.

A: My name is Scott D. Leuthauser. My business address and credentials were set forth in my responsive testimony, filed in this proceeding on September 1, 2006.

Q: What is the purpose of your testimony?

A: I will respond briefly to certain assertions regarding the deferral associated with the Company's efforts to implement the new elevated voltage testing and facilities inspection programs mandated by the Commission's Safety Orders presented by Staff witnesses Denise A. Gerbsch and Robert A. Visalli (the "Staff Panel") in their Responsive Testimony filed on September 19, 2006. I note that, due to the limited time available, and because I fully described the basis for the deferral in our earlier testimony, I am not responding to every point made in the Staff Panel testimony. My silence should not be construed as agreement with the arguments presented by the Staff Panel that are not addressed. I also note that, in this rebuttal testimony, I will use defined terms and acronyms with the meanings defined in my responsive testimony.

1 Q: What exhibits are you sponsoring in support of your testimony?

2 A: I am sponsoring Exhibit\_\_(SDL-3) illustrating that the response to IR  
3 #342, PSC-292 Gerbsch (DAG-31) Attachment 4 contains a list of names  
4 and titles of the employees who are completing the work to comply with  
5 the Safety Order, and Exhibit\_\_(SDL-4) illustrating that in the response to  
6 IR #95, PSC-90 Gerbsch (DAG-3) the Company provided the names of  
7 six employees who were re-hired after being laid off. Exhibit\_\_(SDL-5)  
8 is the letter agreement provided to Staff as referenced in IR #94, PSC-89  
9 Gerbsch (DAG-3) between the Company and the IBEW for the re-hire of  
10 such employees. Exhibit\_\_(SDL-6) lists eight underground splicers hired  
11 to fortify the department to complete inspections. All of these exhibits  
12 were prepared by me or under my supervision and direction.

13  
14 Q: Please describe generally what assertions of the Staff Panel concerning  
15 elevated voltage and facilities inspection you will address.

16 A: First, I will address the Staff Panel's assertion that the Company is not  
17 basing its deferral for the incremental costs of compliance with the Safety  
18 Orders on actual costs (page 85, line 2). Second, I will address the Staff  
19 Panel's claim that there is no evidence that additional employees are being  
20 hired to perform incremental activities required to comply with the Safety  
21 Orders (page 81, lines 11-12). Third, I will address the Staff Panel's  
22 assertion that none of the employees hired to perform new work required

1 by the Safety Orders is incremental because the Rate Plan anticipated that  
2 an additional 231 employees would be hired in the asset management and  
3 field operations areas (page 82 line 7 – page 83 line 14). Fourth, I will  
4 address the Staff Panel's contention that non-incremental transportation  
5 costs are included in the Stray Voltage deferral (page 84, lines 14 -18).

6

7 **II. Response to Staff Assertions**

8 Q: Turning to the first issue, do you have any comments on the Staff Panel's  
9 testimony on page 85, lines 2-10 regarding the basis of the deferral costs  
10 of compliance with the Safety Orders?

11 A: Yes. The Staff Panel suggests that the proposed deferral for the costs of  
12 compliance with the Safety Orders is somehow invalid because it is based  
13 on cost projections. It is my understanding that the Company is required  
14 to forecast the costs eligible for deferral for the period beginning July 1,  
15 2005. We have done so. In developing the forecast, the Company used  
16 data known at the time of development regarding actual costs to calculate  
17 a projection of costs. The Company will track, in the deferral account for  
18 the Safety Order all actual costs (debits) and revenues received through  
19 rates (credits), making the forecast somewhat irrelevant. The  
20 Commission-approved incremental costs will be tracked against the  
21 Commission-approved incremental revenues added into rates through this  
22 CTC Reset Proceeding.



1

2 Q: Regarding the second issue, is there evidence that the Company hired or  
3 rehired new employees to effectuate the Safety Orders?

4 A: Yes. In my previous testimony, I stated that the Company posted and  
5 hired employees, and rehired employees that had been laid off to  
6 undertake new activities required to comply with the Safety Orders. To  
7 support this statement, I have attached as Exhibit \_\_ (SDL-3) a list of  
8 names and titles of employees who are completing the work to comply  
9 with the Safety Order (this information was previously provided to Staff in  
10 response to IR #348, PSC-292 Gerbsch (DAG-31), as Attachment 4 to the  
11 Company's response). The names of the six employees who were re-hired  
12 after having been laid off are listed on Exhibit \_\_ (SDL-4) (previously  
13 provided to Staff in response to IR #95, PSC-90 Gerbsch (DAG-3)).  
14 Additionally, Exhibit \_\_ (SDL-5) is the letter agreement between the  
15 Company and the IBEW for the re-hire of such employees (previously  
16 provided to Staff and referenced in response to IR #94, PSC-89 Gerbsch  
17 (DAG-3)). Not only are these employees incremental, in the sense that  
18 they would not have been re-hired were it not for the new requirements  
19 imposed by the Safety Orders, but the work they perform is incremental in  
20 the same sense.

21 In addition, as I explained in my previous testimony, the Company  
22 posted and hired eight underground cable splicers to meet new

1 requirements of the Safety Orders. All of these new positions were filled  
2 by individuals previously employed by Niagara Mohawk doing other jobs.  
3 A listing of these individuals is included as Exhibit \_\_ (SDL-6) to this  
4 testimony. In most cases their previous positions were backfilled.  
5 Whether or not this is the case does not matter, though, since we have  
6 calculated the incremental costs to comply with the Safety Order not by  
7 tracking FTEs, but rather by tracking the costs of completing the  
8 incremental activities, i.e., the work the Company would not otherwise  
9 perform but for the Safety Order. The compliance with the Safety Order  
10 did not displace any work done before it was issued, so whether or not we  
11 replaced employees re-deployed from other departments to do that work  
12 does not affect the incremental nature of their new duties.

13

14 Q: Does the fact that the Merger Rate Plan rates anticipated the addition of  
15 new positions for the asset management and field operations functions  
16 mean that Niagara Mohawk is not incurring incremental costs for the  
17 employees hired to undertake projects required to comply with the Safety  
18 Orders?

19 A: No. The Merger Rate Plan recognized that the Company would have to  
20 hire additional employees, filling open positions, to perform the work  
21 required to meet the Company's obligations over the course of the Rate  
22 Plan period, based on what was known at the time. The 231 employee

1 positions cited by Staff reflect a negotiated number that the parties agreed  
2 was appropriate based on the regulatory requirements that existed at the  
3 time; it did not incorporate an allowance for the employees that might be  
4 required to meet new regulatory obligations. As stated in reference to the  
5 231 positions in Exhibit \_\_ (SP-10), page 32, "The filling of the open  
6 positions is in support of the 2001 work plan developed by the Asset  
7 Management. As a result of the open positions, the Company is able to  
8 reflect an overall lower overtime level than was experienced in 2000." It  
9 simply is not the case that 231 additional positions were embedded in  
10 delivery rates to perform unknown future work, as Staff suggests. To the  
11 contrary, in aggregate, the Merger Rate Plan reduced Niagara Mohawk's  
12 Electricity Delivery Rates by \$159.8 million or 8.2 percent per year  
13 relative to then-effective Electricity Delivery Rates and 5.1% overall.

14 As I explained in my previous testimony, the stray voltage testing  
15 and inspection programs required to comply with the Safety Orders are  
16 new programs that the Company has implemented to meet new  
17 requirements. Neither these requirements nor the employees required to  
18 satisfy them were contemplated when the Merger Rate Plan was agreed  
19 upon and approved, nor could they have been. Since the tasks that the  
20 employee positions contemplated in the Rate Plan were intended to  
21 perform have not been eliminated, treating the positions required to  
22 perform the work to meet the new Safety Program requirements as

1 included in the positions allowed in the Rate Plan would leave the  
2 Company shorthanded to meet all of its obligations, including the new  
3 obligations imposed by the Safety Orders.

4

5 Q: Does the deferral for compliance with Safety Order requirements include  
6 non-incremental transportation costs?

7 A: No. The Staff Panel does not explain why it believes the transportation  
8 costs are not incremental, but in their initial testimony they cross-reference  
9 the storm restoration cost deferral account method. In my previous  
10 testimony regarding inclusion of labor overheads in the deferral for stray  
11 voltage requirements (starting at page 11, line 17), I explained why Staff's  
12 analogy between the costs of supporting storm restoration work and the  
13 stray voltage program is invalid. In order to perform incremental stray  
14 voltage work, the Company must incur incremental transportation costs. It  
15 is not the case that transportation resources normally dedicated to (and  
16 paid by) another function are temporarily borrowed to perform stray  
17 voltage testing and inspection activities. Rather, vehicles are dedicated to  
18 support this activity. Those vehicles and the associated costs are  
19 incremental, as are the personnel who perform the new activities. Because  
20 these employee expenses are incremental, the associated transportation is  
21 also incremental. Unlike employees working overtime on storm response  
22 on a temporary basis, assignment of an employee's time to the incremental

1 inspection and stray voltage testing programs is a regular (albeit new)  
2 assignment. The employees supporting storm response are on the property  
3 regardless of the occurrence of storms, i.e., they are here to work daily on  
4 the system infrastructure. Employees performing incremental inspection  
5 and testing activities do such work as a regular part of their jobs, and not  
6 as a temporary or emergency activity to respond to a storm. Since work  
7 on incremental inspections and stray voltage testing is regular work,  
8 clearly distinguishable from temporary overtime to respond to a storm  
9 emergency, transportation associated with incremental inspection and  
10 stray voltage testing activities should be recoverable.

11

12 **III. Conclusion**

13 Q: Thank you. I have no further questions at this time.

1 JUDGE STOCKHOLM: Ms. Assaf, please proceed.

2 CROSS EXAMINATION

3 BY MS. ASSAF:

4 Q. Mr. Leuthauser, I direct you to your rebuttal  
5 testimony, September 26th testimony, the bottom of  
6 page five, top of page six.

7 Do you agree that merger rate plan rates  
8 anticipated the addition of 231 new positions for  
9 asset management and field operation functions?

10 A. On line five, page six, I quote what the  
11 purpose of that was for.

12 Q. I'm sorry. I didn't understand your answer.

13 A. Line five, page six, the filling of the opening  
14 positions is in support of the 2001 work plan  
15 developed by the asset management. As a result of  
16 the open positions the company is able to reflect an  
17 overall lower time level than was experienced in  
18 2000.

19 Q. Did the merger rate plan rates anticipate the  
20 addition of 231 new positions for those fields,  
21 asset management and field operations functions? I  
22 just want to know if you agree with the number.

23 A. It was to fill open positions.

24 Q. How many new employees has the company hired to

1 fill these positions?

2 A. I don't know.

3 Q. Is that information you could provide?

4 A. I can check. I don't know.

5 Q. Are you suggesting that you can't go through  
6 records and determine how many employees were hired  
7 from the beginning of the merger rate plan?

8 A. I can find out how many were hired explicitly  
9 into these departments. Keep in mind the merger  
10 rate plan had many reductions imbedded as well. I  
11 would not be able to differentiate the additions  
12 from the reductions. I don't think I can go get the  
13 number.

14 JUDGE STOCKHOLM: Are you saying that as a  
15 result of efficiencies in the merger that employee  
16 count may have gone down and even though you have  
17 hired 231 it may not show as 231 incremental; is  
18 that what you are saying?

19 MR. LEUTHAUSER: That is correct. If you go  
20 to find additional new employees they may not be 231  
21 hired because of efficiencies.

22 BY MS. ASSAF:

23 Q. I wasn't necessarily suggesting there have been  
24 231 new hires. These are new positions that might

1 have been allowed. I was just trying to figure out  
2 of that number how many to date you might have  
3 hired.

4 JUDGE STOCKHOLM: I was trying to understand  
5 the witness' answer.

6 MR. LEUTHAUSER: I don't know if I can  
7 confirm how many were hired of the 231.

8 BY MS. ASSAF:

9 Q. Does the company maintain personnel records?

10 A. Yes.

11 Q. Wouldn't those records indicate who was hired  
12 on what date?

13 A. Yes.

14 Q. And what position they were hired for?

15 A. Yes.

16 Q. Then I am having trouble understanding the  
17 distinction.

18 A. Yes. I can run in the system and find out how  
19 many employees were hired into the asset management  
20 and operations groups during a certain period.

21 Q. You should be able to provide the information?

22 MR. GAVILONDO: We can take that as a record  
23 request.

24 MS. ASSAF: Can we request of the record we



1 get that information?

2 JUDGE STOCKHOLM: Yes, certainly.

3 MR. LEUTHAUSER: Do we know what dates you  
4 wanted hired on and after?

5 MS. ASSAF: From the beginning of the merger  
6 rate plan.

7 MR. LEUTHAUSER: Could you refer to your  
8 rebuttal testimony, page seven, lines 13 through 21,  
9 yes.

10 BY MS. ASSAF:

11 Q. Here you discuss the incremental transportation  
12 expense associated with stray voltage work, correct?

13 A. Stray voltage and inspections.

14 Q. How many vehicles has the company had to buy to  
15 perform the stray voltage testing and inspection  
16 work activities?

17 A. I don't know.

18 Q. Is that information you could provide? Would  
19 the company's records, to your knowledge, allow you  
20 to differentiate why a vehicle was purchased?

21 JUDGE STOCKHOLM: Or what work function it  
22 was purchased for?

23 MR. LEUTHAUSER: No, but I can find out  
24 the number of vehicles supporting the fleet in this

1 department.

2 JUDGE STOCKHOLM: I have questions on the  
3 same pieces of testimony and there is a question  
4 what is meant by incremental. Let me explain my  
5 concern and you can address it as you see fit and  
6 let staff do whatever they want to do in terms of  
7 questioning.

8 If the company starts with two vehicles  
9 and one of the vehicles is parked for some hours a  
10 day because it's not being used, now the company  
11 has an additional task they have to do, they can  
12 accomplish that task with two vehicles because one  
13 wasn't being used a hundred percent of the time.

14 Under that very simplistic example is the  
15 additional time the one vehicle is being used for  
16 the new effort an incremental transportation cost  
17 as you are defining in your testimony?

18 MR. LEUTHAUSER: I will step back and  
19 explain how we define incremental. We identified  
20 what tasks associated with the safety orders we  
21 were not doing, and what tasks we had to do because  
22 of the safety orders.

23 JUDGE STOCKHOLM: All incremental tasks.

24 MR. LEUTHAUSER: We identified those tasks.

1 Some of the tasks identified in the safety order we  
2 were already doing so we established a department to  
3 accomplish and effectuate the safety order. We  
4 established tasks in activity based accounting to  
5 track the additional costs for those items.

6 For example, additional items to do the  
7 elevated or stray voltage tests are charged to one  
8 account where the costs for overhead line inspections  
9 that we are already doing is charged to a different  
10 account. We track the incremental and  
11 non-incremental activities associated with the safety  
12 order.

13 Transportation is allocated for their use.  
14 When it is part of the inspection a group uses  
15 transportation from the company and gets charges  
16 associated with that, so the transportation charges  
17 are added onto the incremental activities as well as  
18 it's an adder on non-incremental activities.

19 JUDGE STOCKHOLM: So you would still incur  
20 incremental charges, as you just explained it to me,  
21 whether or not it was necessary for the company to go  
22 out and get an additional vehicle to allow those  
23 things to be completed; is that correct?

24 MR. LEUTHAUSER: Yes. We would have

1 incremental people to do the work and these jobs are  
2 inspections every day, so they each need a vehicle  
3 every day, so there are incremental vehicles as well,  
4 but generally we don't just tag in the accounting a  
5 vehicle to a person. It's from a pool of vehicles.  
6 And there is an adder onto the employee's costs in  
7 our calculation for transportation.

8 JUDGE STOCKHOLM: For transportation,  
9 understood. I understand. Staff.

10 BY MS. ASSAF:

11 Q. At line 17, Mr. Leuthauser, you indicate that  
12 vehicles are dedicated to support this activity?

13 A. Yes.

14 Q. That does not mean that a vehicle was purchased  
15 to do the stray voltage and inspection work that was  
16 a result of the safety orders?

17 A. Some of the supervisors have their own vehicle  
18 for purpose of accomplishing the job and some of the  
19 personnel have a pool of vehicles that are dedicated  
20 for the department to use in their activities.

21 Q. Is there an allowance or did we bill some costs  
22 in for the pool inspections in the merger Joint  
23 Proposal?

24 A. Not for any of these incremental activities.

1 Q. But for the pool vehicles, I guess I am having  
2 a little trouble here. You are suggesting the  
3 vehicles are indicated to support the activity but  
4 they are drawing them from a pool in some cases?

5 JUDGE STOCKHOLM: Is anybody else drawing  
6 them from the same pool?

7 A. I would have to check if anyone else is drawing  
8 from a pool. Since we use it every day, the  
9 majority of the use would be from our people doing  
10 these inspections.

11 For example, the same person may do overhead  
12 and inspection not incremental on one day and the  
13 next day do an underground inspection which is an  
14 incremental task.

15 Overall they are doing more inspections,  
16 therefore, need more vehicles. So we allocated the  
17 transportation to an incremental piece and some  
18 transportation to the non-incremental piece.

19 Q. It's the same vehicle that's included in the  
20 transportation costs that were part of the merger  
21 rate plan; is that correct?

22 A. Again, because there's more people doing more  
23 inspections there are more vehicles required.

24 Q. How many more vehicles have you--

1 A. That was your question for me to take back.

2 Q. So, we don't know that, okay. Mr. Leuthauser,  
3 earlier you are said it's difficult to determine  
4 some of the positions because you had synergy  
5 savings. Some came in, some came out. Might be  
6 difficult to track them through.

7 I am looking at volume 1 of the merger  
8 petition, January 17, 2001. It's page 98, appendix  
9 C. I don't know that you have that.

10 JUDGE STOCKHOLM: You can show it to the  
11 witness if you would like, counselor.

12 Q. Page 98 is a chart of position reductions. Do  
13 you see that?

14 A. I do.

15 JUDGE STOCKHOLM: Basically labor synergy  
16 savings.

17 MS. ASSAF: Correct, Your Honor.

18 Q. And on this chart it indicates that of the  
19 combined positions of Grid and Niagara Mohawk, 5,720  
20 combined positions for T&D operations, that you  
21 expect a reduction of only 42 positions; is that  
22 correct?

23 A. That's what the exhibit displays.

24 Q. Do you know whether or not--I guess it's

1 probably the same question, another version of the  
2 same question I asked earlier--but do you know  
3 whether or not that estimated reduction is within  
4 the--within an order of magnitude or within the  
5 realm of what actually happened?

6 A. I do not know.

7 Q. Can you provide that information also?

8 JUDGE STOCKHOLM: What category of labor is  
9 it, total company?

10 MS. ASSAF: This is T&D.

11 MR. LEUTHAUSER: Can I get the cite of what  
12 that document was again?

13 MS. ASSAF: This is appendix C to volume 1  
14 of the January 17, 2001 merger petition and it's  
15 page 98.

16 That's all we have, Your Honor.

17 JUDGE STOCKHOLM: Mr. Mager.

18 MR. MAGER: No questions, Your Honor.

19 JUDGE STOCKHOLM: I assume this is true, but  
20 I better ask just to make sure.

21 The accounting for the stray voltage testing  
22 that we have been talking about here, is that also  
23 done under the general rubric of T&D labor? Is it  
24 accounted for in the same place?

1 MR. LEUTHAUSER: Stray voltage testing for  
2 elevated voltage, the company hired outside  
3 contractors to do all that work, no.

4 JUDGE STOCKHOLM: What are the incremental  
5 transportation costs we are talking about here?

6 MR. LEUTHAUSER: Would be for internal  
7 employees doing work for incremental activities  
8 associated with the safety order.

9 JUDGE STOCKHOLM: But not testing for stray  
10 voltage?

11 MR. LEUTHAUSER: That is correct.

12 JUDGE STOCKHOLM: The work that they are  
13 doing, is that accounted for under T&D? In other  
14 words, if you did a table today like counsel just  
15 showed you would these incremental activities be  
16 accounted for in the same category?

17 MR. LEUTHAUSER: I can include that  
18 department or exclude that department in T&D.

19 JUDGE STOCKHOLM: Okay. That's all I have.  
20 We will go back on the record at 9 o'clock tomorrow  
21 morning. If the parties would get here about 20 of  
22 to work with the reporter and see if we can smooth  
23 those edges and make that a little bit more efficient  
24 and hopefully conclude tomorrow.



1                   Is there something before we go off the  
2 record?

3                   MS. ASSAF: We wanted to confirm of the  
4 chart I did show Mr. Leuthauser, the categories for  
5 the positions were A&G, customer and T&D. Of those  
6 three categories where would you expect these  
7 positions to be. Thank you.

8                   JUDGE STOCKHOLM: Okay. Thank you.  
9 Anything else before I shoot too soon? We are off  
10 the record. Be back to start again tomorrow morning.

11                   (Hearing adjourned.)

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