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THOMPSON HINE

ATLANTA BRUSSELS CLEVELAND COLUMBUS DAYTON NEW YORK WASHINGTON, D.C.

via Federal Express

May 22, 2007

Hon. Jaclyn Brilling
Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, New York 12223

Re: Case 07-E-0136-Notice of Central Hudson Gas & Electric Corporation Under Public Service Law Section 70 of the proposed Transfer of the Groveville Mills Hydroelectric Facility and, in the Alternative, Petition of Central Hudson Gas & Electric Corporation and Lower Saranac Corporation for Authority Under Public Service Law Section 70 and for Related Approvals

Dear Secretary Brilling:

Enclosed please find an original and twenty-five copies of the Petition on Behalf of Central Hudson Gas & Electric Corporation for Reconsideration and Rehearing in the above-referenced proceeding. Insofar as Central Hudson is aware, there are no other parties to this proceeding.

Respectfully submitted,

Robert J. Glasser

Enclosures

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PUBLIC SERVICE COMMISSION
OF THE STATE OF NEW YORK

Notice of Central Hudson Gas & Electric Corporation Under Public Service Law Section 70 of the Proposed Transfer of the Groveville Mills Hydroelectric Facility and, in the Alternative, Petition of Central Hudson Gas & Electric Corporation and Lower Saranac Corporation for Authority Under Public Service Law Section 70 and for Related Approvals.	:	Case 07-E-0136

PETITION ON BEHALF OF
CENTRAL HUDSON GAS & ELECTRIC CORPORATION
FOR RECONSIDERATION AND REHEARING

Central Hudson Gas & Electric Corporation ("Central Hudson") requests that the Commission reconsider and rehear its Order Approving Transfer and Directing Accounting for Sales Proceeds (Issued and Effective April 23, 2007) insofar as the Order relates to how Central Hudson must account for the net gain derived from the sale of the Groveville hydro facility. The Order held that "ratepayers are entitled to all of the gain."[1]

The result of the Order, as compared to the result proposed by Central Hudson, is set forth in the table below. Although ratepayers had already received substantial benefits, the Order directed that ratepayers gain from the sale, but Central Hudson gain nothing and remain in a deep loss position:

[1] Order at 11. The basis for that conclusion is set forth at 8-11 of the Order.

	PER ORDER		PER CHGE	
	RATEPAYERS ($000)	COMPANY ($000)	RATEPAYERS ($000)	COMPANY ($000)
Free Energy, 2000-2006	318	0	318	0
O&M Costs in Rates 2000-2006	(25)	0[2]	(25)	0[3]
O&M Costs Not in Rates, 2000- 2006	297	(297)	297	(297)
Avoided (Foregone) Carrying Costs, 2000-June 2006[4]	455	(455)	455	(455)
Avoidance of $0.08/kWh "floor"	175	0	175	0
Rate Plan Revenue Requirement	(90)	60[5]	(90)	60[6]
Loss of Asset Value; Regulatory Lag	(75)	0	0	(75)
1995 Payback Account	(420)	0	(420)	0
Net Benefits Pre-transfer	635	(637)	710	(767)
Pre-tax gain	477	0	0	477
Net Benefits	1112	(637)	710	(290)

Basic Facts

This proceeding relates to the proposed transfer of a small hydro-electric generating facility constructed in the early

[2] The Company received total revenues of approximately $25,000, offset by equivalent costs.
[3] See, n.2, supra.
[4] Foregone carrying costs on actual value of the production facility acquired at zero cost: $700,000 (sale price) x0.106 (pre-tax return) x6 years=$455,000
[5] Over the three years of the current rate plan, the company will receive about $90,000 in revenues, offset by about $30,000 in costs in rate year 1.
[6] See, n.5, supra.

1980s. The facility was constructed as a PURPA IPP by United American Hydro ("UAHG").[7] Central Hudson was required by federal law, state law and Commission policy to enter into a contract to buy power produced at the facility at a rate of at least six cents per kWh (determined in various ways). The contract was entered into in 1982 and was approved by the Commission.[8] The facility began operations in 1983.

Ratepayers had no claim on the asset during the term of the contract, and, had the contract run its course, ratepayers would have had no claim on the asset after the twenty year term of the contract. The developer of this small hydro production facility was free to sell the asset and retain the entire gain, just as many large IPP developers have done with the Commission's approval.

However, in 1995, a contract dispute developed when Central Hudson demanded a reduction in the contract price for power it purchased to offset a $420,000 balance in the "payback account" provision of the contract. UAHG insisted that it was entitled to a "floor" payment of $0.08/kWh, and UAHG filed a voluntary petition in bankruptcy in a forum shopping effort to avoid having the contract interpreted by the Commission.

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[7] Central Hudson's SAPA Comments dated March 29, 2007 in response to the SAPA Notice at 2, and Attachment A to those Comments.
[8] Letter Order (Issued June 15, 1982).

Central Hudson actively resisted UAHG's efforts and, after a trial, a decision against UAHG and in Central Hudson's favor was issued by the bankruptcy judge. Following an unsuccessful appeal by UAHG to the federal circuit court, the parties reached a proposed settlement under which title to the facility would be transferred to Central Hudson. At this point in time, UAHG was willing to transfer the hydro production facility to Central Hudson at no cost. Central Hudson accepted this offer so that it could recapture the negative value of $420,000 in the payback account. After the Commission approved the acquisition of the facility by Central Hudson at no cost,[9] and the bankruptcy court approved the proposed settlement,[10] the facility was acquired by Central Hudson in late 2000.

Subsequent to the acquisition, Central Hudson operated the facility, and utilized the output as a "load modifier" under the NYISO's procedures. Ratepayers received benefits that recaptured the negative balance in the payback account and a number of additional benefits that greatly outweighed the payback account balance, as Central Hudson explained previously.[11] First, operation of the facility produced customer benefits through offsetting purchases that Central Hudson otherwise would have made. Second, ratepayers only paid a pittance for the

[9] Case 99-E-1530, Declaratory Ruling on Acquisition of a Small Hydro Facility (Issued and Effective December 31, 1999).
[10] SAPA Comments, Attachment B.
[11] See Central Hudson's SAPA Comments.

costs of the hydro production facility that produced the benefits they received. Because the Commission approved the acquisition of the facility at zero original cost and the Commission sets rates on an original cost basis, the Commission knew that no portion of the capital asset value of the production facility would be charged to ratepayers. Property taxes related to the facility were included in the property tax allowance established in Case 00-E-1273, and provided Central Hudson with about $6,000 in revenues annually in the period August 2000 through June 30, 2006. In July 2006, a net book value of $74,000 reflecting the betterments that Central Hudson invested (but not the value of the original facility acquired in 2000) was reflected in rates, along with property taxes and other O&M expenses, yielding a revenue requirement of about $30,000 per year under the current rate plan. These values are reflected in the above Table.

After receiving an unsolicited expression of interest to buy the facility in 2005, Central Hudson conducted a sale solicitation in mid-2006, which led to the present transaction in early 2007.

Summary of Central Hudson's Position

Had the contract run to term, ratepayers would have received back the balance in the payback account; nothing more. They had no claim on the asset, and neither an expectation nor a

right of receiving any part of any gain from its sale. If, because of the payments they made between 1983 and 2000 related to the contract, ratepayers had any interest in the value of the facility, that interest was satisfied when the payback account was recouped (as it was through Central Hudson's actions).

Because of Central Hudson's actions, ratepayers not only received back the balance in the payback account, they gained significant additional financial benefits. Central Hudson enforced the contract to protect ratepayers' interests in the payback account, and it prevailed. As shown in the above Table, Central Hudson operated the production facility for six-plus years, eliminated the negative balance in the payback account, and produced additional positive value for ratepayers. Yet, Central Hudson earned virtually nothing for itself.

Upon the present sale Central Hudson proposed that it receive the net gain to reduce the losses sustained. The accounting proposed by Central Hudson did not propose that ratepayers' status change from winners to losers, or that Central Hudson's status as having a loss position be reversed. Central Hudson's proposed accounting ameliorated, but did not eliminate, Central Hudson's losses, and it reduced, but did not eliminate, ratepayers' benefits.

Ratepayers received significant positive benefits as the result of Central Hudson's actions, but the Order unreasonably

advantaged ratepayers further at Central Hudson's expense; incorrectly depicting the facts and applicable equitable considerations, and misinterpreting and misapplying applicable law.

The Order Fails to Recognize the Equities, or Balance Them, Failing to Address Either the Benefits Already Received by Ratepayers or the Losses Suffered by Central Hudson

The Order guaranteed that all of the economic benefits traceable to the value of the production facility would be received by ratepayers, and none by the utility, even though ratepayers never supported the value of the facility, and the Order reached that conclusion without regard for the benefits already received by ratepayers or the financial detriment to the utility. This failure to consider the equities was an unreasonable determination.

The Order Incorrectly Describes the Commission's Ratemaking for the Purpose of Justifying an Unfair Outcome

At page 8, the Order states:

> After Central Hudson acquired the facility, the investment and operating costs related to it have been recorded in utility accounts reflected in ratemaking.

And, at page 9, the Order goes on to state:

> The value of the Groveville facility has been included in rate base since July 1, 2006 and would have been included earlier had Central Hudson sought new rates at an earlier time after it made betterments to the facility.

These statements are either incomplete in material respects, or otherwise incorrect. They incorrectly portray the Commission's ratemaking for the Groveville facility, and the significance of that ratemaking.

The "value" of the Groveville facility includes the value of the asset that was acquired in 2000 by Central Hudson. The buyer did not contract to pay $700,000 for the $74,000 (net cost) in Central Hudson betterments, but for the value of the hydro production facility itself (including the betterments).

In contrast, all that has ever been recognized in rates is a *de minimis* amount of property taxes in the 2000 through June 2006 time period, and a small rate allowance related to the costs of the betterments and O&M expenses. Hence, it is incorrect for the Order to state that the "value of the Groveville facility" has been included in rates.

The value of the hydro production facility is exactly what was not recognized in rates, yet the Order improperly claims that very value for ratepayers.

The value of the hydro production facility acquired in 2000 was not recognized in rates, because the Commission sets rates on an original cost basis. As Central Hudson had explained in the January Filing (at note 2), the Uniform System of Accounts requires that Central Hudson record the asset at zero original cost, and it did so. As a result, the only assets recorded on

Central Hudson's books at a positive original cost are the betterments, not the hydro production facility itself.

So, for the Order to state that the "investment and operating costs" related to the facility were "recorded in utility accounts reflected in ratemaking" is true only in the very limited sense that the "investment costs" recorded on Central Hudson's books reflect the production facility at zero cost, but not because there was any payment by ratepayers for the actual value of the asset that Central Hudson acquired. Indeed, through stating that the costs were recognized in ratemaking, the Order avoids the reality that ratepayers never paid for the value of the production facility that Central Hudson acquired. Yet, the Order directs that the value now be received by ratepayers.

From the initial acquisition by Central Hudson in 2000 until July 2006, ratepayers have been receiving the benefit of the operation of a production facility that they, in fact, did not pay for at all (apart from the *de minimis* property taxes) until July 2006, and afterwards only to a small extent ($30,000 annually) related to a return on the betterments and O&M expenses. Central Hudson made this very point in its SAPA Comments.[12] Inexplicably, rather than addressing Central

[12] SAPA Comments at 4 and Attachment B.

Hudson's point, the erroneous statements described were made instead.

The Order Doubly Benefits Ratepayers, and Wrongly Penalizes Central Hudson

The Order (at 8) also attempts to justify directing the entire net gain to ratepayers' account by asserting:

> The investment and operating costs of the Groveville facility were funded by Central Hudson's ratepayers through regulated rates during the term when the power purchase contract with UAHG was in effect, because Central Hudson, through its fuel adjustment clause, recovered from ratepayers the full cost of the energy purchased from UAHG.

To a similar effect, the Order goes on (at 9) to assert that:

> Because ratepayers funded the costs of creating value in the Groveville facility, both before and after its acquisition by Central Hudson, they are entitled to the gain realized on its sale.

However, ratepayers paid for the costs of power generated by the facility only between 1983 and 2000, prior to the time the bankruptcy court and the Commission approved the transfer of the production facility to Central Hudson. It is incorrect for the Commission to base any part of its decision on those events, as Central Hudson explained in both its responses to Staff's Interrogatories and its comments in response to the SAPA Notice.[13] These points were, again, not addressed in the Order.

[13] At 8, the Order points out that the power purchase costs incurred by Central Hudson under the contract were recovered from ratepayers. Central Hudson did recover the direct costs of the power it purchased under the

During the contract's term, Groveville was a PURPA facility.[14] PURPA precludes the Commission from regulating the facility.[15] The attempt to justify allocating the benefits of the gain on Central Hudson's 2007 sale on the basis of ratepayer payments in the period 1983 through 2000, prior to the time Central Hudson acquired the facility, is an attempt to regulate the facility in the same way the Commission regulated generating plants built by vertically integrated utilities.[16] It therefore falls afoul of the PURPA prohibition.

It is also a double count in ratepayers' favor. Utilities were required to enter into contracts with PURPA facilities, and pay "front end loaded" prices under applicable Commission policies, because it was believed those financial benefits to developers were in ratepayers' interests (it was obviously not in the vertically integrated utilities' interests) that nascent independent power developers receive these benefits.[17]

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contract, but Central Hudson did not receive any earnings from the contract. Any earnings benefits of the contract were realized by UAHG, not Central Hudson, because the purpose of the PURPA provisions was to provide financial incentives to developers of IPP facilities.

[14] See Press Release from UAHG annexed as Attachment A to Central Hudson's response to the SAPA Notice, explaining that the Groveville Facility was a PURPA facility.

[15] 16 USCA § 824a-3. Although this point had been made previously by Central Hudson, it was unaddressed in the Order.

[16] See, e.g., Case 96-E-0909, Order Approving Transfer Of The Danskammer And Roseton Generating Stations And Making Other Findings (Issued and Effective December 20, 2000) and Order Clarifying Prior Order (Issued and Effective January 25, 2001).

[17] Even today, the Commission does not seek to regulate the disposition of gain on sales of IPP facilities, as shown by a decision issued the same day as the present Order. It is therefore also inconsistent for the Commission

With respect to the period after Central Hudson acquired the facility in 2000 through June 30, 2009 (the expiration of the current rate plan), ratepayers did not "fund the costs of creating value" because, as explained above, they have never supported the full value of the production facility.[18]

Moreover, the paucity of ratepayers' funding is clear: over the entire period from 2000 through June 2009, ratepayers will have paid a total of $115,000, or just over 16% of the $700,000 sale price. This $115,000 total amount over the period is at the level of one year's annual carrying costs of a $700,000 capital asset, and is not a fair representation of the value of the facility. It is unreasonable for the Commission to assign the entire sale value to ratepayers because of such small payments over a period of years, and at the same time to refuse any earnings (beyond the *de minimis* amount related to the betterments) to Central Hudson for its actions over the entire period.

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to attempt to base its disposition of the gain in the present case on the same situation it ignores everywhere else.

[18] For similar reasons, the Order (at 10) is incorrect when it states that "Ratepayers also bore the risk of loss on the facility. Consequently, ratepayers are entitled to the gain realized upon its transfer." Ratepayers did not have any "risk of loss" because they paid for the power produced by the facility, but ratepayers never paid for the value of the production facility. If there were to have been a calamity, and if ratepayers were to have funded a replacement, that would have been the first time that ratepayers would have funded the construction of the facility.

The Bellcore Decision Was Misinterpreted and Misapplied in the Order

The Order (at 9) incorrectly interprets the Bellcore decision as authorizing the Commission to direct the value of an asset to ratepayers under any circumstances if ratepayers "bore the costs of creating the asset's value, even though the asset that [sic] was never included in utility rate base." The Order (Id.) goes on to note that inclusion of the value of an asset in rate base is a factor supporting a Commission determination to direct the sale value for ratepayers, and states (incorrectly, as described above):

> The value of the Groveville facility has been included in rate base since July 1, 2006 and would have been included earlier had Central Hudson sought new rates at an earlier time after it made betterments to the facility.

The Bellcore decision does not establish a general rule that any asset ratepayers supported in any way must have its entire value upon sale directed to ratepayers. Instead, the Bellcore decision makes clear that what is at issue is assessing the reasonableness of the Commission's decision, based on the relevant facts.

In the Bellcore case itself, the Court relied upon the fact that the ratemaking treatment applied by the Commission to NYT's Bellcore investment prior to the sale, while not "in" rate base,

"was exactly the same as if Bellcore were part of its rate base" (emphasis added).[19] Since NYT had benefitted from that rate-making treatment, the Court found it reasonable that the Commission assigned the net value of Bellcore to ratepayers upon its sale. Here, the value of the asset has not been included in rate base for twenty-three years, from the time it first began operating in 1983 until July 2006, at which time only about one tenth of the value was first recognized. This small and belated recognition is distinctly unlike the Bellcore situation.

The Bellcore Court's reference to the Rochester Telephone Royalty Case was based on the premise that capturing the value of "name and reputation" for ratepayers was justified because there was no other way in which ratepayers would be compensated for bearing "the costs for creating [the name and reputation] value." In the present case, the situation is different. This case involves a PURPA facility, which Bellcore did not address. While ratepayers paid under the contract for power that the Groveville hydro facility produced, ratepayers had no right to benefit from the contract payments they made. Because of the fact that Groveville was a PURPA facility during the term of the contract, ratepayers could not benefit in relation to the hydro plant asset value from their contract payments for power. The law and the Commission required utilities to enter into power

[19] See, Bellcore, 95 NY 2d, 40, at 50 (2000)

purchase contracts with PURPA IPPs to stimulate the IPP industry, not to vest ratepayers with any interest in those facilities. Any ratepayer interest in relation to the contract payments was satisfied when Central Hudson recouped the payback account. Therefore, it is erroneous and unreasonable for the Order to base any part of its determination on the basis of ratepayer payments under the contract, prior to acquisition of the Groveville facility by Central Hudson.

After the acquisition, the only capital value recognized in rates related to the betterments, not to the value of the hydro production facility itself. The capital value of the production facility has been shielded from ratepayer responsibility after the acquisition by Central Hudson, but not because of Central Hudson inaction as the Order incorrectly states,[20] but because of the Commission's ratemaking policies.

Conclusion

If, because of the payments they made between 1983 and 2000 related to the contract, ratepayers had any interest in the value of the facility, that interest was satisfied when the payback account was recouped. Since that time, ratepayers received substantial additional benefits, but ratepayers have

[20] Order at 9: "The value of the Groveville facility has been included in rate base since July 1, 2006 and would have been included earlier had Central Hudson sought new rates at an earlier time after it made betterments to the facility."

paid for only a small portion (about one tenth) of the value of the facility that produced those benefits.

The Order (at 9) is plainly erroneous in stating that "[t]he value of the Groveville facility has been included in rate base since July 1, 2006...." This, and other erroneous statements in the "Disposition of the Gain" portion of the Order, led to an unreasonable outcome. As ratepayers received substantial benefits but never paid for than about one tenth of the value of the facility, the Order reached the wrong result.

Central Hudson requests that the Commission review the Order, and fairly balance the equities in light of the fact that ratepayers, as the direct result of the actions taken by Central Hudson to advance ratepayers' interests, have already received significant benefits beyond elimination of the payback account. Central Hudson requests that the disposition of the net gain proposed by Central Hudson be approved.

Dated: New York, New York
May 22, 2007

Respectfully submitted,

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