National Fuel

August 27, 2007

Via Hand-Delivery

Hon. William Bouteiller
Administrative Law Judge
New York State Public
Service Commission
Three Empire State Plaza
Albany, New York 12223-1350

Re: Case 07-G-0141 – Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of National Fuel Gas Distribution Corporation for Gas Service

Dear Judge Bouteiller:

Pursuant to the Ruling Establishing Case Schedule issued by Your Honor on April 18, 2007, and pertinent rules of procedure, National Fuel Gas Distribution Corporation submits an original and twenty-five (25) copies of the Reply Brief of National Fuel Gas Distribution Corporation for filing in the above proceeding.

Thank you for your attention to this matter.

Respectfully submitted,

Michael W. Reville

Michael W. Reville

cc: Secretary Brilling (25 copies)
Parties

Case 07-G-0141 – Proceeding on Motion of the Commission as to the rates, charges, rules and regulations of NATIONAL FUEL GAS DISTRIBUTION CORPORATION for gas service.	:	Before Hon. William Bouteiller Administrative Law Judge

REPLY BRIEF ON BEHALF OF
NATIONAL FUEL GAS DISTRIBUTION CORPORATION

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Dated: August 27, 2007
Buffalo, New York

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I. INTRODUCTION

National Fuel Gas Distribution Corporation ("Distribution" or "the Company") filed its initial brief on August 15, 2007. The Company received initial briefs from Department of Public Service Staff ("Staff"), the New York State Consumer Protection Board ("CPB"), Multiple Intervenors ("MI"), Direct Energy Services, LLC ("DES") and a letter in lieu of a brief from the New York State Energy Research and Development Authority "(NYSERDA").[1] In an effort to present as complete an exposition of the issues as possible, the Company filed a large and comprehensive brief. To that end, the Company's brief anticipated and addressed many of the claims that were raised in the initial briefs of the other parties. Consequently, the Company will not repeat its presentation on all subjects in this reply brief. Failure by the Company to address a given point in the initial brief of another party, therefore, should not be taken as acquiescence on Distribution's part to any such argument, but, rather, that our initial brief fully addressed that argument.

The Company's initial brief explained how this rate case will be decided in an era when infrastructure concerns are becoming paramount. It is an era when the need to keep and attract new investment into the State is becoming acute. It is also an era where the Commission must resist punitive ratemaking policies advocated by some and recognize

[1] Distribution's initial brief is referred to as Dist. IB, Staff's as "Staff IB", CPB's as "CPB IB", MI's as "MI IB", Direct Energy's as "DES IB" and NYSERDA's as "NYS IB."

that Distribution has achieved sizeable productivity gains in the recent past. With the volatility in fuel prices, these gains have clearly softened the shock felt by utility customers.

MI's brief, in particular encapsulates the punitive thinking that should be rejected by the Commission.[2]

MI, for example, claims that the Company should be allowed to earn only 8.85%. MI IB p. 20. This claim must be viewed in the context of the companies that MI purports to represent. MI contends that it represents approximately 50 large industrial, commercial and institutional energy consumers in the State. MI IB p. 1. One can only imagine the reaction that MI's industrial clients would have for a similar suggestion that they should earn a rate of return on equity that is below 9%.[3] Worse yet, imagine if they were told that they would earn such a return and still be required to invest an additional $40 million in New York State each and every year, as Distribution must do. Indeed, MI's claim that the Company should have rates set based on cost of equity in the 8% range is irreconcilable with MI's own observation that the Commission has recently "authorized utilities to impose rates that would accord them a reasonable opportunity to earn ROEs of between 9.55% and 9.8%." MI IB p. 3. MI does not even begin to explain why Distribution – a company with a demonstrated history of productivity achievements – should be punished with an equity return that is 100 basis points lower than that given to other New York utilities.

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[2] A significant proportion of this reply brief is addressed to MI's Initial Brief. This is not because MI's brief warrants special attention on the merits, but rather is because MI did not file testimony. Therefore, Distribution could not have anticipated any of MI's arguments in its initial brief.

[3] It matters little that Distribution is a regulated utility when MI's clients are not. While the distinction has some bearing on the issue, it is true nonetheless that they compete in the same capital markets.

MI then goes on to claim that Distribution's entire rate request is "questionable," because Distribution earned a return on equity of 11.05% in the 12 months ended September 2006. The Company's request is not rendered "questionable" by such unadjusted earnings. Ironically, MI is referring to unadjusted earnings for the very historical year that was presented in this case. Discussing unadjusted earnings for a period that is already a year in the past and which is set forth in detail in the Company's filing, with appropriate ratemaking adjustments is not reasonable. Moreover, MI should be familiar enough with ratemaking to understand that rates are being set for the 12 months ending December 2008 – a period that is two years and three months after the period MI finds so disturbing.

What MI fails to consider – and what is relevant - is how Distribution might have earned such a return. MI simply makes a bald allegation without the slightest effort to understand the facts. It is well known that Distribution has no customer growth. Moreover, it is equally well understood, perhaps even by MI, that Distribution's usage per residential and commercial customer is falling. Certainly, the Company's costs are rising. With declining sales and rising costs, how then could Distribution earn such a return on equity? What MI's blind criticism fails to comprehend is that Distribution earned such a return because its employees, and particularly, their management, learned to do more with less. All MI had to do was to read Staff witness Luthringer's testimony to understand the sizable productivity gains that allowed the Company to earn such a return. What MI sees as a bad thing, one who understands regulation would see as a good and laudable thing. For the savings that allowed shareholders to earn a rate of return on 11% also translate into savings for ratepayers into the future. In fact, the

Company's initial brief catalogued the productivity gains that Distribution has achieved over the years and the benefits that customers have gained from them. The Company's Operating and Maintenance ("O&M") and its delivery rates have not remained below the rate of inflation by magic.

Indeed, MI's contention that Distribution has been earning a return that is "well in excess of those being authorized by the Commission" is a tacit confession by MI that it fails to understand both the ratemaking process and the incentive regulation settlement regime that this Commission had pursued for more than a decade. MI was, in fact, a signatory of the Joint Proposal that was adopted by the Commission two years ago in Case 04-G-1047.[4] MI then advised the Commission that the Joint Proposal was reasonable and that its provisions fell within the range of outcomes that would have resulted if that case had been litigated. MI now, however, seems conveniently to have forgotten that the Joint Proposal contained an earnings sharing provision that provided Distribution would have to share earnings with its customers only if those earnings exceeded 11.5%. Furthermore, MI seems also to forget that Staff estimated that Distribution would earn only 9.4% to 10.4% over the two fiscal years ended September 30, 2007. 2005 Rate Order at 20. This means that earnings of 11% in the first of those two years is not relevant to the earnings that would be experienced over the totality of the two years. Second, and more important, if Distribution was provided with a rate plan under which it was expected to earn less than 11%, the fact that it bettered those earnings is a testimonial to the Company's productivity. The Company was permitted to earn up to 11.5% without sharing any earnings. It earned 11% when it was expected to earn

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[4] Case 04-G-1047, National Fuel Gas Distribution Corporation, Order Establishing Rates and Terms of Two-Year Rate Plan, issued July 22, 2005 ("2005 Rate Order" adopting "2005 Rate Plan").

about 10%. With shrinking revenue, the only answer to how those earnings occurred was the Company achieved productivity gains. In other words, the incentives built into the rate plan worked as they were supposed to.

As a harbinger of things to come, MI concocts footnote 4, in which it purports to show that there is “little doubt” the economy in Buffalo is very weak compared to the State as a whole. MI IB p. 4.

This becomes a pervasive theme in MI’s brief – an argument MI reaches for time and again to argue against any rate relief. The problem with MI’s blathering claim is that it is simply wrong[5].

MI cites statistics for the City of Buffalo. Distribution does not serve the City of Buffalo alone. Distribution does, however, serve all of Erie County. If, for example, one were to look at data for the larger area of Erie County compiled by the U.S. Census Bureau, one would see that the median household income of Erie County at $42,122 is almost identical to the State median household income of $45,343 – which includes the much more prosperous areas of Manhattan, Westchester and the Long Island counties. When the median value of owner occupied housing of approximately $90,000 in Erie County is compared to the approximate value of $150,000 in the state, it can be seen that Erie County is much more affordable than is the state, at large. Moreover, the U.S. Census Bureau data demonstrates that there are fewer people living below the poverty level in Erie County than in the state as a whole. If MI had deigned to make such a claim through a witness it could have been refuted on the record. The fact remains that

[5] Here, and in many other places, the absence of any witness sponsored by MI permits MI to make the most specious claims in its brief, immune from the rigors of cross-examination.

no issue in this case should be influenced by such extra-record material – all the more so when such a claim is so demonstrably misleading.

Finally, in the course of responding to the section on "UNCOLLECTIBLES" in Staff's initial brief (Staff IB pp. 33-34), the Company has discovered that Staff, perhaps unwittingly, has created a difficult problem with the record. In its brief, Staff claims that an adjustment of $9,409,000 must be made to uncollectible accounts expense. Staff IB p. 34. This came as a surprise to the Company inasmuch as Staff had explicitly advised the parties that it was presenting a new accounting exhibit, intended to replace Mr. Wojcinski's earlier exhibit, that eliminated this adjustment. When the Company discovered the matter, in an informal discussion it was advised by Staff that Staff was hewing to its original exhibit. The Company has since then learned through informal discussion that Staff's reply brief will acknowledge the issue and reflect Mr. Wojcinski's prior adjustment. This, at least, is Distribution's understanding, which is admittedly subject to a different interpretation insofar as the Company learned of the issue in the midst of drafting the instant brief, leaving little time for a full exposition of the matter. It is nonetheless something that concerns Distribution because, without the adjustment as promised by Staff, Distribution would be highly prejudiced.

On June 21, 2007, Staff sent an e-mail to the parties, copied to the ALJ, which presented Mr. Wojcinski's "Revised Exhibit (GRW-1)." That e-mail, and the revised exhibit accompanying it, is attached hereto as Appendix A. As explained below, that exhibit completely eliminated and corrected the incorrect adjustment of $9.409,000.

At the hearing, however, Staff apparently did not offer the revised exhibit but, instead introduced Mr. Wojcinski's original exhibit. This appears to have been an oversight because Staff counsel were well aware of the revision. In fact, at the hearing, Company counsel explicitly brought the matter of revisions to your Honor's attention and your Honor responded:

> I am aware of the modifications made. They were provided in advance to all parties. The parties have had an ample opportunity to inspect these changes. It's just for the creation of the record that we're trying to abbreviate the iterations of the prefiled testimony.

Tr. 1138. Parties were not aware of the content of the exhibits that Staff was proferring to the bench for admission. Staff's e-mail indicated that it was replacing Mr. Wojcinski's exhibit with a revised one. Because Staff did not advise the parties that its e-mail of June 21st was no longer operative, we assume that Staff's introduction of its earlier exhibit was the oversight that will be identified in Staff's reply brief.

This issue goes beyond the adjustment to uncollectibles. For example, Staff claims that Distribution's rates should be reduced by $19.3 million. Staff IB p. 1. Yet this proposed reduction appears in neither Mr. Wojcinski's original exhibit (GRW-1) or in his revision.

Furthermore, pursuant to the schedule set by your Honor Distribution's rebuttal testimony was due no June 28th. Staff presented the revised exhibit to the parties on June 21st. In reliance on Staff's revised exhibit, the Company abjured presenting rebuttal directed to Mr. Wojcinski's original exhibit. Therefore, because of Staff's oversight, Distribution was deprived of its right to rebut Staff's claims.

Without an adequate record an administrative proceeding is an exercise in futility. 300 Gramatan Ave. Associates v. State Div. of Human Rights, 45 N.Y.2d 176, 181 (1978)("In final analysis, substantial evidence consists of proof within the whole record of such quality and quantity as to generate conviction in and persuade a fair and detached fact finder that, from that proof as a premise, a conclusion or ultimate fact may be extracted reasonably -- probatively and logically.”). Distribution had a right to rely on Staff’s e-mail. If Staff was going to change its mind, it had a duty to so advise the parties. It appears now, however, that Staff will correct the oversight in its reply brief. Accordingly, Staff’s revised exhibit should be substituted for whatever exhibit Staff entered into the record as GW-1.

II. CONSERVATION INCENTIVE PROGRAM

A. The Spending Levels Proposed By The Company Are Appropriate.

Staff contends that the Company’s Conservation Incentive Program (“CIP”) spending should be capped at $10.8 million instead of the $12 million sought by Distribution. Staff IB p. 103. In Staff’s view, the 1.23% identified by its witnesses as the percentage of total revenue applied by the Commission to the electric system benefits charge in Case 05-M-0900 is appropriate. Staff, however, candidly concedes that the Commission increased that percentage to a level of 1.42% of total revenue in December 2005. Id. Staff argues that Distribution’s proposed $12 million level would constitute a level of 1.36% of the Company’s revenue. Id. Yet Staff goes on to contend that “the proposed annual CIP program spending should be comparable to the spending levels authorized by the Commission for the electric SBC during July 2006 to June 2011. Staff IB p. 104. That level, as Staff recognizes is 1.42% of total revenue. Case 05-M-0090, Order Continuing the Systems Benefits Charge (SBC) and the SBC-Funded Public Benefits Programs, issued December 21, 2005, p. 30, Ordering Clause 1. Therefore, based on existing SBC spending levels, the Company's proposed $12 million spending level is well within Staff's range.[6]

Lest there be any doubt as to MI's purpose, MI makes it clear: MI simply wants its clients excused from any responsibility to help pay for the CIP; if they are, MI has no real interest in the cost of the program. MI IB p 27. As MI's ability to achieve that goal is unclear, MI contents itself with playing the role of the spoiler. In a tortured exercise, explained by the fact that it offers no witness on the matter, MI attempts to show that the CIP cost should be reduced dramatically. MI succeeds only in demonstrating the futility of its effort.

The Company has presented a comprehensive program, where all the costs are documented and presented. Dist. IB pp. 9-17. In other words, the Company developed a comprehensive program and the costs were a consequence of that program – not vice versa. Playing games with numbers and using other proceedings that MI has failed to show are remotely comparable, MI pulls a recommendation of CIP funding out of its hat. The sheer futility of MI's effort is demonstrated by its claim that CIP funding should be "somewhere in the range of $5 million to $7 million." MI IB p. 35. Where in that range and what programs would be offered, MI cannot say.

A most obvious weakness of MI's presentation lies in its reliance on settlements. MI IB p. 30. It more than a little amusing that MI does so in light of its professed shock that anyone would dare rely on a settlement. MI IB p. 46. Consistency, apparently is not MI's strong suit.

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[6] Staff's argument that the current spending levels should be used may well be an error of drafting on Staff's part. Regardless, it makes little sense to fund gas conservation programs at a lower level than electric conservation programs are currently receiving.

In the realm of settlements, MI claims that the recent order adopting Keyspan's settlement establishing a gas efficiency program should be somehow controlling in limiting Distribution's CIP expenses because the Distribution's program is allegedly "excessive" when compared to Keyspan's expenditures and revenue. MI IB p. 30. If MI had only bothered to read the order approving the settlement, it would have seen that the conservation programs approved there were for an interim basis only, to have programs available for the coming winter. Cases 06-G-1185, 1186, The Brooklyn Union Gas Company d/b/a Keyspan Energy Delivery New York, et al., Order Authorizing Interim Gas Energy Efficiency Programs and Related Deferrals, issued July 18, 2007, p. 2 ("Keyspan Order"). MI would also have seen that after the interim period was over, Keyspan planned to double its spending. Keyspan Order, p. 8. Had MI read further it would have seen that other parties, including the Natural Resources Defense Council, proposed to treble spending in the upcoming consideration of a more permanent program for Keyspan. Keyspan Order, p. 9.

The Consolidated Edison conservation program cited by MI (MI IB p. 31-32) was a program tailored to that company and is to be administered by NYSERDA. Case 03-G-1671, Consolidated Edison Co. of NY, Inc., Order Establishing Gas Efficiency Program For 2007-2008 Heating Season, issued May 16, 2007. Consolidated Edison, of course, is a very different company from Distribution. Distribution has a much greater degree of gas heating saturation and Consolidated Edison has many, many more cooking-only customers with low levels of gas usage.

Even assuming, arguendo, that these cases might provide some guidance as to the appropriate funding level for Distribution's CIP, it can be easily demonstrated that MI's comparison to the funding levels of these three programs is extremely misleading in both its analysis and conclusion.

MI claims that the important comparison to make is the ratio of CIP costs to operating revenue. Such a comparison is completely irrelevant. The very different market characteristics between Distribution, on one hand, and these three companies, on the other hand, are incontestable. Indeed, a comparison of Distribution's market characteristics to the rest of the State was provided in Mr. Meinl's testimony. Perhaps the most telling difference is the high market share for natural gas heating in the counties of the state served by Distribution. Tr. 1637. Seventy-eight percent of the households in the counties served by Distribution utilize natural gas to heat their homes compared to 47% of the households in the remaining New York counties. Id. The implication of this is that a natural gas energy efficiency program for Distribution's territory will be almost twice as effective in delivering an energy efficiency message to residential households than in other parts of the State.

Because of this high market share, an energy efficiency program targeting Distribution's heating customers will reach most of the heating market in western New York. The need to emphasize energy efficiency for the remaining heating fuels will therefore be much less in the counties serviced by Distribution than in the other counties in the State.

Rather than use the ratio of operating revenues to program costs, a more meaningful comparison would be the number of heating customers by utility. Space heating needs of residential customers offer the greatest opportunity for energy efficiency savings for the residential customer class. The table below summarizes the number of space heating customers for Distribution and the three other LDCs cited in MI's brief.

Company	Residential Space Heating Customers[7]	Ratio of Distribution to Other Company (Customers)	Energy Efficiency Program Costs
Distribution	465,589		$12,000,000
Con Ed	248,997	1.87	$14,000,000
KEDNY	454,799	1.02	$10,000,000
KEDLI	329,527	1.41	$ 5,000,000

As can be seen from the table, Distribution has more residential heating customers than each of the other LDCs cited by MI, and more by a wide margin than two of the three. When considering this fact, it becomes evident that Distribution's proposed budget compared to the other LDCs is appropriate.

MI's argument (MI IB pp. 32-33) that Distribution's CIP should be constrained by the levels of earlier pilot programs for gas efficiency programs and the electric SBC rings hollow.[8] If MI's thinking were to be adopted, the learning of previous pilot programs would be discarded whenever an entity was embarking on a new conservation plan and that entity would be forced to re-plough the same field by commencing a pilot program of its own. MI's claims are not surprising, however, in light of the fact that its real purpose is to thwart the inception of any conservation program. MI's contention that the Commission should wait until the conclusion of the process in Case 07-M-0548[9] to design a program for Distribution should be seen for the delaying game it is. Under MI's

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[7] Source: Northeast Gas Association, see App. B..

[8] MI's contention that only 56% of Staff's ratio of 1.23% was allocated to energy efficiency (MI IB pp. 33-34) is yet another of MI's games with numbers. The order MI relies on was issued over six years ago. It has since been superseded. Moreover, the appendix that MI cites also refers to low income programs. Distribution's CIP includes low income programs. Case 94-E-0952, Order Addressing Petitions For Clarification And/Or Rehearing and Adjusting SBC Budgets, issued July 3, 2001, App. C.

[9] Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard, Order Instituting Proceeding (issued May 16, 2007).

scenario, we should just wait for the result of one generic collaborative process in order to begin anew a collaborative process to design a program for Distribution. All of this, according to MI, should happen notwithstanding the fact that Distribution has a plan that was proposed in January of this year. If MI had constructive criticism of the Company's CIP, it had only to offer a witness to advance that criticism. It did not.

Furthermore, MI conspicuously avoids the fact that two of the orders it cites, Keyspan and Consolidated Edison, involved approval of proposed conservation programs in order to get them in place as soon as possible. It is more than a little ironic that the very orders MI cites stand diametrically opposed to MI's claim that the Commission should wait and talk, not implement and fine tune. The CIP that the Company has proposed is consistent with the policy initiatives, not only of this Commission, but of the U. S. Department of Energy and Environmental Protection Agency (Tr. 1643), the National Association of Regulatory Utility Commissioners (Tr. 1645) and the American Gas Association (Tr. 1645), not to mention many state regulatory commissions. Distribution's customers deserve conservation. MI offers only conversation. MI's obstructionist stance should be seen for what it is and be disregarded entirely.

B. <u>SC 13 Customers Should Pay for a Portion of the CIP.</u>

MI's argument that Service Classification ("SC") 13 customers should not pay a penny toward the CIP boils down to a simple claim that, because those customers are not included in the CIP, they should not pay for the costs of the program. MI IB pp. 54-55. MI would have the Commission adopt a very restrictive analysis that ignores the larger societal good. If conservation is warranted because it reduces pollution, improves the general economy and reduces the cost of energy generally, MI simply cannot contend that larger customers will not enjoy those benefits. Therefore, MI's claim that it is somehow inequitable for larger customers to pay a share of the CIP rings hollow.

In an effort to demonstrate that large customers should not be allocated any costs of the CIP because they will not receive any benefits, MI claims that well-head prices will not be affected by conservation programs. MI IB p. 57. In support of this claim, MI points to a response that the Company gave to an MI interrogatory. MI claims (MI IB p. 57) that:

> Indeed, NFG acknowledged that 'it is doubtful that energy efficiency gains achieved solely on the Company's system would have a material impact on the American natural gas market.' citing Ex. 24, MI-56.

MI, however, misapplies this quote in its attempt to use it to justify no allocation of CIP costs to large customers. The materiality quote cited by MI is a reference to the impact on natural gas prices from the effect of energy efficiency gains <u>solely</u> from any energy efficiency gains resulting from reduced consumption on <u>Distribution's</u> system. Tr. 1650. Materiality is a relative term. Mr. Meinl was very careful to point out, that although the effect of conservation from Distribution's system alone would not likely have much of an impact on the U.S. natural gas market, the cumulative effect of Distribution's efforts and those of other LDCs could be profound. <u>Id.</u> Moreover, what is a material change in price when applied to individual customer classes will differ from class to class due to differences in cost allocation and volumes. In other words the same change in natural gas market prices may be material to large volume customers but immaterial to small volume customers relative to costs to achieve that result. The table below will demonstrate this.

Assumed % Price Impact from Energy Efficiency	Change in Gas Cost Based on Assumed Price in Case of $10.30/Mcf **	Average Large Customer Savings from Gas Cost Change ***	Average Large Industrial Customer Annual Return on CIP Charge ****
A	B = A x $10.30	C = B x 350,000 Mcf	D = (C - $3083)/$3083
11.7% ACEEE High (Tr. 1649)	$1.21	$423,500	13,613%
4.4% ACEEE Low (Tr. 1649)	$0.45	$157,500	5,009%
1.0%	$0.10	$35,000	1,035%
0.5%	$0.05	$17,500	468%
0.3% *	$0.03	$10,500	240%
0.1%	$0.01	$3,500	14%

* This is the percentage of Distribution's small volume natural gas market to the U.S. natural gas market.
0.3% = 65.15 Bcf/ 31,821 Bcf.
65.15 BCF is the sum of SC 1, SC 2, SC 2A and SC 3 consumption from Exhibit 45, TJC-6, Schedule 2, Page 1.
21,821 Bcf U.S. Natural Gas Consumption, Energy Information Administration, Monthly Energy Review July 2007, Page 73.
http://www.eia.doe.gov/emeu/mer/pdf/pages/sec4_3.pdf

** Exhibit 45, TJC-12, Schedule 2, Page 5.

*** Average customer TC 4.0 Class consumption of 350,000 Mcf.
Exhibit 45, TJC-6, Schedule 2, Page 1.

**** Exhibit 67, EHM-11, Schedule 3, Sheet 1
$3083 = Proposed TC 4.0 monthly CIP charge of $256.90 x 12 months.

Unlike the large volume customer classes that may achieve a staggeringly high 240% return on its CIP charge investment merely from a percentage change in natural gas charges proportionate to Distribution's percentage of the national natural gas market, residential customers would likely need the impact of a coordinated national effort for the potential market price savings to fully cover their CIP costs.[10]

[10] The percentage change in natural gas prices required to offset fully the annual CIP costs proposed to be allocated to the residential class is approximately 1%.
1% = annual residential CIP costs of $9.60 divided by annual natural gas costs of $1,102.
$9.60 = residential monthly CIP costs of $0.80 (Exhibit 67, EHM-11, Schedule 3, Sheet 1) x 12.
$1,102 = approximate residential consumption per account of 107 Mcf x $10.30/Mcf average natural gas supply cost.

These results are consistent with the observation made in the ACEEE study cited by Mr. Meinl. Tr. 1649-1650.

Page vi of the Executive Summary of that ACEEE report states:

> It is important to note that while efficiency investments are made in the industrial sector, total industrial gas consumption increases as a result of increases in industrial activity made possible by the lower gas prices – the avoiding of natural gas 'demand destruction' that translates into plant layoffs and closures.[11]

The record demonstrates that MI's claim that large volume customers will receive no benefit from the CIP is inaccurate. As the above quote from the ACEEE report demonstrates, a compelling argument can be made that they have the most to gain from energy efficiency programs. Indeed, MI acts like the other farm animals in the classic fable *The Little Red Hen*,[12] content to reap the benefits resulting from the action of others while providing no effort in making those benefits come about. It is doubtful that MI would agree to forego the price declines that its clients will enjoy from energy efficiency gains achieved through efforts of these other classes. Fairness dictates that MI's customers should pay cost of the programs that will lead to those declines.

MI also plays loose with the facts when it cites to Mr. Eck's cross-examination to support MI's claim that all of the energy conservation consulting services that Distribution provides to its larger customers have the function of increasing gas consumption. Mr. Eck was careful to point out to MI's counsel that, in every instance, while gas consumption might increase, the customer's overall energy efficiency increased. Tr. 990-991. Furthermore, Mr. Eck explained that natural gas equipment is far more efficient at the point of use than is electricity in many applications. Tr. 961.

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11 April 2005; American Council for an Energy-Efficient Economy; *Impacts of Energy Efficiency and Renewable Energy on Natural Gas Markets;* Report No E052; p. vi., www.aceee.org.

12 www.en.wikipedia.org/wiki/The_Little_Red_Hen.

Therefore, when a large customer uses efficient gas equipment to replace an electric application, society benefits in the form of cleaner air and less overall energy use. Id.

MI's claim that SC 13 customers also should escape any responsibility for CIP costs because they are bypass threats (MI IB p. 55) is another example of MI's penchant for exaggeration. Mr. Eck explained quite clearly that customers that are at risk for bypass are able to take advantage of Distribution's flexibly priced transportation service. Tr. 949. In this way, the Company is able to offer a rate that is competitive with the potential bypass. Id. MI's protestations of unfair treatment notwithstanding, smaller customers do not have a comparable flex down rate.

MI's request to avoid a reasonable allocation of CIP costs should be denied.

C. NYSERDA'S Proposal Should Be Rejected.

NYSERDA, like MI, failed to offer a witness in this proceeding. NYSERDA, nevertheless, asserts that" the record adequately demonstrates that NYSERDA has existing natural gas EE programs that could immediately operate in NFG's territory." NYS IB p. 3-4. This is hardly the case. NYSERDA's sole support for this is its cross-examination of Dr. Elfner. Tr. 618-620.) Dr. Elfner stated: "I am not familiar with the full slate of NYSERDA programs targeted solely to gas users." Tr. 619 That cross-examination does not establish the existence of any programs, their applicability to Distribution or their effectiveness.

NYSERDA next asserts that ratepayers and customers of NFG would "benefit from an EE program that was approved by the PSC, upon the design and agreement by a collaborative effort." NYS IB p. 2. Distribution does not have any reticence about talking with NYSERDA or any other party about how its program can be improved in the future. Mr. Meinl stated this explicitly and agreed with Dr. Elfner's proposals to work collaboratively. Tr. 1692. But such talks must follow approval of the CIP.

NYSERDA ultimately recommends "the Commission not approve the CIP as proposed, but rather issue an Order that requests NFG, NYSERDA and other interested parties to initiate collaborative discussions to create and begin implementation of a cost-effective [program]." NYS IB p. 4. This recommendation should not be adopted. NYSERDA had every opportunity to submit a witness to recommend changes to the CIP or to propose a different program altogether. It chose not to do so. The CIP should be adopted as proposed. NYSERDA can have another chance to play a constructive role when that program is reviewed and fine-tuned into the future.

IV. REVENUE ISSUES

A. State Income Tax.

The Company's initial brief explained in detail why Staff witness Wojcinski's proposed base rate reduction of $4.1 million to reflect State Income Tax ("SIT") overcollections was bad policy and worse ratemaking. Dist IB pp. 19-20. Staff recommends that any SIT overcollections remaining after the base rate reduction should be transferred to the Cost Mitigation Reserve ("CMR") account to be used for Staff's various recommendations in this case. Staff IB p. 26. Staff's CMR proposal demonstrates the inherent unreasonableness of Mr. Wojcinski's base rate proposal.

Under the Company's proposal, customers will see the SIT overcollections either refunded via a bill credit or applied to reduce the impact of CIP costs on customers. Tr. 1550. Under Mr. Wojcinski's proposal, dollars will sit in the CMR until Staff decides a use for them. The Company's proposal is a much more efficient and responsible means of giving the overcollections back to customers in a timely fashion.

B. Late Payment Charges – Uncollectible Effect.

The Company has demonstrated that Staff's proposed reduction of uncollectible accounts expense by $4,250,000 to reflect the cessation of late payment charges ("LPCs") on deferred payment agreements ("DPAs) is wrong for two reasons: 1) LPCs are lawfully imposed on DPAs and therefore the adjustment is baseless and 2) such a change is grossly overstated and would not even be reflected in the Rate Year. Dist. IB pp. 58-59.

Staff, recognizing that its proposed adjustment was miscalculated, now seeks to rescue it with some last minute legerdemain.

The record firmly establishes that, even if LPCs were to be eliminated, none of the LPCs related to DPAs would show up as uncollectible accounts expense in the Rate Year. After the end of the Rate Year, only a small fraction of uncollectible expense would be affected if LPCs could no longer be collected in DPAs. Ms. Truitt showed that only 12% of LPCs on DPAs were written off, and of that amount, 15% to 20% were subsequently recovered after write-off. Tr. 1558-1559. Therefore, she demonstrated that uncollectible accounts expense would only be affected by 10% of the LPCs. Tr. 1559. Staff now claims in its brief that it "believes this percentage is low, and that the future payment behavior of customers who will no longer be required to remit late payment charges on deferred payment agreements is unpredictable and unknown." Staff IB p. 67.

This claim suffers from two glaring infirmities. First, Staff is trying to convey new evidence. The place to do so would have been on the record. A brief is not the vehicle to present evidence. Hussman v. Durham, 165 U.S. 144, 150 (1897) ("We cannot, of course, take the intimation of counsel in the brief as evidence of a fact not appearing on the record"). Second, Staff is not even proposing evidence. It is merely offering a guess. Surmise, conjecture and speculation have no place in the ratemaking. Soto v. New York City Tr. Auth., 6 N.Y.3d 487, 494 (2006).

Based entirely on a guess that Ms. Truitt's estimate of the percentage of LPCs that would be written off might be wrong and should be increased, Staff abandons its discredited $4,250,000 adjustment and now recommends half of that 50% adjustment to the LPC charges. Staff IB p. 67. This is no more reliable than Staff's earlier claim. Ms. Truitt offered evidence. Staff offers conjecture. If Staff had a basis to contest Ms. Truitt's calculations, the place to do so was on cross-examination of her rebuttal testimony. Staff's abject failure to do so demonstrates the emptiness of its claim.

Staff next argues that any difference between Staff's estimate and the actual write-off should be recovered from the CMR or deferred until the next rate case. Staff IB p. 67. Again, this proposal was not presented on the record. If Staff is serious, perhaps Staff should have proposed a true-up of the Company's entire uncollectible accounts expense.

Finally, Staff does not even try to dispute the Company's demonstration that, even if LPCs were prohibited on DPAs, the first time the effect would begin to appear would be after the Rate Year had expired. Staff IB pp 67-68. Instead, Staff claims that "regardless… a mechanism for this determination must be established." Staff IB, p 68.[13] Presumably the "this" is Staff's proposed reconciliation mechanism. Again, if Staff is proposing a true-up, it should propose a true-up for the entire uncollectible accounts

[13] It is interesting that Staff sees a need to reflect an LPC effect that might arise after the Rate Year when it had no similar qualms about the rate deficiency that would arise when SIT credits would be used up at the conclusion of the Rate Year.

expense. In any event, it is plain for all to see that Staff concedes its uncollectible accounts adjustment for LPCs on DPAs is lost.

IV. EXPENSE AND RATE BASE ISSUES

A. Site Investigation And Remediation.

1. Staff's Proposed Treatment of SIR Costs is Demonstrably Unreasonable.

The dispute over a proper allocation of insurance proceeds for site investigation and remediation ("SIR") expenditures has received a great deal of attention, as it should. Four parties briefed the issue: Distribution (Dist. IB pp. 24-45); Staff (Staff IB pp. 34-41); CPB (CPB IB pp. 5-8); and MI (MI IB pp. 42-48). Most of the issues raised by these parties were already addressed in Distribution's initial brief, and need no further attention here. However, perhaps because of the great amount of information and argument that has been generated on SIR, the parties' briefs indicate that there remain a few important misunderstandings of fact, some material to the outcome of the debate.

At the outset, there appears to be a misunderstanding, on the part of the briefing parties, of the appropriate standard of care to apply to Distribution's actions, and at what point to apply that standard. This is best illustrated by CPB's odd statement that the reasonableness of the Company's 1999 decision regarding allocation of the proceeds is "irrelevant" to the issue at hand. CPB IB p. 6. MI, too, is uncertain as to the appropriate standard, suggesting that the Company should be held to a standard of "optimal" behavior. MI IB p. 43.

Staff, for its part, believes that the Company is to be held to a standard that requires the "ideal" choice of allocation methodologies, Tr. 1287, or if not that, then any standard that benefits Distribution's ratepayers the most. Tr. 1322.

Layered over the SIR issue is a contentious dispute over access to the 1996 report prepared by consultants hired by counsel for National. (the "IES Report"). Distribution has resisted production of the IES Report because it is privileged. Judge Bouteiller agreed with Distribution and so ruled. Case 07-G-0141, Ruling Concerning Staff's Request for a National Fuel Gas Document (issued July 17, 2007) ("Ruling"). Staff has appealed the Ruling to the Commission, where the matter remains pending as of this writing. In its brief, Staff criticizes Distribution's effort to protect the document and avoid waiver of the privilege. This is also discussed below.

2. <u>The Company's Allocation Methodology Did Not Favor Unregulated Subsidiaries.</u>

CPB errs significantly when it claims, "the benefit of shifting cost responsibility from unregulated to regulated subsidiaries is the elephant in the corner of the room that cannot be ignored." CPB IB p. 6. While there was some liability expected for the unregulated subsidiaries, the Company stipulated that, after Distribution, all of the claims in the IES Report were for Distribution Pennsylvania ("PA") and for National Fuel Gas Supply Corporation ("Supply"). Ruling p. 3; Tr. 1606. Both are regulated entities with SIR responsibilities of their own. Both were entitled to a share of the insurance proceeds. Both have to answer to regulatory agencies for environmental liabilities. Both might have incurred SIR costs well in excess of their respective allocations.

The amount of insurance proceeds allocated to Distribution's <u>unregulated</u> affiliates was $2.7 million, or only 7.5% of the total amount available under the settlements. Exh. 65 (RLT-10, Schedule 2, p. 5 of 29). The other $34.3 million went to the <u>regulated</u> subsidiaries, demonstrating that the Company's allocation methodology was <u>not</u> designed to shift insurance proceeds to unregulated affiliates, as CPB believes.

This is no minor mistake of fact on the part of CPB. It undermines CPB's argument completely: If there is an "incentive to allocate as much of the insurance proceeds received as possible to unregulated subsidiaries," as CPB warns, National failed to act on it. Instead National allocated the vast bulk of insurance proceeds to the regulated entities, where, as with Distribution, SIR expense is a legitimate and recoverable cost of business. See, e.g. Trunkline Gas Company, 90 F.E.R.C.¶61,017, 61,062 (2000) ("it is the [F.E.R.C.'s] policy to encourage [environmental clean up] efforts"); Case R-00049255 et al., PPL Electric Utilities Corporation, Opinion and Order (entered December 22, 2004) (Pennsylvania P.U.C. granting recovery of deferred MGP clean-up costs).

CPB's argument actually highlights the fact that despite what CPB sees as incentives for nefarious allocations, National stuck with the premiums-based allocation methodology, and allocated almost all of the proceeds to the regulated entities with SIR liabilities. This point is important because it reveals the dilemma that faced National with respect to the insurance proceeds. With three sizable regulated entities (Distribution, PA and Supply) facing potential and actual environmental liabilities, National needed to develop an allocation methodology that protected each subsidiary's share of insurance proceeds against confiscation by another. Tr. 1566. And obviously, National needed an allocation methodology that would pass muster with all three regulators, and not just one.

What CPB seems to be suggesting is that National should have adopted a policy that was based first on allocations but then it should have changed that policy when Distribution began experiencing greater levels of claims. This is clearly the same as

Staff's "heads I win, tails you lose" approach that is tailored to give unfair advantage to New York ratepayers. Whatever this is, it is not a policy. At best, it is an ad hoc approach under which New York ratepayers will always come out best. See Dist. IB p. 36. In fact, one wonders what CPB would have replied if, midstream when Distribution did begin submitting most of the claims, the policy was changed to a claims-based method - only to have the Pennsylvania division immediately submit a $25 million claim, consuming the balance of the settlement proceeds.

It is seductively easy to second-guess National's allocation method now, after all of the facts that were unavailable to National are now established. But the outcome-based analysis advocated by CPB, MI and Staff overlooks the irrefutable fact that Distribution's customers received substantial value precisely because National chose a method that "locked in" Distribution's $17 million share.

In this regard, the premiums-based methodology can be analogized to a hedging program. The Commission requires gas utilities to hedge a portion of gas purchases to protect against the price volatility that is characteristic of wholesale gas markets. See, e.g., Case 97-G-0600, Order Requiring the Filing of Proposals to Ameliorate Gas Price Volatility and Requesting Comments (issued June 5, 1997). This was explained by Distribution in prefiled testimony, (Tr. 1467-68), and was not addressed in brief or on cross by any party:

> If current market prices [for natural gas] fall below the hedged price, consumers arguably lose the benefit of those lower prices, but they maintain the benefit of known and certain prices protected by the hedge. Absent the hedge, however, consumers would be subjected to the greater risk of unknown, future market price increases. Thus, the utility sacrifices occasionally lower market prices for the benefit of price certainty occasioned by hedges.

> When confronted with the risk of uncertain SIR liabilities facing a number of NFG companies, National adopted a methodology for allocation of insurance proceeds that "locked in" Distribution's share and protected it from claims by other subsidiaries.

As with a gas hedging program, the fact that SIR expenses might have wound up higher than Distribution's share is beside the point. Distribution's customers received value in the form of an assured allocation of $17 million, something that Mr. Luthringer's claims-based or expenditures-based methodologies would not have been able to provide in 1999.

National believed that the premiums-paid methodology struck a balance among the three regulated entities and the unregulated entities who also paid premiums precisely because it protected each subsidiary's share, and was grounded in the rational concept that each subsidiary that paid value deserved to receive value. It effectively balanced the uncertainty associated with the potential claims among all regulated subsidiaries. Because the total potential liability for each of the regulated entities exceeded the proceeds available under the insurance settlements, none of the alternative allocation methodologies – whether on the basis of claims, expenditures, or proportion of estimated liabilities – was fair to all of the subsidiaries. The <u>only</u> allocation methodology that <u>assured</u> an allocation for each regulated affiliate was the premiums-based methodology. Every other allocation method was a gamble.

3. <u>The Parties Admit That The Company's Method Was Reasonable.</u>

In its initial brief, Distribution argues that the SIR issue boils down to a determination of whether the decision to allocate on the basis of premiums paid was reasonable at the time the decision was made. CPB, oddly, says that the reasonableness of the Company's decision is irrelevant. CPB IB p. 6. This assertion, which was accompanied by no support,[14] may be the result of CPB's mistaken belief that National funneled vast sums of insurance proceeds to unregulated affiliates. National did no such thing, as explained above.

Fundamentally, the standard that governs the actions of Distribution, or in this instance National, is reasonableness. Missouri ex rel. Southwestern Bell Tel. Co. v. Public Service Com., 262 U.S. 276, 288-89 (1923); Pub. Serv. L. §66(12); Case 27869, Consolidated Edison Co. of N.Y., Inc., Opinion No. 82-2, 22 NYPSC 98, 106 (issued January 21, 1982).[15] This is not "irrelevant" to the Commission's analysis, it is the analysis. Neither the parties nor the Commission can replace the Company's reasonable decisions with a new decision based on hindsight. The question is not complicated: Whether it was reasonable for National to have allocated $17 million of insurance settlement proceeds to Distribution, and the balance of the total to Distribution's affiliates – overwhelmingly the regulated affiliates with their own SIR liabilities – based on the information known by National at the time the decision was made.

As it happens, CPB and MI admit that National's decision was reasonable. Despite a barrage of litigation rhetoric, the evidence suggests that Staff, too, believed that National's decision was reasonable based on the circumstances obtained at the time.

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[14] CPB says that the reasonableness standard is "irrelevant" because "it should not be necessary for ratepayers to postulate, much less prove, the existence of bad faith or a conspiracy in order to raise an issue of inappropriate allocation." CPB IB p. 6. This reasoning is unavailing. The utility's demonstration of reasonableness, by definition, would mean the absence of bad faith or conspiracy.

[15] It is possible that Distribution's standard of care with respect to insurance allocations is even lower than the reasonableness standard in Consolidated Edison. The reasonableness standard is a high standard of care that, in New York, has been applied in circumstances involving the "serious risks and economic consequences associated with the operation of a nuclear plant." Consolidated Edison, 22 NYPSC p. 107. In circumstances where such risks "associated with the operation of a nuclear plant" are not attendant, a lower standard of "rational basis" obtained. Case 22815, Consolidated Edison Company of New York, Inc., 4 NYPSC 129 (212-13) 1964 (cited in 22 NYPSC pp. 105-06).

In a concession, CPB states directly that the "the use of a pre-determined allocation factor did afford some protection for ratepayers against the possibility that much or all of the coverage afforded by the Aegis policy could have been exhausted by claims from the unregulated subsidiaries." CPB IB p. 7. Here, too, CPB gets it wrong about the share allocated to unregulated companies – by far, most of the proceeds went to regulated companies – but CPB gets it right about the protective aspect of the allocation procedure. This is an admission that the Company's decision, based on the circumstances that obtained at the time, was reasonable.

MI says that "the allocation methodology for SIR insurance proceeds adopted by NFG Parent was not optimal, and arguably was not even reasonable." MI IB p. 43. This, despite MI's bombast, is an admission that the Company's chosen methodology was arguably reasonable.

Staff argues at length that looking back through the lens of currently known information, National's allocation decision was unreasonable. The facts, however, suggest that Staff thought otherwise prior to the evolution of its litigation position in this case. Mr. Luthringer "admits that he was aware of the approximately $16.1 million total company SIR [non-Aegis] settlement, and that Distribution's allocated share of this settlement was approximately $8.4 million." He also was "aware that these settlement proceeds were being allocated to NFG subsidiaries based on past premiums paid." Exh. 23, Dist.- RTA 2. So Mr. Luthringer was informed of National's allocation methodology seven years ago, and since that time, not once did he assert that it was unreasonable.

Mr. Luthringer admitted under cross-examination that the premiums-based allocation would have protected Distribution's share of proceeds had any affiliates' SIR costs exceeded that affiliate's. Tr. 1322. It is also established that, when the allocation was established in 1999, Distribution was not the only subsidiary that might have incurred SIR costs that exceeded the total value of the insurance settlements. Tr. 1573.

The totality of the evidence in this case leads to the inescapable conclusion that Mr. Luthringer and his colleagues involved in the SIR Review believed that National's allocation methodology was reasonable based on the information known to National at the time. Whether National should have changed its mind and adopted a different allocation methodology after SIR expenses became known is not the issue here. The appropriate question for this analysis is whether the decision was "reasonable at the time, considering that the company had to solve its problems prospectively, without the benefit of hindsight." Case 27869, Consolidated Edison Company, Opinion No. 82-2; 22 NYPSC 98, 106 (issued January 21, 1982).

4. Distribution Does Not Claim That Staff's Knowledge Of SIR Is Imputed To Or Binding On The Commission.

Completely missing the point, MI argues at length about the elemental fact that Staff does not bind the Commission. MI IB pp. 42-43, 45-47. Nowhere does Distribution state or suggest that the Commission is bound by Mr. Luthringer's knowledge of Distribution's SIR activities, or the findings, opinions, actions or inactions of Mr. Luthringer and his colleagues who conducted the SIR Review. Dist. IB pp. 32-33. MI seems to think that this line of argument, a born loser if there ever was one, forms part of Distribution's position on SIR. It does not, and Distribution said so in its initial brief. Id. MI is trying to create an issue where one does not exist.

This does not mean, however, that the issue of Staff's involvement in the SIR insurance matter since 2000 has no relevance or is immaterial. Staff is not mere ornamentation, as MI apparently believes, whose function ought not be ascribed serious meaning by a regulated company. To the contrary, Distribution is acutely aware of Staff's investigatory powers, which derive not only from the Commission but also are expressly articulated in the Public Service Law. Pub. Serv. L. §§66(3); 66(8); 66(11); 66(19); 71; 72. Staff auditors, two[16] of which are assigned permanently to Distribution, regularly perform analyses, reviews and informal audits of the Company's functional areas. They routinely submit testimony against Distribution in rate proceedings, including this one. Distribution assigns significant meaning to the actions, opinions and inactions of Staff in its ordinary investigatory role, and even more meaning when Staff goes beyond its day-to-day routine as it did when it conducted the SIR Review.

It is precisely for these reasons that Distribution regarded Staff's SIR Review, and Staff's acquiescence following the SIR Review, as bearing significantly on the reasonableness of the allocation methodology that was adopted in 1999 and applied, with notice to Staff, for a period of more than seven years. Stated otherwise, given what Staff knew (or, perhaps, what Distribution reasonably thought Staff knew), it was inconceivable to Distribution that Staff would acquiesce in silence if Staff believed the Company's allocation methodology were as odious as Mr. Luthringer describes it today.

Again, Distribution is not suggesting that the Commission is bound by Staff's informed acquiescence or complicity in the Company's SIR decisions. See Exh. 23 (Dist. 54); Tr. 1318-1319. Instead, the actions of Staff, through its permanently assigned auditors and others on the SIR Review team, were factors relied upon by National to confirm the reasonableness of its decision to allocate SIR proceeds on the basis of premiums paid. Tr. 1575-1582. While it is true that Distribution may rely at its peril on

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[16] The two auditors are Messrs. Luthringer and Wojcinski.

the actions and advice of Staff on matters of regulatory import, the fact remains that this is how business is routinely conducted by every utility in the State. MI's alternative – that utilities seek formal Commission approval through a declaratory order or other formal means – would impose an unmanageable level of administrative burden on the Commission, and be tantamount to institutionalizing a process of replacing utility business judgment with that of the regulator's. Worse, it is ridiculous in the extreme to suggest, as MI does, that National's SIR allocation methodology is presumptively suspect because the Company did not file a petition for declaratory order or seek further guidance from Staff. MI IB pp. 46-47.[17]

Staff does not bind the Commission. But the outcome of the SIR Review helped to justify the Company's belief that National's decision to allocate SIR proceeds on the basis of premiums paid was reasonable.

5. CPB's Further Contentions are Unavailing

CPB contends further that National, armed with the knowledge that 64% of potential SIR liabilities were attributed to Distribution, should have allocated more than it did to Distribution. CPB IB p. 7. CPB makes this point to support Mr. Luthringer's expenditures-based adjustment, which retroactively allocates 85% to Distribution.

Mr. Luthringer's 85% allocation is hardly supported by the Company's stipulation that the IES Report allocated 64% of estimated potential SIR liabilities (as of 1996) to Distribution. The Company's stipulation undermines Mr. Luthringer's adjustment for the simple reason that 64% is less than Mr. Luthringer's 85%. But National's 1999 decision

[17] MI's contention that Distribution was remiss in not seeking advance approval of insurance proceeds allocation cannot even be reconciled with Mr. Wojcinski's rejection of the idea that Distribution should have sought advance approval of another accounting decision – the pension contribution. Tr. 1388-1389.

to allocate on the basis of premiums necessarily was based on more than a simple look at the allocation of estimated liabilities in the IES Report. Dist. IB p. 33-36.

CPB's contention suffers from the same weakness as the other briefing parties' complaints about insurance allocations insofar as it is, again, a hindsight analysis. While it is true that National knew, in 1996, that 64% of potential liabilities were attributed to Distribution, as provided in the IES Report, National knew nothing of when SIR costs would be incurred, by which subsidiary, and in what amount. What National did know, however, was that any of the three regulated subsidiaries with SIR liabilities could individually have consumed 100% of the available insurance proceeds. Tr. 1581; Dist. IB p. 33. If National had allocated 64% of the insurance proceeds to Distribution on the basis of the IES Report's estimates,[18] Distribution's regulated affiliates might have been substantially shortchanged, given that the liability estimates for both of them were extremely high.

Perhaps CPB's proposed allocation method is no better or worse than National's. But the point is not that National was required to choose the method that ten years later would be recognized as best for Distribution. The briefing parties themselves essentially admit that National's allocation method, while not <u>best</u> for Distribution, was reasonable, and that is where the analysis should end. It is only looking back today, when all the facts are in, that these parties can say that National should have done a better job at predicting the future, or should have shifted proceeds from Supply or Distribution PA to

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[18] The IES Report was prepared to facilitate settlement discussions. Tr. 1565-66. It was not prepared for the purpose of informing National on an appropriate methodology for allocating insurance proceeds. Obviously, National considered many factors into its decision, including the risk that any of three regulators – the New York Public Service Commission, Pennsylvania Public Utility Commission and Federal Energy Regulatory Commission would disagree with an allocation methodology that favored one regulated subsidiary over another.

Distribution. They would not have said the same in 1999, or at any time when Distribution's affiliates might have incurred SIR costs that exceeded the remainder of the insurance proceeds. That is why National's allocation method was reasonable.

6. Neither Staff Nor the Commission Need the IES Report to Perform The Necessary Analysis.

Staff includes a section in its brief entitled "Appropriate Information Has Not Been Forthcoming." Staff IB pp. 38. In that section, Staff argues that it needs access to the IES Report in order to make an informed decision about the SIR insurance issue. MI rightly identifies Staff's contention regarding access to the IES Report as nothing more than a red herring. MI IB pp. 47, n. 64. Judge Bouteiller already ruled that Staff could get the information it needs through the alternate means provided by Distribution, or otherwise through Judge Bouteiller. Ruling pp. 3-4. It is becoming apparent that this is a manufactured issue.

Staff's stated concern about the IES Report arises from the Company's stipulation that 64% of the potential liabilities identified by the consultant are attributed to Distribution. Staff IB pp. 38-39. See Dist. IB pp. 34-35. This proportion is deeply disturbing to Staff because it is less than Staff's preferred allocation of 85%, which is based on expenditures. Id. It is, however, more than the allocation applied by National, which is based on premiums paid. Dist. IB pp. 29-30.

Staff raises new arguments to support its continuing quest for access to the document. Staff believes that $71 million of estimated liabilities allocated to Supply are overstated because Supply's actual SIR expenses through August 15, 2006 were only

$1.8 million. Staff IB pp. 39.[19] Staff is also suggesting, for the first time, that the substance of the report needs to be audited by Staff. Id. That is, Staff wants to replace the professional judgment of the consultant who prepared the report in 1996 with its own opinions regarding the validity of the estimates. The objective of Staff's efforts is to find more support to bolster its 85% adjustment, and maybe even increase the allocation. Staff IB pp. 39.

There is no basis for Staff's criticism of the estimates in the IES Report.[20] The IES Report was developed for the purpose of facilitating settlement discussions with National's insurers. Tr. 1565-66. The consultant estimated the potential liabilities faced by Distribution and its affiliates, based on known information in 1996, when the document was completed. Performing an audit today of the consultant's findings in 1996, and using that "audit" for the purposes sought by Staff would be manifestly unfair to Distribution because Staff would have the advantage of hindsight, which was obviously not available to the consultant in 1996.

It is also beside the point. The proper analysis is whether National's decision to allocate on the basis of premiums was reasonable when it was made in 1999, given what National knew then, and given what National believed might happen prospectively. National's decision was admittedly based on an educated guess – educated in part by the contents of the IES Report – that any one of the three largest subsidiaries facing SIR liabilities might submit a claim that would consume 100% of the insurance settlement

19 This information was disclosed to Staff when the Company filed its rebuttal testimony. Tr. 1573. It is not clear why Staff waited until its initial brief to argue that the information was relevant to its need for disclosure of the IES Report.

20 The same criticism can be applied to the IES Report's estimate of Distribution's share. Through August 2006 Distribution incurred approximately $27 million in SIR expenses. Tr. 1290. Using Staff's logic, this, too, equates poorly to Distribution's liability estimate of more than $200 million.

proceeds. To protect against that result, National adopted the premiums-based allocation methodology.

B. The Debit Balance of the Pension Internal Reserve Merits Rate Base Inclusion.

1. The Company's Actions Were Reasonable.

Distribution does not disagree with Staff's observation that, generally, companies will not deposit more in the external pension fund than they receive in rates. Staff IB p. 27. On the other hand, as Staff's brief explicitly recognizes, there may be periods where a company might be required to fund the pension above the rate allowance. In such cases, the company has the opportunity to demonstrate that this was a prudent course of action. Staff IB p. 27. The Company has demonstrated conclusively that its pension payments were prudent. Dist. IB pp. 45-51. Staff's brief cannot now claim that Distribution's action was not prudent when its witness was asked directly by the Administrative Law Judge ("ALJ") if the Company's conduct was imprudent and he declined to respond. Tr. 1389.

Distribution has demonstrated that, due to a market drop of 40%, sliding interest rates and pensioner changes, the Company's pension plan had gone from being $106 million overfunded in 2000 to $121 million underfunded in mid-2003. Dist. IB pp. 46-47. Given an assumption that the plan would continue to earn 8.5%, the Company's actuary estimated that, without additional funding, National would have to make a cumulative payment of $229 million in 2006 and 2007. Dist. IB pp. 47-48. Therefore, National decided to make payments of $35 million per year in order to smooth out the estimated $144 million minimum ERISA payment expected to be due in 2006. Dist. IB p. 48. These are the facts.

Staff now seeks to weave a story out of disparate facts and unsubstantiated claims to show that National never needed to make pension payments above the minimum rate allowance. Staff IB p. 29. Staff avers that the need to make the pension payment existed only "at one point in time." Staff IB 28-29. Of course, this finds support only in the colloquy between Staff witness Wojcinski and Company counsel during which Mr. Wojcinski prefaced his every response with "at that point in time." Tr. 1390. The futility of Mr. Wojcinski's preface is manifest in the fact that all human action takes place "at that point in time." The Commission explicitly recognized this elementary fact when it found that "the prudence of the company's conduct must be judged by asking whether it was reasonable at the time…." Case 27869, Consolidated Edison Co. of N.Y., Inc., Opinion No. 82-2, 22 NY PSC 98, 106 (issued January 21, 1982.) (supra).[21] Mr. Wojcinski admitted that "at that point in time" National was looking at low interest rates and a poorly performing stock market. Tr. 1390. He also conceded that National's actuary was projecting a minimum ERISA payments of nearly one quarter of a billion dollars would be due if additional funding was not undertaken. Id. Mr. Wojcinski's attempt to taint those payments because the actuary sounded its warning "at that one point in time" (Id.), is meaningless in light of the Commission's recognition in the Consolidated Edison, supra, that "the company had to solve the problems prospectively, without the benefit of hindsight." 22 NY PSC 98, 106.

Staff cites to Exh. 59, p. 11 as support for a claim that, if National had only funded at the rate allowance it would not have faced a minimum ERISA funding requirement in 2006. Staff IB p. 29. A close examination of that exhibit reveals the post

[21] See also, Consolidated Edison Company, Inc., Order Denying Petition for Rehearing and Clarification (issued January 3, 2002) pp. 7, 16.

hoc game Staff is playing. Exhibit 59 is a response that Company witness Bauer gave to a Staff interrogatory. In essence it looks back, from the perspective of 2007, on what the Company's actual experience would have been if it had only funded the pension at the rate allowance. This is what Mr. Bauer said:

> A backward-looking analysis of what National Fuel could have contributed to the pension trust since 2000 is not relevant to the decision the Company's faced in 2002 – 2003 regarding the need to fund above Distribution's rate allowance. As I have explained in my testimony and in other interrogatory responses, the then expected outlook for the market and interest rates would have necessitated a minimum pension contribution of $225 million for 2006 and 2007. While it's true that in hindsight the exceptional actual performance of the stock market would have allowed National Fuel's pension contributions from 2000 through the present to equal the rate allowance, this does not negate the prudence of the funding decision that was made in 2002-2003.

Exh. 59 p. 11. Again, Staff's points make sense only in hindsight. But hindsight, of course, is not relevant to a decision that had to be made in light of a looming pension funding crisis - without the benefit of hindsight.[22]

Tacitly conceding that National did have to address a significant funding problem in 2002, Staff contends, nevertheless, that National should have reviewed its annual funding requirements and reduced them when the problem began to dissipate. Staff IB p. 32. The problem with Staff's claim is that it ignores the facts. National expected that it would need to fund the upcoming 2006 ERISA minimum payment of $144 million. It planned to do so with annual payments of $35 million in each of fiscal years 2003 - 2006. Tr. 1434-1435. As the stock market performance improved and interest rates rose

[22] It is exactly this hindsight analysis that Staff appears to apply at p. 12 of the Staff initial brief regarding rating agencies. If Staff is not applying its hindsight analysis here then it is merely applying the unsubstantial opinion of how rating agencies would have evaluated National's pension funding. Mr. Bauer testified that if the payments had not been made and the Company had faced a funding requirement of $229 million its ratings would have been adversely affected. Tr. 1422. Staff's claim rests on what actually happened not what could have happened if the payment did arise as the actuary predicted it would. Tr. 1164. Staff's claim that it is "unlikely (Staff IB p.12) the Company could have downgraded has no support.

National did reduce funding. The initial annual payments of $35 million were reduced to $20 million and then to $16 million. Exh. 63 p. 6. Staff is simply wrong when it intimates that the Company did not reduce the pension payments as the funding levels improved. It did.

Staff's attempt to make a point about the use of pension expense in rates to write down the internal reserve (Staff IB p. 30) is, simply, baffling. Exh. 26, DPS 415 shows that the Company is using $8,732,434 of the rate allowance of $16,101,999 to fund the qualified pension and $5,897,475 to write down the debit balance of the internal reserve (the remaining $1,472,090 of pension rate allowance is used to fund the Executive Retirement Plan ["ERP"] and Retirement Savings Account plans). On one hand, Staff argues that the Company should pay $5.9 million of the rate allowance into the external fund. Staff IB p. 30. On the other hand, Staff argues that the Company should use up to the entire $16,101,999 rate allowance to write down the debit balance. Staff IB p. 31. The recommendations are irreconcilable and highlight the degree to which Staff flounders about for any rationale it thinks might defeat the Company's just claim for recompense.[23]

The fact is that the Company has determined to use $5,897,475 of the rate allowance to reduce the debit balance each year because it is a measured response to eliminating the balance over time. See Exh. 26, DPS 415, p. 2. Staff, as explained, inconsistently also recommends the Company use the entire Rate Year pension allowance to offset the pension internal reserve debit balance. Staff IB p. 33. That recommendation

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[23] Staff states that the Company has not proposed a recovery mechanism for the approximately $10.3 million of interest it has accrued on the pension internal reserve balance. Staff IB p. 30. This is true but irrelevant. There are other instances in which interest is accrued on regulatory balances (for example, on the OPEB internal reserve credit balance) but not immediately reflected in the ratemaking process.

makes no sense because it completely ignores the fact that the plan's active participants continue to accrue additional pension benefits (i.e., service cost[24]), the cost of which needs to be funded to the trust at some point in time. While it's true that under the law the Company could put off funding service cost until well in the future, doing so would simply delay the inevitable. Mr. Bauer has clearly demonstrated that the timing of pension funding can have a meaningful, positive impact on future pension expense. By continuing to fund its pension at a modest level that is in line with the plan's service cost, the Company effectively balances two competing interests: 1) it makes significant progress in reducing the debit balance in the pension internal reserve, and 2) it proactively addresses the funding of new benefits earned under the plan (which in the long run will lower the overall pension expense borne by ratepayers).

2. Ratepayers Are Much Better Off For National Having Made The Payments.

In the Rate Year alone, Distribution's customers are benefiting from a revenue requirement that is $5.2 million lower than it would have been had National not made the payments to the external pension fund. Tr. 1436. Therefore, Staff's claim that "[I]nstead, ratepayers are faced with costs not only in the rate year but for years after" (Staff IB pp. 30-31) is mystifying. This claim, bereft of record citation, is, simply, a flight of fancy. Even with the Company's requested rate base treatment of the debit balance of the internal pension reserve, ratepayers will still be $2.3 million better off. And this benefit that will continue over the years. Id. This is due largely to the fact that the funds that were deposited into the external trust enjoyed the benefit of a significant

[24] For example, as shown on page 91 of National's 2006 Form 10-K, active participants accrued $16.4 million of service cost for the year ended September 30, 2006. Distribution is roughly 60% of the plan, so its share of National's service cost for that year is approximately $10 million.

stock market run-up in the years after 2003. These payments have already produced additional returns of $22.1 million that have reduced pension expense and will continue to generate compounded returns that will reduce pension expense for customers in the future. Tr. 1436. While Staff argues that the payments "put ratepayers needlessly at risk" (Staff IB p. 29) it fails abjectly to demonstrate how this is so. It fails because the facts tell a different story.

Staff concedes that the funds got the advantage of high market returns in the past several years but complains that ratepayers will be at risk if the market returns do not equal the cost of financing the Company's rate base. Staff IB p. 30. It is not entirely clear what Staff is saying here. The payments have already enjoyed the good market returns over the past years. The Company will be writing down the balance of the internal reserve in rate base by $5.9 million each year. Therefore, ratepayers' exposure will fall each year. Indeed, the roughly $37 million debit will have been reduced to just $18,795,559 at the end of the Rate Year. Exh. 26, DPS 415 p. 2. This means that, while the revenue requirement benefit of approximately $5.2 million will remain the same, the share of revenue requirement due to the rate base treatment will fall as a result of the continuing write down of the debit balance of the internal reserve. Id. Staff does not seriously contest that ratepayers have benefited from the Company's action because it cannot.[25] Furthermore, if markets were to fall in the future, the payments made by National have provided a cushion that will continue to protect pensioners and ratepayers.

[25] Staff somehow finds fault in the fact that funding the external pension reserve also allowed the Company to make additional payments to the external OPEB in the amount of $3.3 million. Staff IB p. 29. Staff's brief fails to explain how this is not a beneficial, additional aspect of the funding. Mr. Wojcinski's own testimony shows that National had not been able to fund its non-union OPEB funds at appropriate levels. Due to the additional pension payments, National was able to make these deposits to the OPEB funds pursuant to the use of section 401(h) accounts. Tr. 1340.

Perhaps conceding the weakness of its position, Staff also claims that, if the Commission concludes that a return on the internal reserve debit balance is appropriate, the return should not be allowed in rate base. Staff IB p. 31. Instead, Staff would have the Company accrue a carrying charge. Id. The Company agrees that there are instances in which the interest accrual method is preferable (for example, if the timing of contributions is unknown because of Internal Revenue Service [“IRS”] regulations). Exh. 26, DPS 413. In the Company’s circumstance, however, the contributions giving rise to the debit balance have already been made and there is little uncertainty with regard to the timing of future contributions. Id. Therefore, rate base treatment is preferable because it provides for current recovery of Distribution’s carrying costs (as opposed to deferring that recovery to future periods). Id.

Staff further argues that, should the Commission approve the accrual of a carrying charge, it should be at the short-term debt rate, not the latest authorized pretax rate of return. Staff IB p. 32. Staff claims that the pension situation was a short-term problem and therefore should earn a short-term return. Id. Staff’s argument is without merit. As described above, the funding that gave rise to the debit balance occurred in 2003-2005, nearly five years before the start of the Rate Year. Further, the debit balance is expected to be fully amortized in early 2012, approximately ten years after the funding commenced, hardly a short period of time. Exh. 26, DPS 415. In addition, Staff fails to recognize, that had the internal reserve contained a credit balance, the Company would be required to pay its customers interest on the balance at “the company’s latest authorized pretax rate of return even if the funds representing the credit balance were simply a substitute for short-term borrowings.” Case 91-M-0890, Statement of Policy and Order

Concerning the Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other Than Pensions (issued September 7, 1993) ("Policy Statement"), App. A, p. 6. Fundamental fairness requires that, if the Company must pay interest to its customers at the pretax rate of return, then the Company should earn interest at the same, pretax rate of return – not a short-term debt rate.

Staff also implies that allowing a return equal to the pretax rate of return potentially creates an incentive for Distribution to in the future "game the system" by borrowing short-term to fund the pension and then in turn earn an overall rate of return on the internal reserve balance resulting from that funding. Staff IB p. 32. Staff is grasping at straws. Staff forgets the built in safeguards that would prevent this circumstance from occurring. For one, IRS Code Section 4980 imposes a 50% tax on any employer revision of assets from a qualified pension plan. Thus, absent a pressing reason for contributing funds, the arbitrage opportunity envisioned by Staff could prove quite costly. Second, both the Company and Staff recognize that, in order to earn a return on an internal reserve debit balance, companies must demonstrate that funding above the rate allowance was prudent. Again, absent a true funding need, it is extremely unlikely any attempts at arbitrage would pass the prudence test.

Save offering inaccurate or confusing arguments, MI's contribution adds little to the discussion of pension treatment. MI, for example speaks of the pension internal reserve account as of September 30, 2006. MI IB p. 36. That amount, of course, is irrelevant to the Rate Year and likely is advanced solely to distort and prejudice the consideration of the issue. The correct number, as Staff points out, is $20,786,582. Staff IB p. 28.

MI also hopelessly confuses the facts when it endorses Mr. Wojcinski's contention that the Policy Statement authorizes rate base treatment of pension funding above rate levels only where such payments are necessary to preserve the tax-effective status of the plan. In MI's view, "that situation is not present here." MI IB p. 38. MI apparently turns a blind eye to the fact that Mr. Wojcinski: 1) could point to no provision of the Policy Statement which says that; and 2) was unable to provide any substantiation for his claim that tax effective status of a pension fund could be lost by underfunding– either at the hearing or subsequently. See Dist. IB p. 52.

It should not be lost on the reader that MI explicitly recognizes that "NFG acted in the best interests of its customers by 'overfunding' contributions to the external pension trust, and that customers are benefiting from that decision." MI IB p. 36. MI's claim that Distribution is not entitled to a "bonus" in the form of a higher rate base (MI IB pp. 36-37) is simply an effort to prejudice and direct the discussion away from the uncontested fact that ratepayers are better off for the pension payments having been made. Again, let there be no mistake - Distribution is not seeking a "bonus." Distribution is merely asking for the carrying costs on the payments that MI expressly acknowledges were made "in the best interests of [] customers" and which have produced benefits for those customers. A bonus conjures images of a payment that is over and above what is due. Distribution is seeking recovery of costs that have produced significant benefits for its customers.

It is incontestable that the Policy Statement expressly provides for utilities to seek rate base treatment of debit balances in the pension reserve where, at management's discretion, payments in excess of the rate allowance are made. Staff explicitly acknowledges that the purpose of the Policy Statement was "preventing ratepayers or shareholders from benefiting from, or being harmed by, a particular technique a company may employ in funding the pension." Staff IB p. 26. Here, National made pension payments that have resulted in rates that are over $5 million lower than they would have been had they not been made. It would be one thing if Distribution were asking for carrying costs on prudent pension payments that, nevertheless, resulted in costs to ratepayers. But here, when the payments were made in the best interests of customers and pensioners <u>and</u> those payments have resulted in <u>lower</u> rates, it is little short of ridiculous to contend that the Company should not recover the carrying charges through rate base recognition of the debit balance of the pension reserve. Indeed, if rate base recognition is not available in <u>this</u> case, under <u>these</u> facts, then the Company contends that it is never available. The Policy Statement does not contemplate such a result.

C. <u>Labor, Benefits and Productivity</u>

The areas of labor, benefits and productivity are being addressed together because Staff's proposals, which treat these categories separately, result, in many cases, in a gross double counting of its adjustments.[26]

Distribution, pursuant to precedent, filed this case with the standard productivity adjustment of 1%. Tr. 1532-1533. Ms. Truitt, however, recalculated that adjustment to remove the part of the adjustment that would deny the Company recovery for pensions and OPEBs because the Policy Statement provides for a full recovery of that expense and the 1% productivity adjustment denies that full recovery. Tr. 1533. Mr. Luthringer

[26] We have addressed the proposal to add Health Care costs to the general inflation pool separately because of the clearly inconsistent treatments Staff proposes to afford to Health Care costs and Injuries and Damages.

restored the full 1% adjustment because he claimed that it was not specific and did not relate explicitly to pensions and OPEBs. Tr 1301.[27]

Based on the use of a historical five-year trend, Staff has proposed adjustments of $2,436,000 to reflect Staff's forecast of weekly employee complement level (which provides for 48 fewer full-time employees in the Rate Year) and $339,000, to reflect six fewer supervisory employees in the Rate Year. Staff IB pp. 22-23.

The Company has previously discussed in its initial brief why Staff witness Luthringer's forecast of continuing employee reductions at rates experienced in past years in inappropriate. Dist. IB pp. 59-60. Should the ALJ, however, credit Staff's claims and adopt its proposed reduction of employees in the Rate Year, then it should be clear that the Commission also cannot, at the same time, adopt the standard 1% productivity adjustment.

By imputing employee reductions into the Rate Year, Staff has explicitly duplicated and double counted the productivity adjustment. The 1% productivity adjustment was intended to provide an incentive to a company to be more efficient. By imputing employee reductions equivalent to a 6% adjustment into the Rate Year, Staff has taken away the incentive. Worse, still, not only has Staff imputed employee cuts equating to a 6% adjustment, but it has also layered on top of that an additional productivity imputation in the form of the standard productivity adjustment of 1%. This is punitive in the extreme.

The Commission addressed this very thing in Case 05-E-1222, New York State Electric & Gas Corporation, Order Adopting Recommended Decision With

[27] Mr. Luthringer, is, of course, wrong because the effect of applying the 1% adjustment serves directly to reduce pension and OPEB recovery – in contradiction to the Policy Statement. Tr. 1533.

Modifications (Issued and Effective August 23, 2006) (“NYSEG Opinion”). There the Commission imputed a 3% productivity adjustment instead of imputing merger and other cost savings directly. The Commission relied, in part, on Staff’s observation that, despite the historic reduction of 564 employees that NYSEG had achieved from December 2001 to June 2005, NYSEG had not forecast any reduction of employees into its rate year. NYSEG Opinion p. 64. In the Commission’s view, NYSEG’s failure to forecast any employee reductions mandated the imputation of the 3% productivity adjustment. NYSEG Opinion p. 66.

In this case, the employee reductions that Staff imputed into the Rate Year amount to a productivity adjustment of approximately 6%. This is twice the NYSEG level and, unlike NYSEG, Distribution does not have any merger-related opportunities to justify such reductions. Here, again, Staff is effectively “punishing” Distribution for its past success in achieving productivity gains that exceed those of its peers. In any event, it seems clear that Staff can either impute explicit employee reductions or impute a percentage productivity adjustment. But, Staff cannot have it both ways. Where, in this case, Staff seeks to impose force reductions that equate to a productivity adjustment of 6%, the imputation of an additional 1% adjustment on top of that is simply adding insult to injury.

Staff’s zeal to impute phantom productivity gains is not limited merely to the employee count. For example, Staff claims that the ERP expenses should be disregarded unless they are “offset by productivity.” Staff IB p. 21. Staff makes the same claim with respect to the Top-Hat retirement plan. Id.[28] Here, again, we are constrained to point out

[28] We also show, infra, Staff has proposed additional phantom productivity by recognizing meter maintenance revenue that doesn’t exist.

that Staff has reduced the number of supervisory employees in addition to its reductions to the general labor count. Therefore, Staff has already imputed significant additional productivity to the management ranks. Its qualification for recognition of the ERP and Top-Hat plans having been met, the expenses for these supplemental retirement plans must be recognized.

Finally, with respect to Lump Sum Payments, Staff implicitly recognizes that this is a tool by which management moderates wage inflation by dividing annual raises between base and lump amounts. Staff IB p. 24. Given this, it is mystifying why Staff opposes recognizing the Lump Sum Payments in rates. They are not a "double count" of the proposed management pay raise, as Staff claims. As Ms. Shiley testified, the allocation of any wage adjustment between base and lump sum increases, is determined on an individual basis, after that individual's total compensation is determined. Tr. 295.[29]

D. Depreciation

1. The Remaining Life Method is Superior to the Whole Life Method.

The Company's brief demonstrated the superiority of the Remaining Life Method. Dist. IB pp. 81-84. Staff, CPB and MI all oppose the adoption of the Remaining Life Method, largely on the same grounds.

Staff claims, without citation, that it calculated an over accrual of 3% and typically depreciation rates would only be modified if the over or under accrual was 10% or greater. Staff IB p. 17. Lacking substantiation, Staff's claim cannot be credited.

[29] In any event, Staff has not included the entire management pay raise in the base salary of the labor element, because, as explained in our initial brief, Staff has proposed, improperly, to limit that increase to the union wage increases.

Distribution's depreciation expert, Mr. Spanos, testified that Distribution is in an underaccrued position as of the Rate Year. Tr. 333. This means, using the proposed life and salvage parameters, the Company will not be recovering enough depreciation expense. Tr. 334. Mr. Spanos also addressed CPB witness Elfner's claim (Tr. 592) that the Company's book reserve will exceed its theoretical reserve by $12 million dollars in the Rate Year. Mr. Spanos explained that this disparity exists almost wholly due to the utilization of the whole life method with no adjustment for the reserve variance. Tr. 334. Use of the Remaining Life Method would not produce such a drastic difference because remaining life rates are developed to compensate for any variance that exists. Id. More important, Dr. Elfner's comparison is based on a gross mismatch. He used a theoretical reserve based on current life and salvage estimates and compares it to a book reserve based on proposed rates. Id. This is completely inappropriate.

The CPB also argues that the Commission has not adopted the Remaining Life Method for gas plant accounts and claims that the matter was "directly addressed less than a year ago" in the NYSEG case. CPB IB p. 4. With all due respect, the matter was not "directly addressed in that case."

In fact, the Commission's decision pointed out that "[o]n exceptions NYSEG does not address the relative merits of the remaining and whole life depreciation methods." NYSEG Opinion p. 67. In fact, NYSEG did not even address the adjustments Staff made to average service lives and net salvage. Id. Instead, NYSEG apparently was content to make a general assertion that the Judges did not provide for adequate electric system capital investment recovery. Id.

Based on NYSEG's scanty reply, the Commission found that it had not "demonstrated a sufficient reason for us to move abruptly away from the whole life depreciation method…." Id. at 68. Under the circumstances, it is a stretch to contend, as does the CPB, that the Commission directly addressed the matter less than a year ago. Here, in contrast to NYSEG, the Company did show why the Remaining Life Method is preferable - because it more accurately tracks depreciation recovery, while the whole life method leads to under or overrecoveries that are not tracked for recovery. NYSEG is, therefore, inapposite. Distribution has amply demonstrated why the Remaining Life Method should be adopted.

2. Plastic Mains Should Have an Average Service Life of 55 Years.

The Staff's, MI's and CPB's critiques of the Company's position that the Average Service Life ("ASL") for plastic mains should be reduced to 55 years, all rely wholly on Staff's witnesses' objection to it. Staff IB p. 18, MI IB p. 26, and CPB IB pp. 4-5. The argument against reducing the service life to 55 years, however, is circular.

CPB claims that there isn't enough retirement history to permit establishment of an accurate survivor curve. CPB IB p. 4. Next, CPB argues that the Company's proposed 55-year average service life is "drastically out of line with those the Commission has adopted for other gas utilities in the State." CPB IB p. 5. Staff also claims that the ASL of plastic mains should be 70 years "based on statewide comparison of experience." Staff IB p 19. These arguments fail to consider that all the utilities began installing plastic main at about the same time. Therefore, if Distribution's retirement history is insufficient, so is the retirement history of the other utilities. That means that the ASLs of the other companies in New York are no more accurate than the 55-year

ASL that CPB is criticizing. The mere fact that other New York utilities have ASLs for plastic that are based on similar assumptions does not verify those assumptions.

In fact, CPB admits that it would be appropriate to lower the ASL of Distribution's plastic mains if there were "concrete data" to show that conditions are different from those of other utilities. CPB IB p. 5. There is such data.

Staff, CPB and MI all express concerns that acceptance of Distribution's proposed service life for plastic mains will provide Distribution with the lowest expected life for utilities in New York. They ignore, however, the estimated lives for plastic distribution mains in other states. Exhibit. 20, Schedule 2. demonstrates that the proposed ASL of 55 years is more than reasonable. It further shows that, if Staff's proposal that the 70-year ASL be continued is accepted, New York will have the longest service life for plastic mains in North America. Id. In New York where infrastructure is becoming a primary concern, this is hardly a step in the right direction. This is especially true where plastic main is failing after less than half its estimated 70 years in the ground.

The experience in other states is not the only evidence that a 70-year ASL for plastic main is too long. Staff's Safety Panel testified that early vintage plastic main is becoming brittle and must be replaced. Tr. 1186-1187 Company witness Spanos supported Staff's observations and noted, too, that highway projects have also required the retirement of plastic main, leaking or not. Tr. 344-345. Given that the oldest vintage of such plastic pipe is no older than 38 years, it is clear that a 70-year ASL for Distribution's plastic mains is excessive.

3. The Lives For House Meters and House Regulators Should Not Be Changed.

Staff argues that the 52-year service lives for House Meter Installations (Account 382) and House Regulator Installations (Account 384) should not be different from the 36-year service life of House Meters (Account 381) and the 30-year service life of House Regulators (Account 383). Staff IB p. 18. Staff argues that no reason exists to differentiate between the ASL of the cost of the installation on one hand, and the cost of the asset on the other. Id. Staff is mistaken. Mr. Spanos directly addressed this issue. He explained: "quite often the meter or house regulator is retired or replaced prior to the time the associated installation is retired. Therefore, the installation costs would not be expected to have the same life characteristics as the meter and house regulator they were originally installed with." Tr 340. No evidence was adduced by Staff to refute this claim. The numbers calculated by Mr. Spanos speak for themselves. Staff's proposal is unsupported.

E. Health Care Costs

CPB does not dispute the Company's demonstration that Health Care costs have historically risen much more rapidly than the other components of the broader price indices. CPB IB p. 8. CPB alleges, however, that this is "not dispositive for ratemaking purposes." Id.

CPB, just as Staff (Staff IB p. 20) and MI (MI IB p. 40), point to the Commission's NYSEG decision as being dispositive that Health Care costs are not to be removed from the pool. CPB IB p. 8. In that decision, the Commission stated:

> We find that the standard ratemaking practice that applies a general inflation factor to health care costs, and other cost categories, remains valid in today's circumstances and prevailing conditions. We find no basis or any reason to alter this approach for NYSEG at this time.

NYSEG Opinion p. 55.

CPB notes that its witness, Dr. Elfner, stated that, if Health Care costs were to be inflated at a higher rate than the inflation rate, the inflation pool would have to be adjusted to remove the Health Care component. CPB IB p. 9. CPB acknowledges that the Company did just that in its rebuttal. Id. CPB now claims, however, that the Company's acceptance of CPB's proposal was an "overture [that] would be only the beginning." Id. In CPB's view, because the Company argued that items such as housing, food, clothing and shoes and farming inventory do not affect Distribution, those items would also need to be removed from the number. CPB has taken the Company's arguments out of context. Ms. Truitt explained that the GDP deflator "is a convenient, and for the most part, non-controversial inflation index to use for cost elements included in the inflation pool" (Tr. 1554), nothing more, nothing less. In reply to Dr. Elfner's claims about the Company's cost structure and the GDP deflator, Ms. Truitt identified elements of the GDP deflator that do not correspond to the Company's cost structure. Tr. 1554-1556. CPB seizes on this statement to claim that additional adjustments to the inflation number would be required. This defeats the purpose of using a convenient index for cost elements to be included in the inflation pool. The real issue is whether Health Care costs are sufficiently different to be excluded from the inflation pool. Ms. Truitt justified that they are. She made an adjustment to the inflation rate to apply to the inflation pool simply to accommodate the CPB.

It is certainly true that the Company is unaffected by things such as groceries, housing and food. The Company is, however, affected by the cost of fuel, steel, plastic and other commodities. All of the above had risen faster than the costs of groceries or clothes. That is not the point.

The Commission has adopted the general inflation factor as a convenience. Nevertheless, the Commission's 1977 Policy Statement on Test Periods in Major Rate Proceedings ("1977 Policy Statement") continues to govern litigated rate cases. It states "[a]ll assumptions of changes in price inputs because of inflation or other factors or changes in activity levels due to modified work practices or other reasons should be separately developed." 1977 Policy Statement p. 8. It goes on to explain that "[a]ll assumptions, escalation factors, contingency provisions and changes in activity levels should be quantified and properly supported." Id. Where, as here, health costs have been rising at many times the rate of inflation for many years and will still rise higher than the rate of inflation in the Rate Year, the Company has met this burden. Ms. Truitt demonstrated, via several sources, that Health Care costs are expected to rise by 12% to 14% into the Rate Year. Tr. 1515. Staff did not dispute this. Because the evidence that Health Care costs will rise at many times the rate of inflation is unrefuted and unrefutable, these costs should be removed from the inflation pool and forecasted separately.

Finally, it is irrational for Staff to claim that Health Care costs cannot be adjusted for irrefutable cost increases but then turn around and argue that Injuries and Damages – another inflation pool item - must be adjusted for speculative cost decreases. Staff IB pp. 48-49. Assuming arguendo that Staff could provide ironclad evidence that workers compensation costs would decline by 10% in the Rate Year (Staff IB p. 49), there would be absolutely no reason to recognize that change while refusing to recognize the known increase in Health Care costs.

It is long past time for the Commission to remove Health Care costs from the inflation pool. It is a regulatory policy that continues in the face of reason and irrefutable evidence that Health Care costs have quadrupled since 1980 and continue to rise much faster than other costs. Tr. 1514-1515.

F. Uncollectible Accounts.

Staff provides a confusing and somewhat misleading presentation of the uncollectibles issue in this case. In the heading of this section of the brief, Staff identifies a total uncollectible adjustment of $3.6 million to the Company's revenue requirement.

Specifically, Staff made an adjustment of $3,565,000 to correct uncollectibles expense and the Company agrees with it.

Staff then goes on to describe two uncollectible adjustments that they claim to be in dispute. The first adjustment is a late payment adjustment and the second adjustment was proposed by the Gas Rates Panel.

The first adjustment is clearly in dispute and addressed elsewhere in the Company's brief. The second adjustment, set forth at page 34 of Staff's brief is extremely concerning because this adjustment seems to resurrect an error in Staff's calculations that the Company believed Staff had revised. Because of the effect on the record as a whole, we have addressed this matter in the Introduction to this brief.

On June 21, 2007 Staff sent to the parties in this case, including, the ALJ, a revised revenue requirement that excluded the $9.4 million adjustment proposed by the Gas

Rates Panel. This revised exhibit was provided after conversations with the Company where Staff admitted that this adjustment should not have been made because no corresponding decrease in revenues associated with the merchant function charge ("MFC") was made.

Staff attempts to explain these adjustments in footnote 10 to its brief. It is interesting that Staff provides no cite for the adjustment discussed in the footnote. Instead, Staff provides a jumble of adjustments related to the overall revenue requirement associated with storage inventory adjustments and MFCs.

The Company recognizes that these issues can be confusing. Staff, however, adds to this confusion by 1) not recognizing its revised exhibit, and 2) missing base rate revenue requirements and the impact of the storage inventory adjustment agreed to by both Staff and the Company.

The Company provided a revenue requirement and rate design summary in its initial brief in order to provide a summary of the rate impact of its position at the time of its initial brief as well as to add some clarity to the storage inventory issue.

The table below summarizes the rate impacts of the Company's proposal presented at the bottom of page 1 of Appendix B to the initial brief.

Total Base Rate Increase	$36,512,937
CIP Charge	6,004,496
Storage Inventory Credit	(1,483,358)
GRT	1,105,951
Total	$42,140,027

Staff's footnote claims that MFC revenues should be removed from sale of gas portion of the revenue requirement. Staff IB p. 34, fn. 10. Staff errs. The uncollectible costs and revenues associated with the MFC are included in the total base rate increase of$36,512,937. Also included in this amount is the impact of removing storage inventory from rate base. Id. Finally, the total storage inventory credit, utilizing the other customer capital rate, is reflected in the $1,483,358 Storage Inventory Credit that will be applied through a 0.2930% credit to sales customers monthly gas cost rate.

V. ROYALTY

Staff proposes to resurrect the royalty imputed in Distribution's rates in its last litigated rate case ten years ago. Staff IB p. 41. No parties but Staff and Distribution briefed the royalty issue. Distribution's initial brief addresses, in detail, the Company's point-by-point rebuttal of Staff's attempt at a royalty adjustment. Dist. IB pp. 87-103. In its brief, Staff generally repeats the same arguments set forth in Mr. Wojcinski's testimony. Tr. 1352, Staff IB pp. 41-46. Two items in Staff's brief, however, call for a reply.

Distribution notes at the outset that Staff either misunderstands the royalty or is attempting to extend its scope to include adjustments ordinarily the subject of a traditional rate making analysis. In this case, Staff uses the royalty in place of the application of interest, in place of a lead-lag study, and to modify the longstanding common cost allocation formula, among other things. Further, Staff's royalty in this case is presented as a catch-all adjustment, with no effort made to connect the imputation level, or any part of it, to the alleged improper affiliate transaction. By forcing Distribution into a guessing game about what part of Staff's royalty is attributed to which alleged impropriety, the royalty becomes seemingly impossible to rebut – it effectively becomes an automatic adjustment, and not a rebuttable presumption. Indeed, it begins to resemble the productivity adjustment, which the royalty decidedly is not.

The two components that form the royalty remain the standard to be applied today. Dist. IB p. 89 (quoting Case 92-C-0665, New York Telephone Company – Incentive Regulation Plans et al., Opinion No. 94-2, issued January 28, 1994). Distribution rebutted the royalty in its initial case by demonstrating that the Company adhered to the Affiliate Rules adopted in the 2005 rate case. Dist. IB pp. 92-95. The witnesses' statements regarding Distribution's compliance with the Affiliate Rules were not challenged by any party in testimony, at the hearings, or in the initial briefs. On this basis, alone, the Company rebutted the royalty.

As noted above, two items in Staff's brief call for a reply. The first is Staff's substantially inflated description of the royalty in the 2005 rate case (Case 04-G-1047). Staff says that "Staff's pre-filed testimony . . . recommended a royalty imputation of $8,984,000." Staff IB p. 42. Distribution identified the same alleged recommendation in its brief at page 90, fn.17. While it is true that Staff proposed something casually identified as a royalty imputation in the last case, Staff's presentation was more an afterthought than a serious attempt to develop a serviceable, rate-case quality recommendation for the Commission's consideration. Staff's "royalty" was a value entered on an exhibit. It was not accompanied by testimony. It apparently was not even developed by the witness (Mr. Wojcinski), but instead was merely inserted upon "the advice of counsel." Dist. IB p. 90 (citing to Exhibit 23 (in this proceeding) Dist.-14 (Exhibit __ GRW-1, page 1)). There was no analysis. Nowhere did Staff's testimony mention even the word "royalty," and nowhere did Staff argue, or even hint, that Distribution failed to rebut the royalty in its initial case. Staff's "recommendation" was nothing more than an unsupported value, plucked from the ether, with no attribution beyond the label of "royalty" affixed to the entry "on the advice of counsel."

But Staff's overstatement appears to have a purpose. By inflating the significance of its "royalty" in the last case, Staff presumably wants to create the impression that there was a controversy regarding affiliate transactions sufficient to justify a royalty of nearly nine million dollars. Were this true, it would shore up Staff's royalty argument in this case. The fact is, however, there was no royalty controversy in the last case. There was only Staff's unsupported entry, which had no significance then, and has even less significance now.

The second item in Staff's brief that deserves a reply is a new rationale, or possibly a revision of a prior rationale, posited to support the royalty adjustment. Staff contends that its "current royalty adjustment of $1,531,000 is justifiable on the sole basis that Distribution lost interest of up to $5 million due to the allocation method chosen by National to divvy up proceeds from SIR insurance settlements." Staff IB p. 42.

There appear to be two parts to this rationale. The first part, touched on in Mr. Wojcinski's pre-filed testimony, Tr. 1354, also discussed in Staff's brief, analogizes to the intercompany tax agreement among National and its subsidiaries[30] ("tax agreement") to argue that National underallocated SIR insurance proceeds to Distribution. Staff IB p. 42. The second part is the $5 million interest that, to Staff, would be owed Distribution's ratepayers if the insurance proceeds had been "properly" allocated. Id.

The most significant flaw in this rationale is that there is no support for it in the record beyond an oblique reference to $5 million of "lost" interest offered by Mr. Wojcinski during cross examination. Tr. 1403. In fact, Staff cites to nothing else in its

[30] For a complete description of the tax agreement, See Tr. 1457-1464.

brief. We do not know the basis for Mr. Wojcinski's $5 million figure. We do not know where, when or on what principal amount the interest accrued. The record is devoid of any supporting calculations, values, data or any information whatsoever that Distribution might review in order to mount its defense. Nor is Mr. Wojcinski's first exposition of the tax agreement analogy any help because it says nothing about a $5 million interest adjustment. Tr. 1353-54.

Staff's proposal to use lost interest as a basis for the royalty also fails on the merits. An adjustment today based on interest that, to Staff, should have been applied on the balance of insurance proceeds that have long since been distributed, cannot support a royalty. There is no "subsidization" in the Rate Year. See, Case 94-G-0885, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of National Fuel Gas Distribution Corporation for Gas Service, Opinion 95-16, issued September 15, 1995 at 29. There is no "transfer to non-regulated affiliates of intangible assets" or "improper cost allocation" with non-regulated affiliates. New York Telephone, supra, p. 9-10. Nor could there have been any transaction with "non-regulated affiliates" to the tune of $5 million, in the form of interest or otherwise, because overwhelmingly, the insurance proceeds were allocated to National's regulated subsidiaries.

It is also worth noting that an interest adjustment is usually an ordinary rate making adjustment. Here, Staff is using the royalty as a catch-all replacement for an ordinary rate adjustment because, it appears, Staff recognizes that (a) Distribution rebutted the presumption in its initial case; and (b) Staff has no evidence that can independently support a last-minute $5 million lost interest adjustment.

Even if Staff's new theory were cogently developed in the record, Staff's analogy to the tax agreement is inapt. The Company adopted its premiums-based allocation to preserve each subsidiary's share of insurance proceeds when future SIR liabilities were uncertain. Dist. IB p.37. The tax agreement serves no such purpose, nor can it be even loosely associated with a similar rationale. Under the tax agreement, tax payments otherwise due to the IRS from each subsidiary are paid up to the parent and the net consolidated sum is then paid to the IRS. In the past, National transferred some of the tax payments to compensate Seneca for its tax losses, something that has not happened lately and will not happen in the Rate Year. Tr. 1462. There is no overall corporate "policy to reimburse subsidiaries that incur financial losses," as Staff suggests. Staff IB p. 43. There is the tax agreement, and it serves its own narrowly defined purpose.

It appears that Staff's tax agreement analogy is really no more than a different version of Mr. Luthringer's claims-based methodology for allocation of insurance proceeds, which was extensively addressed in Distribution's initial brief. Dist. IB pp. 26-27, 35-38. As a royalty adjustment, it is deficient for the reasons stated above, and in the Company's initial brief. Dist. IB pp. 98-99. Staff's brief changes nothing.

VI. RATE OF RETURN

1. Capital Structure

The Company established conclusively that the appropriate equity ratio to use for ratemaking is the 51.09% equity ration recommended by Mr. Hanley. CPB IB pp. 106-110.

Staff contends instead that an equity ratio of only 44.35% is appropriate. Staff IB p. 4. Although not entirely clear from its brief, Staff appears to quarrel with Mr.

Hanley's analysis that demonstrated Distribution's business risk profile on a stand-alone basis would be 4, while its parent, National's, business risk profile is 7. Staff claims that the most likely business profile would be that of 24 "regulated transmission and distribution companies." Staff IB p. 4. Those companies have an average business risk profile of 3 and a split rating of BBB+/A-. Based on those companies, Staff's Rate of Return Panel claimed that the appropriate equity ratio for Distribution lies in the range of 40% to 47.5%. Tr. 1094-1095. Staff's recommended equity ratio is fatally flawed.

Staff's brief fails to disclose what its witnesses conceded. The 24 companies upon which Staff relies include electric, gas and <u>water</u> companies. Tr. 1093. The risk of electric and water companies differ from gas company LDCs. Not only did the Generic Finance R.D. take pains to recommend different proxy groups for gas and electric companies, it included water companies in an entirely separate industry group. Therefore, because the 2.9 risk profile of Staff's group includes that of electric and water companies (<u>Id.</u>), it cannot be said that the resulting equity ratio is reflective in any way of a stand-alone natural gas LDC.

Staff argues that "Mr. Hanley should have reflected Distribution's lower financial risk, relative to its parent, in his determination of Distribution's business profile score rather than his determination of Distributions most likely bond rating." Staff IB pp. 5. Apparently Staff missed the fact that Mr. Hanley demonstrated conclusively that, where parents and subsidiaries both have rated debt, parents that have business profile scores of 7 have utility subsidiaries with business risk, on average of 4.4. Tr 205. This is a direct, objective measurement. National has a business risk profile of 7. Therefore, an imputed, business risk of 4 for Distribution is accurate, if not conservative. <u>Id.</u>

Staff also contends "Mr. Hanley's bond rating determination is wrong because it does not reflect S&P's process of ascribing bond ratings of one notch below that of the parent to the subsidiary nor does it reflect Moody's process of ascribing a rating of no higher than one notch above that of the parent. Staff IB p. 5. Staff is speaking out of both sides of its mouth. Mr. Hanley cannot be wrong because he failed to ascribe a bond rating to Distribution that is one notch below National's <u>and</u> one notch above it. In fact, Mr. Hanley explained that, if separately rated, Distribution would have a higher bond rating than does National because it is less risky. Tr. 155. Therefore its bond rating would be A- and not a split rating as Staff claims it would. <u>Id.</u>, Tr. 207.

Staff's brief concedes that, even where a split bond rating of A-/BBB+ is used with a business profile of 4, an equity ratio of 43% to 51.5% results. Staff IB p. 5. Of course, the 51.5% result is higher than Mr. Hanley's recommended equity ratio. Moreover, Staff's testimony on the subject conceded that a bond rating of A- with a business profile of 4 would produce an equity ratio range of 44.67% to 52.67%. Tr. 1097. Here again, Mr. Hanley's result is within the range, while Staff's is below the lower bound of that range. Clearly, Staff's proposed equity ratio is substandard.

Furthermore, Staff cannot rely on the Generic Finance case when it likes the result and ignore it when it doesn't. The Recommended Decision in the Generic Finance case explicitly found that the Commission should provide revenue sufficient to support an A bond rating. Case 91-M-0509, Recommended Decision (issued July 19, 1994) at 88 ("Generic Finance R.D."). Staff even concedes that the Commission found that an A bond rating is desirable. Staff IB p. 5, fn 2. The midpoint of S&P's equity ratios for companies rated A with a business profile of 4 is 51.50%. Tr. 155. Staff's proposed imputed equity ratio of just 44.35% which is based explicitly on a split rating of BBB+/A- and a business profile of 3, abjectly fails this test. It produces an equity ratio that is woefully insufficient to support an A bond rating.

MI purports to offer its opinion on the proper equity ratio but it is clear that it has cobbled together arguments that rely more on the cost of a given ratio rather than its appropriateness for ratemaking. MI IB p. 20. Beyond that, MI simply parrots Staff's witnesses' arguments about the use of 24 allegedly comparable utilities (MI IB p. 23), failing to see that these companies are not comparable. They are overwhelmingly electric and water companies and not mostly gas distribution companies. Therefore, their usefulness in determining an appropriate equity ratio for Distribution is of no value.

It is interesting to note that, although MI loudly proclaims that the precedent in the NYSEG case is all controlling (see e.g., MI pp. 8, 10), MI is utterly mute on the precedential value of that case when it comes to a determination of the proper equity ratio to use. There, the Commission noted the "established regulatory practice in New York in fully litigated rate case proceedings…to use the consolidated capital structure of the holding parent company for ratemaking purposes." NYSEG Opinion p. 87.

The equity ratio of Distribution's parent, National, is 53.9%. Tr. 153. Mr. Hanley, in an effort to moderate the costs for ratepayers, developed a lower equity ratio of 51.09%. This did not give parties carte blanche to impute hypothetical equity ratios that are reflective of utilities rated BBB+. See Tr. 1094. MI's silence is indicative only of its shifting views of the value of precedent. Staff's equity ratio is meaningless because it is based on electric and water companies. If Mr. Hanley's proposed hypothetical equity ratio is rejected, National's 53.9% equity ratio must be adopted. The record warrants nothing else.

B. The Cost of Equity.

Staff contends that Distribution's cost of equity is just 8.85%. Staff IB p. 5. Staff concedes that this result is the product of a traditional Capital Asset Pricing Model ("CAPM") of 10.54% and a zero beta CAPM of 10.63%, the average of which is 10.58%. Staff IB p. 6. Staff also developed a proxy group Discounted Cash Flow ("DCF") method that produced a median cost of equity of 8.38%. Id. After giving the DCF result twice the weight of the CAPM, Staff's method produces an equity cost of 9.10%. Id. Staff then reduces this cost by 25 basis points to reflect the assumption that the Commission will adopt a Revenue Decoupling Mechanism ("RDM"), producing the irrationally low result Staff claims is Distribution's cost of capital. Staff claims that this is the method mandated by the Generic Financing case. Staff IB p. 5.

In Staff's view, its method produces "a superior result." Staff IB p. 8. Staff's contention is based on its belief that it did not "include analyses solely incorporated to inflate the resultant cost of equity." Id. Of course, Staff ignores the fact that it included one analysis incorporated solely to deflate the cost of equity. Staff's own brief demonstrates that the DCF method produces results that are, on average 220 basis points below its two CAPM results. The Company has demonstrated in its initial brief the manifest infirmities of the DCF and they will not be repeated here. Dist. IB pp. 117-120. Suffice it to say, however, that Staff cannot criticize other methodologies simply because they tend to inflate the cost of equity when it is undeniable that Staff's DCF analysis woefully deflates the Company's cost of equity. Staff's analysis was based on a range of

DCF results that are simply not credible. Whether Staff's analysis shows that Ameren's DCF cost of equity is 3% or 4% or 6%, is not the point. The point is that none of those numbers is believable. And, because Staff's DCF analysis relies on numbers that are not believable, it is, itself, not believable.

The DCF, if it is to be used, at all, is so riddled with error that it must now play a subsidiary role to the more reliable CAPM. The Company's initial brief demonstrated that the Company's CAPM results and Staff's CAPM results are so close as to confirm their reasonableness. Dist. IB p. 120. Therefore, the CAPM is inherently reasonable and must take precedence over the demonstrably inferior DCF method.

Most of MI's presentation on the cost of equity is irrelevant because it is almost solely a critique of the analysis that Mr. Hanley presented in his initial testimony and ignores that fact that his rebuttal testimony represents a significant effort to explain the so-called Generic Finance methodology and harmonize it with the Company's cost of equity here. Furthermore, while MI contends that the Commission has authorized companies to earn returns on equity of between 9.55% and 9.8% recently, many of the decisions that MI cites in support of its claim are orders approving settlements. MI IB pp. 3-4. It is more than a little difficult to reconcile MI's use of settlement agreements to support its views on the cost of equity when, elsewhere in its brief it loudly proclaims that "settlement agreements and joint proposals [are] by their very terms, [] not precedential…." MI IB p. 46.

MI's criticism of Mr. Hanley's elimination of ridiculously low individual cost of equity results in his cost of equity analysis (MI IB pp. 11-13) rings hollow. MI cries, "from a policy perspective, adoption of NFG's exclusionary practice would be disastrous." MI IB p. 13. One really wonders if MI understands the import of its words. Presumably MI would have the Commission rely on costs of equity that are so low as to be patently absurd.[31] If the constituent numbers that make up an analysis are infirm, the analysis by definition is infirm. Simply because other numbers are used doesn't resurrect such a faulty analysis.

MI's contention that Mr. Hanley's exclusion of a few understated numbers renders his CAPM analysis infirm is equally incorrect. Before any such adjustment, Mr. Hanley's company specific, traditional CAPM produced an equity cost of 10.14% and 10.15% for his proxy groups. Exh. 10, FJH-1, Sch 14 p. 2. His Empirical CAPM was not so adjusted and produced equity costs of 10.35% and 10.34%. Id. at p. 3. MI states that if median results are used instead of averages, a lower equity cost would have resulted. MI IB p. 12. MI, however, fails to produce any support for the use of a median result. Apparently, in MI's view any result is fine – no matter how absurd - as long as it brings down a company's cost of equity. Any result, however, is not "fine." Again, if the individual components of an analysis are not credible, then the analysis, itself, is not credible. This is true whether one uses the mean, the median or the average of such absurd results. Blind reliance on absurdly low results is not what experts do. Experts are supposed to exercise judgment. If any number is accepted, no matter how ridiculous, one might as well throw darts and call it an "analysis.'

[31] Staff witness Capers was asked, for example, whether it was likely that Ameren Corporation had a cost of equity that was 3% or 4.79%. She replied, "Yes, it is likely." Tr. 1149. The notion that an investor would place his or her money in the equity of a company with a return of that nature when federally insured certificate of deposits are paying higher rates is simply not credible. Tr. 227. No more proof of this is needed than the fact that the Missouri Public Service, which regulates Ameren's Union Electric subsidiary, just recently found that AmerenUE's cost of equity is 10.2% on an equity ratio of over 52%. Case ER-2007-0002, In re Union Electric d/b/a AmerenUE, issued May 22, 2007; 2007 Mo. PSC LEXIS 716 (Mo. PSC 2007).

Staff contends that the Company's cost of equity should be reduced by 25 basis points to account for, allegedly, lower risk due to the adoption of an RDM. Staff IB pp. 9-10. Here, too, MI, having no witness of its own, simply parrots the views of Staff's witnesses. MI IB pp. 18-20.

First of all, the 25 basis point reduction results from a gross misapprehension of Mr. Hanley's testimony. He explained that, if the RDM was not adopted, the Company's cost of equity should be adjusted upward by 10 basis points. Tr. 189-190. This was a result of his assessment that the RDM and weather normalization clauses ("WNC") together reduced risk by about 25 basis points. Tr. 189. Based on the fact that 70% of his proxy group companies had one or both of these mechanisms, Mr. Hanley stated that 70% of the 25 basis points would have to be added back to the cost of equity if the RDM were to be rejected. Tr. 189. Nevertheless, because Distribution would still have the WNC, he estimated that only 10 basis points should be added if the RDM were to be rejected. In this case, there is a consensus that the RDM should be adopted. Nevertheless, because 70% of the companies in Mr. Hanley's proxy groups already have such a mechanism, it would only be appropriate to reduce the cost of equity, if at all, by 30% of 25 basis points, or 7.5 basis points. Furthermore, that number is probably overstated because Distribution would still have a WNC.

Both Staff (Staff IB p. 9) and MI (MI IB p. 19) recognize that the downward adjustment of 25 basis points is based solely on the fact that Staff's proxy group of 13 companies is heavily weighted toward electric operations and therefore most of the companies in it do not have an RDM. In fact, it includes only two gas LDCs, one of which has an RDM. Tr. 211. The Company has previously explained why Staff's proxy group is unrepresentive of a gas LDC and is not in conformity with the Generic Financing R.D. Dist. IB pp. 115-117. Mr. Hanley's gas LDC proxy groups should be used. When they are, no adjustment to reflect to RDM is necessary.

VII. PENALTY ISSUES

A. Service Quality Penalty Mechanism

The Company has explained that the Commission simply lacks the power to impose arbitrary penalty[32] mechanisms for service standards. Dist. IB pp. 131-133. This is especially so where the standards vary from utility to utility, based on no apparent reasons, and are not supported by any law or regulation. Id. Staff merely replies, baldly, that the Commission does have such authority. Staff IB p. 62. This is hardly an adequate exposition of the Commission's power.

Staff also claims that the current Service Quality Performance Mechanism ("SQPM") "has been effective in promoting satisfactory customer service by Distribution." Staff IB p. 61. There is simply no basis for this statement. The mere fact that the Company has voluntarily implemented this mechanism as a result of previous rate case settlements is not evidence that, without the mechanism, service quality would have been any different. To the contrary, Company witness Gossel, testified: "Distribution had been providing excellent customer service prior to the implementation of any SQPM and will continue to do so without one." Tr. 118. He showed that, even where the SQPM contained null zones that allowed the Company to slip below certain

[32] Perhaps recognizing that its penalty scheme is unlawful, Staff resorts to using the label "earnings consequences" in place of "penalties" for the SQPM, and "regulatory liability" for the safety performance mechanism (infra). Obviously a dodge, these new labels do not change the fundamental fact that the Company's "earnings consequences" or "regulatory liability," if the latter is even remotely applicable, would come in the form of a penalty.

performance measures and still avoid a penalty, the Company did not miss a single annual customer service target. Id.

Staff goes on to complain that Distribution is asking the Commission to trust it to continue to provide adequate customer service and that it has not provided any assurances that it will do so. Staff IB pp. 61-62. Staff has turned regulation on its head. Pointedly, Staff cannot even define adequate customer service. Staff admitted there is no regulation that does so. Tr. 1066. Neither could Staff point to a statute that does so. Id. Staff further admits that the Commission does not have a regulatory framework for the different categories of service in the SQPM and that the hurdles for each category differ from company to company. Tr. 1067–1069.

Even if the Commission had the power to order the implementation of the penalty laden SQPM, its sheer arbitrariness would militate against such approval. Where the Commission's lack of power to assess and collect penalties is considered, it should become clear that such a plan cannot be imposed on a utility as a matter of law. Perhaps if Staff would devise a true incentive mechanism, that has both penalties for some objective level of poor service and rewards for some objective level of excellent service, the Company might be more receptive to Staff's proposal.

B. Safety Penalty Mechanism

Staff contends, without any substantiation that its proposed Safety penalty mechanism is "necessary to insure that the public does not receive a diminished safety effort by the company and ensure safety reliability." Staff IB, p 69. Staff goes on to claim that "it is important to remember that the company has agreed to similar targets in past rate cases." Id. Two things should be abundantly clear. First, Staff has no evidence that its proposals will advance safety in any way. Second, the "legality" of Staff's proposal rests on nothing more than the empty claim that the Company must have waived any objections because it agreed to a similar program in a settlement. Neither claim is availing.

The Company has already demonstrated the many infirmities of Staff's proposal (Dist. IB pp. 125-131) and they will not be repeated here. Nevertheless, several points made in Staff's brief do merit a response.

Taking Staff's second point first, the fact that Distribution might have agreed to certain safety penalty mechanisms in the past in the context of a settlement is not, as a matter of law, dispositive here.[33] Lest Staff forget, the Joint Proposal that it signed and submitted to the Commission, contained the following reservations::

> It is specifically understood and agreed that this Joint Proposal represents a negotiated resolution of the Company's rates and services for the period of the rate plans contained herein, is intended to be binding only in this proceeding and only as to the matters specifically addressed herein. Neither the Company, the Commission nor its Staff, shall be deemed to have approved, agreed to or consented to any principle or methodology underlying or supposed to underlie any agreement provided for herein.

2005 Joint Proposal, p. 54. Moreover the Joint Proposal goes on to state explicitly:

> None of the terms and provisions of the Joint Proposal and none of the positions taken herein by Signatory Party may be referred to, cited or relied upon by any party in any fashion as precedent of otherwise in any proceeding before this Commission or any regulatory agency or before any court for any purpose except in furtherance of the purposes and results of this Joint Proposal.

<u>Id.</u> These provisions were adopted by the Commission. 2005 Rate Order at 36, Ordering Clause 1. Therefore, the Company's agreement to adopt the safety mechanism in the

[33] The mechanism was accepted in the total package as part of a comprehensive settlement.

Joint Proposal in Case 04-G-1047 is wholly irrelevant. Indeed, Staff is prohibited from referring to it as precedent in any manner.

Staff's claim that the safety mechanism is necessary to ensure that the public receives an adequate level of safety is equally infirm. Staff's own brief, in fact, demonstrates that this is not the case. Staff points to a statewide standard, developed jointly by Staff and the state utilities, requiring, inter alia, all gas utilities to respond to 75% of all gas leak and odor calls within 30 minutes. Staff IB p. 74. Staff notes that the Company "is currently exceeding these standards" but, conspicuously, fails to state the degree to which the Company is doing so. Company witness House demonstrated that Distribution is exceeding the statewide standards by a wide margin: The 30 minute standard is 75%, Distribution is at 91.1%; the 45 minute standard is 90%, Distribution is at 97%; and the 60 minute standard is 95%, while Distribution is at 99%. Tr. 255. Therefore, in the one area of Staff's proposal where there are statewide standards, the Company's performance far exceeds those standards. In fact, with the lone exception of Rochester Gas & Electric Corporation ("RG&E"), which has a 30-minute response of 92.8%, Distribution's emergency response time far exceeds that of its peers. Case 07-G-0461, 2006 Gas Safety Performance Measures Report, issued June 1, 2007, p. 19.

In the area of excavator damages, Mr. House testified that the Company is in full compliance with the One-Call regulations and that it works closely with contractors. Tr. 256. Moreover, Distribution is vigilant about pursuing contractors that damage Company facilities and vigorously deals with repeat offenders. Tr. 257. When the members of Staff's Safety Panel were asked if there were deficiencies in Distribution's efforts to protect its facilities from excavation damages, the members who work most closely with the Company on a day-to-day basis, could name none. Tr. 1240-1241.

The Company has always been keenly concerned with the safety of its customers and the general public. It is full compliance with all applicable laws and safety regulations. Mr. House summed up why Staff's program is unnecessary:

> Distribution has a comprehensive program, consisting of many components, to address gas safety issues….[T]he Company's actual experience is driven by its comprehensive safety programs which reflect not only safety codes but solid engineering and sound business practices honed over many years. Staff's proposals would simply substitute a crude and derivative measurement, bearing no relationship to the needs and requirements of public safety and good utility practice, for the Company's comprehensive approach to safety.

Tr. 243. Staff's safety penalty mechanism should be rejected.

VIII. MI'S "POSITION" ON RATE MODERATORS SHOULD BE DISREGARDED

MI claims that its "position" on rate moderators should be adopted. MI IB p. 48. One's first reaction on seeing this claim should be to inquire "what position would that be?" MI never sponsored a witness in this proceeding and one could only guess at what its position might be on any matter. Certainly, the house of cards that MI assembles in its brief can hardly qualify as a "position."

MI initially proceeds from the position that Distribution is holding customers' money and wants to keep it. MI IB p. 49.[34] Nothing could be further from the truth. MI, for example, points to $ 4million of state income tax over-collections (MI IB p. 49) without conceding that the Company had proposed an immediate refund of such monies

[34] MI also claims that its proposal is necessary because the Company's service territory is "enduring difficult economic times" and that "gas prices are at or near historic highs." Here, again, MI indulges its penchant for exaggeration. Gas prices are today around $6 per mcf, far from the post-Katrina high of $16 per mcf. This is another of MI's references to its misleading use of statistics in footnote no. 5 of its initial brief.

through a bill credit. Tr. 1549. MI also points to the balance of monies in the Cost Mitigation Reserve ("CMR"), suggesting darkly, "there is no compelling reason why NFG should be permitted to retain customer money indefinitely." MI IB p. 49. The Company is suggesting no such thing. MI need only have read Mr. Meinl's testimony to see that the Company, in its rebuttal filing, proposed to use the funds in the CMR, as well as the SIT overcollection, to defray the costs of the CIP. Tr. 1690. By using CMR monies and the SIT overcollection to pay for the CIP, ratepayers will see an immediate, tangible benefit in the form or rates that were lower than they would otherwise have been had the CIP been included in base rates as was initially proposed.

IX. DISCONTINUATION OF PROGRAMS

A. Earnings Sharing Must Be Discontinued.

Mr. Meinl proposed in his direct testimony that the current earnings sharing mechanism[35] be discontinued. Tr. 1670-1671. No party disputes this proposal. Therefore it should be adopted and earning sharing must be discontinued.

A mechanism that requires refunds in excess of a certain level of earnings cannot constitutionally be imposed in the absence of a provision for reparations if earnings were to fall below a certain level. Prendergast v. New York Tel. Co., 262 U.S. 43 (1923); Bronx Gas & Electric Co. v. Maltbie, 271 N.Y. 364 (1936).

[35] Earnings sharing mechanisms are creatures of settlements, not rate cases. An earnings sharing mechanism is inherently a mechanism that makes adjustments to prior periods – in this case to force the sharing of earnings over a certain level with customers by refunding or otherwise providing for such "excess earnings." As such, absent the utility's agreement, the imposition of such a mechanism is a prohibited retroactive adjustment of rates. Purcell v. New York Cent. R.R. Co. 268 N.Y. 164 (1935); cert. den., 296 U.S. 545 (1935). As the courts have held, "ratemaking is a prospective and not a retrospective process." Niagara Mohawk Power Corp. v Public Service Comm'n, 54 A.D. 2d 255, 257 (3d Dep't 1976).

B. Some Retail Competition Programs Should be Discontinued

DES submitted an initial brief in support of DES witness Kallaher's proposals to restore programs previously adopted to promote retail access. In its initial brief, Distribution addressed all of Mr. Kallaher's arguments, and the Company will not repeat itself here. See Dist. IB 173-77. CPB also briefed DES's issues, and is in accord with Distribution. CBP IB pp. 19-21. DES's brief, however, raises some additional points that justify a reply.

DES contends that Distribution's Purchase of Receivables ("POR") program should be continued, "at a minimum, for the duration of any rate plan adopted as part of this proceeding." DES IB p. 2. DES is correct that Distribution's current plans are to allow the POR program to run its course. Tr. 1673; Dist. IB p. 173. Under the schedule adopted in the 2005 Rate Plan and the agreement for POR service, the POR program will conclude in November 2008.[36] In this proceeding, the Rate Year ends in December 2008.

To the extent that DES seeks an order from the Commission requiring the Company to continue its Purchase of Receivables "for the duration of any rate plan adopted as a part of this proceeding," (DES IB p. 2.) there is no record or legal basis to support such an order. The Company voluntarily adopted a Purchase of Receivables program as part of the Joint Proposal in Case 04-G-1047. The program was designed in the context of a comprehensive settlement and is the product of comprise, not evidence. By its terms, the Joint Proposal cannot be cited or used as precedent in any way. Therefore, DES's reliance on a program that arose from a settlement is procedurally

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[36] Notice of discontinuance must be served on ESCOs one year prior to the date of termination of POR, leaving more than enough time for aggrieved ESCOs to seek relief from the Commission. See, CPB IB p. 20 (discussed infra).

infirm. Assuming <u>arguendo</u> that the Commission had the power to require Distribution to continue the program, there is no evidentiary basis on which to do so.

CPB agrees with continuation of POR, but only if Distribution retains the discretion to cancel it "if they find that it is no longer effective and necessary." CPB IB p. 20. CPB notes, correctly, that "if NFGD ever decides that the POR program should come to an end, the one-year advance notice required will give all affected parties ample to bring any concerns they may have before the Commission long before the Company's decision takes effect." <u>Id</u>.

Accordingly, the existing POR stands, subject to the protections inherent in the program's termination procedures.

DES also wants the Discounted Retail Access Transportation Service ("DRS") program (a/k/a Marketer Referral Program, or "MRP"), which is Distribution's version of an "ESCO Referral Program," to be restored. DES IB p. 3. The DRS program expired by its own terms on July 31, 2007. Case 04-G-1047, Order Adopting National Fuel Gas Distribution Corporation's Plan for an ESCO Referral Program (issued June 2, 2006) p. 3. Distribution addressed continuation of the DRS program in its initial brief (Dist. IB pp. 174-75) in the context of continuation of retail access promotions generally. This reply is necessitated by DES's contention that "the record establishes a strong justification for the existence of the program." In fact, the record does no such thing.

As of this writing, the DRS program has expired. Notice has been provided to customers. The DRS phone center has been shuttered. Advertising stopped long ago. The program is history.

Whether the program was a success or not is beside the point. It ran its course and there is no record support for it in this proceeding. Like POR, the DRS program was adopted in a settlement agreement. The settlement agreement provides, explicitly, that its provisions are "binding only in [the 2005 Rate Plan] proceeding as to the matter specifically addressed herein." 2005 Rate Plan at §VII.F. (p. 54).

Accordingly, the DRS program cannot be resurrected in this case. If DES wants to continue to pursue its request for an ESCO Referral Program in Distribution's service territory (or anywhere else in New York State), the proper forum is the Commission's proceeding recently commenced for the very purpose of considering the continuation of programs designed to promote retail competition. Case 07-M-0458, Order on Review of Retail Access Policies and Notice Soliciting Comments (issued April 24, 2007). Dist. IB p. 175.

CPB agrees with Distribution's proposal to discontinue DRS. CPB IB p. 21. CPB supports, however, an "ESCO Introduction Program" of the kind proposed by DES in its testimony, Tr. 416, and addressed by Distribution at pages 176-77 of its brief.[37] Distribution is unfamiliar with the program described by CPB and cannot state whether it would support or oppose it generally. In this proceeding, however, there is no record support for an "ESCO Introduction Program." CPB's proposal for a collaborative to follow an order in this case should also be rejected pending the Commission's determination, in Case 07-M-0458, regarding continuation of promotional programs such as DES's, or any, "ESCO Introduction Program."

[37] DES did not brief its proposed "ESCO Introduction Program."

X. CAPACITY ISSUES

A. Staff Erroneously Argues That Producers Have An Unconditional Right To Produce Into A Local Distribution System.

The Company needs to know how much gas is coming into its system for billing and operational reasons. Producers have an economic interest in knowing how much of their gas is produced into the Company's system. One source of Distribution's flowing supply is local production, through hundreds of receipt points scattered about Distribution's service territory. In its initial brief, the Company described how 334 orifice meters out of 783 local production meters are not capable of accurately measuring the flow of gas into the Company's mainline system. Dist. IB pp. 134-135, n. 27. This is not disputed. The Company also explained that the measurement problems are the result of degradation in the performance of the producers' wells. Dist. IB p.134. This also is not disputed. Distribution's proposed solution to this problem is the adoption of a set of reasonable, industry-accepted generic rules set forth in proposed Tariff Leaf 37.1(f). These rules, if adopted, would bring to Distribution's territory a set of receipt facility gas flow characteristics that local producers would be required to meet in order to maintain production into Distribution's system.

In its initial brief, Staff agrees that orifice meters should be replaced with rotary meters.[38] Staff also appears to have abandoned a previous argument where it challenged the fact that measurement problems facing the Company are solely the effect of modifications to local production receipt facilities resulting from changes in the local producers' operations. The only issue, therefore, is who pays for the replacement meters.

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[38] *See* Staff brief p. 78 wherein Staff writes: "Staff's recommendation to replace these meters with rotary meters resolves these issues."

Staff asserts that the Company and its ratepayers must bear the responsibility to "fix the problem." Staff IB p. 78.

Local producers themselves are responsible for protecting their investments. Dist. IB pp. 138-140. While Distribution bears a responsibility to provide producers with access to its distribution system, this does not mean that producers have no responsibility to assure that their deliveries can be accurately measured, especially when the problem of inaccurate measurement is the result of, in most cases, declining production from the producers' wells.

B. Distribution Should Not Subsidize Producers' Investments.

Throughout this proceeding Staff argued vociferously that Tariff Leaf 37.1(f) should be rejected because the American Gas Association ("AGA") standards incorporated by reference cannot be publicly disseminated and, as such, "the service recipients would be severely disadvantaged." Tr. 428.

Staff now argues, for the first time, that it opposes Tariff Leaf 37.1(f) because "the standards already exist in the Commission's Rules and Regulations making the tariff language unnecessary." Staff IB p. 77. It appears that Staff is correct – the standards do indeed exist in the Commission's regulations at 16 NYCRR §226.10. This discovery, of course, undermines a good deal of contentious argument on both sides of the issue.

Importantly, it means that Distribution already has the authority to shut in producers who fail to meet the AGA standards, as provided in the Commission-approved interconnection agreement. See Interconnection Agreement (Exh. 36 (LPP-1, pp. 23, 30 of 36). So Staff is incorrect when it contends that the proposed tariff leaf would "nullify portions of the existing Commission approved interconnection agreement." Staff IB p.

77. In fact, the tariff leaf is, at worst, superfluous, and at best, a tool to further implement the Commission's intentions reflected in 16 NYCRR §226.10.

The issue then boils down to cost responsibility. Staff says that "if orifice meters are the problem, then it is the responsibility of Distribution to fix the problem." Staff IB p. 78.

Staff believes that Distribution's effort to shift costs from ratepayers to producers is an "abuse of its monopolistic position." Staff IB p. 78. Staff seems to be saying that the producers have an absolute right of continuing access to the Distribution system, paid for by Distribution.

Staff's position is extreme. Neither the Company nor the ratepayers are responsible to maintain the profitability of local producers' assets and Staff has not shown otherwise.[39] If a local producer wants to continue producing into the Company's system, it should be required to meet reasonable receipt facility requirements. The AGA standards, designed by the industry and applied in New York and other jurisdictions, are manifestly reasonable.

Staff argues that the Company has not addressed metering issues as part of its compliance with prior Commission orders, and that it does not believe Distribution's proposal satisfies the orders. Staff IB p. 78. The Company anticipated and refuted these claims in its initial brief. Dist. IB pp. 146-148. Interestingly, however, Staff goes on to

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[39] And, even if the responsibility did fall on the ratepayers, Staff, once again, miscalculates the cost to replace orifice meters with rotary meters. The replacement cost of the 334 low flow orifice meters will be approximately $901,800 for the measurement equipment ($750 for the rotary meter and $1,950 for the pressure and temperature corrector for a total measurement equipment cost of $2,700 (Tr. 815; Dist.IB p. 147)) and between $200,000 and $400,000 for the installations. (Dist. IB p. 147). Staff recommends adding $100,000 per year in capital to the construction budget. Tr. 444; Staff IB p. 80. However, Staff assumed an average cost of $1,000 per rotary meter, but did not account for the corrector. Exh. 36, IR-23. Thus, the capital requirement would be approximately $300,000 per year for three years or $900,000 for a one-year program. Tr. 816, Dist.IB p. 147, n. 40.

state that "Staff's recommendation to replace these meters with rotary meters resolves these issues." Staff IB p. 78. The problem is that Staff wants rate base treatment for the costs associated with the production meters, which it asserts is "consistent with the referenced cases and previous practice." There are no referenced cases that the Company can find in the Staff's initial brief. If instead Staff is referring to prior Commission orders, then as the Company has explained, it has complied with those orders. Second, if the "previous practice" is that of the Company, then the statement is misplaced. The Company installed the meters when the wells were connected to the Company's system. What is happening now is different – modifications to receipt facilities resulting from changes in a local producer's operations are the producer's financial responsibility.

C. Mitigation of Gas Supply Asset Costs

1. A Capacity Release True-Up Is Unworkable.

Distribution's initial brief addresses most of the issues raised by Staff with respect to a capacity release true-up mechanism. Briefly reiterated, Staff wants Distribution to apply a credit or surcharge on the bills of customers buying gas from ESCOs to reflect differences between the weighted average cost of Distribution's pipeline capacity ("WACOC"), and the cost of Distribution-held capacity that is released to the ESCO as part of a mandatory release program. Staff IB pp. 81-82; Dist. IB pp. 153-55. Distribution has shown that it cannot apply the mechanism to ESCO customer bills because ESCOs on Distribution's system, unlike many downstate utilities, use a mix of Company-released capacity and their own capacity, which is authorized by the Company's voluntary capacity program. Tr. 824, Dist. IB p. 154. As a result, it is not possible to determine which of the ESCO customers are served from the Company's released capacity and which are served from the ESCO acquired capacity. Tr. 824, Dist. IB p. 154. Thus, crediting or surcharging the proper customers is simply not possible.

Furthermore, even if it were possible to identify the appropriate ESCO customers to receive a credit or pay a surcharge (it is not) the Company does not perform billing services for a large portion of small-volume ESCO load because the Company's aggregation service allows ESCO single-retailer billing. Tariff Leaf No. 266.5. So, for those customers there is no Distribution retail bill on which to apply a true-up credit or surcharge.

As explained in its initial brief, the Company developed a program that significantly mitigates the swings between WACOC and released Company capacity, rendering a credit/surcharge mechanism unnecessary. Tr. 825, Dist. IB pp. 154-155.[40] This is the only solution available at this time, given the Company's unique inability to apply a credit/surcharge mechanism to retail bills of ESCO customers. Staff's blind pursuit of its credit/surcharge mechanism in the face of the real impediments to it on Distribution's system is baffling, and not helpful to the process. Further, the issue would not be solved if the Commission sided with Staff and directed Distribution to implement a credit/surcharge mechanism because the mix of ESCO customers – in terms of capacity mix and billing models – would not change. Perhaps, if the Company's arguments are unpersuasive, an alternative would be to direct the parties to, within a reasonable time after the date of the order addressing the Company's rate filing, hold a collaborative for the purpose of developing a mutually agreeable solution.

[40] As calculated in the Company's brief, the true-up credit to an average residential customer would be about 35 cents per month. Dist. IB p. 155.

2. The CMR Allocation And Sharing Percentages Should Be Restructured.

The Company agrees with the CPB's position to restructure both the CMR allocation (from $1 million to $2 million) and increase the Company's sharing percentage from 15% to 20%. Dist. IB pp. 155–158. Staff disagrees with Distribution and CPB and would instead start the sharing immediately at the first dollar, with no change to the sharing percentage. Staff IB p. 84. Staff dislikes CPB's proposal for two reasons. First, Staff argues that the Company has failed to identify any future programs that need funding from the CMR; and second, Staff alleges that even the CPB "revised its position" on this issue. Staff IB pp. 83-84.

On both points, Staff is wrong. Regarding the Company proposed that CMR funds and SIT overcollections should be used to defray the cost of the CIP. Dist. IB pp. 156-57. CPB agrees. CPB IB pp. 12, 26.

Regarding Staff's second point, in fact CPB did not "revise its position" so far as to reject the Company's proposal for CMR funding of CIP. While CPB is concerned about "the possibility of an interclass subsidy if revenues generated from assets paid solely by firm sales customers were used to offset costs that would otherwise be borne in part by transportation customers," CPB nonetheless supports the concept of using CMR funds generated from off-system sales and capacity release revenues to offset CIP costs. The only question, to CPB, is how to design the appropriate mechanism, which can be addressed, as CPB proposes, in the CIP collaborative. Id. The Company believes, however, that its CIP cost recovery proposal reasonably balances the CPB's subsidy concern since it allocates the costs of the CIP proposal to all customer classes.

3. "Storage Fill" Arrangements Should Be Included in the Company's Net Revenue Sharing Formula.

Staff opposes the Company proposal to apply the sharing mechanism to storage fill arrangements. Staff IB p. 89. This issue was thoroughly addressed in Distribution's initial brief at pp. 153, 158-59. Staff's brief confirms that Staff completely misunderstands what a "storage fill" arrangement is and what is involved. For this reason, these transactions are further described here.

The Company has existing storage capacity entitlements, just like it has existing transportation capacity entitlements. When the Company identifies an opportunity to maximize those assets, and those opportunities do not conflict with any statutory or regulatory constraints, the Company pursues those opportunities. For example, the Company will release its existing transportation capacity, through a capacity release transaction, thus optimizing its transportation assets. Similarly, the Company will appoint as agent on its storage capacity contracts the gas supplier from whom it is purchasing gas, through a storage fill arrangement, thus optimizing its storage assets.[41] Furthermore, the Company will use its transportation capacity rights to sell gas, through an off-system sale, to maximize its transportation assets. Note the similarity between the storage-fill arrangements and off-system sales: both use sales and purchases of gas to extract value from the underlying capacity (storage or transmission) asset.

Accordingly, just like capacity release transactions and off-system sales, storage fill arrangements optimize the Company's assets. Staff, however, sees storage fill arrangements simply as an "outsourcing of Distribution's gas purchasing function." Staff

[41] The Company cannot merely "release" its storage capacity to the gas supplier due to Federal Energy Regulatory Commission restrictions. Instead, the Company appoints the gas supplier as agent on its storage contract so that the gas supplier agent is authorized to inject the gas the Company is purchasing directly into the Company's storage entitlements.

IB p. 89. That is entirely incorrect. The Company is continuing to make its own purchases of gas, but is allowing the supplier to make some use of the Company's storage capacity rights.

Staff, then, is mistaken when it asserts that storage fill arrangements are not like off-system sales or capacity release transactions because storage fill arrangements "affect the commodity cost of gas purchased, not fixed costs." Staff IB p. 89. In fact, storage fill arrangements optimize storage capacity, a fixed cost asset, to reduce commodity costs, just like off-system sale optimize transportation capacity, a fixed cost asset, to reduce commodity costs.

The Company sees value in pursuing storage fill arrangements, even though they require additional effort on its part, similar to the effort that is expended in identifying, arranging and executing off-system sales and capacity release transactions. That such value exists is plainly evident by the fact that gas suppliers are willing to pay the Company for the flexibility to inject the Company's gas purchases into the Company's storage capacity whenever the supplier desires. And, rather than an outsourcing of the Company's gas purchasing function, it is a narrowly-prescribed means to optimize the value of the Company's storage entitlements *through* its gas purchasing function, just like the Company optimizes its transportation capacity *through* its gas purchasing function (via off-system sales).

It appears, however, that Staff is unwilling to recognize the value of these transactions, and goes so far as to imply, if not to assert, that storage fill arrangements do not optimize the Company's assets or reduce fixed costs. Staff IB p. 89. Staff's position on this issue suggests that storage fill arrangements are disfavored and should not be pursued. Given their complexity and the risks of doing business on the pipeline grid, it would make little sense for Distribution to pursue storage fill arrangements if the Commission were to support Staff's position. Staff is wrong, however, because storage fill arrangements do indeed optimize the Company's assets (just like off-system sales and capacity release transactions), and take the same amount of effort, if not more, as off-system sales and capacity release transactions to execute. Storage fill arrangements should therefore be encouraged by allowing Distribution to retain a share of the revenues, just like off-system sales and capacity release transactions.

XI. RATE DESIGN

A. Staff's Own Brief Undercuts Its Limitation Of Minimum Charge Increases.

The Company has demonstrated that the SC 1 and SC 2 Minimum Charges should be increased to approximately $20 per month. Dist. IB pp. 159-161.

Staff's brief claims that the minimum charge should be increased by no more than $3.30 per month. Staff IB p. 52. Staff argues that the Company's proposal results in a minimum bill that is above the Company's cost to serve a customer of $19.12 per month, excluding an allocation of mains. Id. Staff claims, without citation, that the Commission has traditionally excluded an allocation of mains to determine minimum costs. Staff agrees that the Company's proposal properly moves SC 1 rate design in the direction of the cost to serve. (Staff IB p. 53). Staff, however, fails to recognize that its proposal falls short of that goal.

The current minimum charge is $13.54 per month. Therefore, Staff's maximum increase of $3.30 will move that charge only to $16.84. Given Staff's recognition that a bare bones cost to serve SC 1 and SC 2 customers is $19.12, Staff's proposal falls short of the cost of serving these customers. At the very least, if Staff objected to a cost of service calculation that included mains, it should have used the barebones cost of $19.12 to set the minimum charge, as it included no allocation of mains.

Furthermore, Staff should not have excluded the cost of mains. Staff IB p. 53. While Staff argues that the Commission has traditionally excluded the cost of mains, Staff's lack of citation raises a significant question as to whether this is so.

In his Recommended Decision in the 1988 Consolidated Edison case, Judge Cohen recognized:

> The specific areas of criticism of the study, relating to allocation of a minimum mains system and certain overhead costs to the customer component, are not compelling. The Commission has specifically accepted the minimum sized distribution system concept in connection with the allocation of non-demand related electric distribution costs to the customer component, Cases 29327, et al., Niagara Mohawk Power Corporation, Opinion 87-3, pp. 238-39 (issued March 13, 1987), and that concept is equally applicable to a gas distribution system.

Case 88-G-259, Consolidated Edison Company of New York, Inc., Recommended Decision, issued July 17, 1989 p. 54. Judge Cohen's finding was not specifically overturned by the Commission. Case 88-G-259, Consolidated Edison Company of New York, Inc., Opinion No. 89-34 issued October 13, 1989. Moreover, in a later case involving Rochester Gas and Electric Corporation, the Commission did not state that an allocation of gas mains to a calculation of customer costs was per se incorrect. Case 98-G-1589, Rochester Gas and Electric Corp., Order Adopting Terms of Joint Proposal, issued February 28, 2001 p. 22 ("We note that even if the allocated portion of gas mains is removed from the calculation, the resulting minimum cost would still be about $15 per month, which largely consists of direct costs for such items as the customer's meter, service line and billing."). The notion that customers can be served without any minimally sized system is fiction.

When the cost of a minimum distribution system is recognized, as it should be, the monthly cost of serving SC 1 and SC 2 is $30.47. Tr. 682, Exh. 4, RMFA-1. This is 50% greater than the Company's proposed minimum charge. The Company's cost of $20.13 in the winter and $20.01 in the non-winter period is demonstrably reasonable.

CPB claims that the increase will be burdensome on low usage customers and that the increase should be limited because a large jump "is too much." CPB IB p. 19. There is no evidence that low usage customers are low income customers. In fact, Mr. Meinl demonstrated just the opposite. The average usage of customers taking service under the Social Service Aggregation program is 150.9 Mcf compared to 105.9 Mcf for an average heating customer. Tr. 1665. Mr. Meinl also conducted a survey that demonstrated that customers with the highest consumption lived in zip codes that correlated with the lowest income. Tr. 1677. As to the issue of low use per customer, tellingly, the zip codes with the lowest usage per account had the very highest percentage of seasonal homes. Tr. 1668. Clearly, a large percentage of low usage customers are owners of vacation homes – hardly candidates for CPB's concerns about affordability.

Moreover, low usage customers are clearly not paying their fair share toward system costs. Mr. Meinl explained that a non-heating customer contributes 45% less than the average residential customer toward the recovery of non-gas costs under current rates. Tr. 1666. Even under proposed rates, the non-heating customer will still be contributing 35% less. Id.

CPB has been making the same claims about low usage customers for many years. In fact, in a 1992 LILCO case, the Commission noted:

> CPB's exception will also be rejected, for the reasons given by Judge Deixler. The Judge noted that (1) cooking-only customers properly bear the full costs of the service line because they benefit from avoiding the later cost if usage increases; (2) trenching costs do not change with the size of the service lateral and main extension and the record contains no information about the relative size of these costs; (3) because there are no new cost studies in the record, it cannot be said with assurance what a modified customer cost might be; (4) the only cost studies available show that customer costs are still considerably higher than the amount recovered; (5) there is no reliable record evidence about the income distribution of LILCO's customers to support CPB's allegation of inequitable rate increases; and (6) the fact that all customers pay the initial block rate whether or not they go on to pay the intermediate and terminal block rates undermines the claim of disproportionate increases.

Case 91-G-1328, Long Island Lighting Company, Opinion No. 92-35 issued November 25, 1992, pp. 48-49. As the saying goes: Plus ca change, plus c'est la meme chose.

B. Staff's Unbundling Proposal Is Contrary To Commission Policy And Favors ESCOs Over Consumers.

If it were adopted, Staff's proposed MFC would be larger than the MFC in Distribution's filed case. This is because Staff's includes an extra component currently in delivery charges – records and collection – to the MFC, which is a component of natural gas supply ("NGS") charges. The effect of Staff's proposal would be beneficial to ESCOs because it would artificially increase Distribution's NGS charge, making the ESCO's gas commodity "price to compare" more attractive to the customer. See Dist. IB at 165-66.

Likewise, Staff's proposal to include a billing and payment processing ("BIPP") on Distribution's full service bill, but not on bills rendered by Distribution for ESCO merchant service, would have the effect of creating the impression that Distribution's bills are higher than the ESCOs', even when Distribution is performing a billing function on behalf of the ESCO. See Dist. IB at 168-70.

These issues as presented in Staff's initial brief were largely addressed in Distribution's initial brief. It is noteworthy, however, that the parties that stand to benefit most from Staff's MFC and BIPP proposals – ESCOs – are curiously silent on the issue. One can only conclude that the ESCOs do not perceive that Distribution's proposed rate design, which hews closely to the current rate design, is in need of a fix, suggesting that that Staff's proposal is a solution in search of a problem.

Staff's proposals, however, are not so benign. To begin with, Staff's MFC does not comply with the Commission's policy statement on unbundling,[42] which states clearly that an unbundled rate for credit and collection activities is not required when utilities perform the ESCOs' billing function. Unbundling Policy Statement at 19, n. 59 (Dist. IB p. 167). This answers the concern over "an ESCO customer paying in full for two credit and collection systems," Staff IB at 97, which does not exist when the utility is performing the billing function. Further, Staff's proposal appears to ignore the unbundling cost of service study, which is supposed to be followed when designing unbundled rates. Dist. IB at 166.

Staff's initial brief does not change the fact that Staff's proposal for the BIPP is just a bad idea. Dist. IB at 168-70. Staff seems to be oblivious to the impact of its BIPP on customers, who were confused when the BIPP was added two years ago, and would be more confused if it were subsequently removed from bills with ESCO charges. Staff's reliance on the Unbundling Policy Statement to defend its BIPP proposal, Staff IB p. 98,

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[42] Case 00-M-0504, Provider of Last Resort Responsibilities – Unbundling Track, Statement of Policy on Unbundling and Order Directing Tariff Filings (issued August 25, 2004) ("Unbundling Policy Statement").

is unavailing. The page cited by Staff (Unbundling Policy Statement at 23) addresses call center and service costs, and information resources costs, not BIPP charges.

Staff's MFC and BIPP proposals appear to be designed to promote ESCO services by, e.g., creating the appearance of a lower ESCO NGS charge. While efforts to maintain a fair platform for competition should be supported, there is less support these days for programs that are designed to assist ESCOs. See Case 07-M-0458, Order on Review of Retail Access Policies and Notice Soliciting Comments (issued April 24, 2007); Dist. IB p. 175; CPB IB p. 19. Distribution's MFC and BIPP proposals help to maintain a fair platform for continued growth in ESCO markets, without imposing a burden on Distribution's customers or creating an artificial advantage for ESCOs.

C. No Cogent Reason Has Been Advanced To Retain The "No Harm, No Foul" Rule.

Distribution has in place a very generous rule under which marketers sending gas to its system can be out of balance, up or down, by 10% without incurring penalties. Layered onto this rule is an even more generous rule called the "No Harm, No Foul" rule. Under this rule, as long as the entire pool is in balance, an individual marketer can be out of balance and still avoid penalties. The "No Harm, No Foul" rule simply provides a fail-safe when the entire pool of SC 13D customers, i.e. all SC 13D customers served by all marketers, is within the 10% tolerance zone. Currently, the failure of, generally, smaller marketers to remain within imbalance tolerances is not causing additional costs or operational difficulties. In Distribution's view, however, this is not the point. All marketers on the system should keep their deliveries within allowable bounds. When they do not, they should incur penalties.

Staff claims that the "No Harm, No Foul" rule mimics the trading of imbalances. Staff IB p 84. Staff goes on to argue that the rule should be retained because it would be too impractical to develop a real imbalance trading system. Staff IB p. 85. Finally, Staff asserts that smaller customers that rely on an assumption that the entire pool will be in balance are actually putting themselves at greater risk if it is not. Staff IB p. 85.

Staff's claim that the primary purpose of the "No Harm, No Foul" procedure is to minimize the need for imbalance trading ignores the fact that the unintended consequence of the rule is to render smaller marketers immune from the SC 13D tariff balancing provisions. Such marketers do not need to trade imbalances because they have been made virtually immune from the consequences of being out of balance.

Staff also confuses matters when it claims that smaller <u>customers</u> rely on an assumption that the entire pool will be in balance. Within the context of SC 13D service, marketers – not customers - nominate on behalf of pools of transportation customers. Other than providing the consumption captured by three-times daily meter readings, the customer's role in the nomination and balancing process is passive. Marketers – not customers - make the business decisions that affect transportation nominations and ultimately imbalances. Distribution's proposal is not designed to penalize customers but rather to influence the behavior and business decisions of the marketers.

The largest marketers have a greater incentive to stay within balance because they have a near certainty of a daily cash out when they fail to do so. Smaller marketers, as the data provided by Distribution shows, have no such certainty and therefore gain a competitive advantage over larger marketers. In effect, they become 'free riders." If larger marketers can be in balance, smaller marketer should be, too. So long as the marketers monitor the three-times daily provided customer meter readings and make adjustments their nominations at one or more of the four industry standard nomination cycles, it should not prove too difficult to be within 10%, plus or minus, of the daily pool consumption.[43]

MI also opposes the elimination of the “No Harm, No Foul” rule. MI IB pp. 70-73. In an effort to help its cause, MI provides an example showing, a hypothetical DMT pool, in which, on one given day, Marketer “X” is 12% long and Marketer “Y” is 12% short. MI IB p. 71. In MI’s view, “absent the rule…Marketers “X” and “Y” (and possibly their customers) would be assessed punitive imbalance penalties.” Id. MI turns logic and accountability on its head.

Each marketer in MI’s hypothetical construct was provided three meter readings and four nomination opportunities and still did not balance its customer pools- even though the largest marketers repeatedly demonstrate this to be an achievable task. Standing alone, each marketer in MI’s hypothetical is outside the 10% tolerance zone. If all marketers acted that way chaos would ensue. It is simply not asking too much that all marketers keep within reasonable balancing tolerances. More important, if marketers that cannot stay within reasonable bounds pass the costs of being out of balance to their customers, those customers will flock to the more responsible marketers. The “No Harm,

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43 The relative infrequency of imbalance levels outside the 10% tolerance zone for the largest markets proves this point. In a competitive market, customers should migrate to those marketers providing the best service. Moreover, if “best service” is defined as operating within the 10% tolerance zone, then the SC 13D market is not functioning properly so far as migration is concerned. Retaining “No Harm, No Foul” protects smaller marketers from exposure to the daily cash out, thereby creating a lower cost structure for those marketers and protects them from the competition provided by larger marketers. Distribution notes that after an initial growth period, the number of customers served under SC 13D service has remained within the 45-52 range since May 2006. The most recent months (45 SC 13D customers in May 2007) can at best be described as stable and perhaps more accurately as in slow decline.

No Foul" rule simply rewards uneconomic behavior and tilts the competitive playing field to the advantage of smaller ESOPs who flout the rules.

Staff and MI lose sight of the fact that the objective of SC 13D service is for marketers to be in balance. The 10% tolerance zone is not a storage service or entitlement (e.g. virtual storage) to long or short the system based upon the daily business circumstances of the marketer. Distribution neither expects nor demands daily balancing perfection. Given the tools and data available to each marketer, however, it is not unreasonable to expect marketers to be within the 10% tolerance zone. Distribution's proposal to eliminate the "No Harm, No Foul" rule should be approved as proposed.

XIII. OTHER

A. Telemetering of Large Volume Customers.

Conceding that Distribution has all but completed the telemetering program for customers with usage over 55,000 Mcf, Staff, nevertheless obdurately sticks to its claim that all customers, even those with multiple meters should be telemetered. Staff IB p. 88. The Company demonstrated in its initial brief that the requirement identified in Case 00-G-1858 has been satisfied, the project is essentially complete and only customers remaining have so many meters that they are more typical of a small customer that it would not be cost effective to install such equipment. Dist. IB p. 179. Even MI agrees that Distribution has provided persuasive rationale to permit reasonable exceptions to the general telemetering requirement. MI IB pp. 73-75.

Staff does not refute Distribution's rationale and only offers that funding for this project exists in a specified CMR account titled "system enhancements." Staff IB p. 88. The fact that "sufficient funding" might be available does not offset the monthly operating costs that would be borne by the customers nor does it create a substantial operational benefit to system. If any of the few remaining customers request installation of the telemetering equipment, Distribution would not object to installation. But forcing installation of such equipment is neither justified for the individual customer nor the system as a whole.

XIV. CONCLUSION

For all of the foregoing reasons, Distribution respectfully request that the Administrative Law Judge resolve the contested issues in the manner advocated by Distribution.

Respectfully submitted,

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Dated: August 27, 2007
Buffalo, New York

Appendix A

From: <ellen_jeffers@dps.state.ny.us>
To: <agansberg@nixonpeabody.com>, <andrew.fisher@corp.idt.net>, <bmiller@saul.com>, <bvmil@yahoo.com>, <bwiles@pulp.tc>, <cgoodman@energymarkets.com>, <chris.kallaher@directenergy.com>, <CMI@readlaniado.com>, <critaccio@couchwhite.com>, <david.prestemon@consumer.state.ny.us>, <dkoplas@fluentenergy.com>, <doug.elfner@consumer.state.ny.us>, <dstreed@idtenergy.com>, <fmarkle@gasmark.com>, <fpullaro@energysavings.com>, <ganorlander@pulp.tc>, <gary_dewilde@rge.com>, <gary.marchiori@contellation.com>, <gebissell@integrysenergy.com>, <gpond@hiscockbarclay.com>, <info@iogany.org>, <james.melia@Klgates.com>, <jdelvecchio@nfrinc.com>, <jlarison@gasmark.com>, <jmascaro@ecny.org>, <jmelia@klgates.com>, <john.walters@consumer.state.ny.us>, <john_favreau@dps.state.ny.us>, <linda_dent@rge.com>, <ljcyran@intelligentenergy.org>, <lwb@nyserda.org>, <marcia.collier@us.ngrid.com>, <mcordaro@energetix.net>, <mdangelo@intelligentenergy.org>, <meinle@natfuel.com>, <mk2@nyserda.org>, <mmager@couchwhite.com>, <nmkinsch@llgm.com>, <NTestani@empireadvocates.com>, <RDennis@knowledgeinenergy.com>, <revillem@natfuel.com>, <rhobday@energetix.net>, <rkruse@duke-energy.com>, <rob@crownenergy.biz>, <robert.hoaglund@us.ngrid.com>, <rriga@duke-energy.com>, <saul_rigberg@dps.state.ny.us>, <seth.lamont@directenergy.com>, <skardas@cenhud.com>, <srantala@energymarketers.com>, <ssampson@cecomet.net>, <truittr@natfuel.com>, <ufogel@aol.com>, <wstoughton@idtenergy.com>
Date: 6/21/2007 3:45:44 PM
Subject: Re: Case 07-G-0141

Please find attached Staff's Wojcinski Testimony, Revised Exhibit (GRW-1) which was distributed at the June 13, 2007 Settlement Conference.

Ellen L. Jeffers
NYS Department of Public Service
Three Empire State Plaza
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CC: <william_bouteiller@dps.state.ny.us>, <jeffrey_grugan@dps.state.ny.us>

National Fuel Gas Distribution Corporation
New York Division
Income Statement and Rate of Return Computation
For the Twelve Months Ended December 31, 2008
($000 omitted)

	Company TME 12/30/08		Staff Adjs	As Adj by Staff		Revenue Requirement	As TME 12/30/08
Operating Revenues							
Sale of Gas	$ 736,852	(1)	$ (1,000)	$ 735,852	(19)	$ (20,711)	$ 715,141
Other Revenues							
Late Payment Charges	6,811		(4,250)	2,561	(19)	(175)	2,386
Other Revenues	686			686			686
State Income Tax Reconciliation	-		4,000	4,000			4,000
Excess Earnings - Ratepayer's Share	-		-	-			-
Pension/OPEB	-			-			-
Back out Credit	-			-			-
Capacity Release Revenues	-			-			-
ELIRA	-			-			-
Cost Mitigation Reserve				-			-
RD&D	-			-			-
LIRA	-			-			-
Total Other Revenues	7,497	(2)	(250)	7,247		(175)	7,072
Transportation Revenues	69,516			69,516			69,516
Total Revenues	813,865		(1,250)	812,615		(20,885)	791,730
Less: Gas Purchases	528,820		-	528,820			528,820
Revenue Taxes	12,018		-	12,018	(19)	(579)	11,439
Net Revenues	273,027		(1,250)	271,777		(20,307)	251,470
Operating Expense							
Labor	49,878	(3)	(3,701)	46,177			46,177
Employee Benefits	28,207	(4)	(5,465)	22,742			22,742
Uncollectibles	22,058	(5)	(7,815)	14,243	(19)	(369)	13,874
Avian Flu Response	329	(6)	(329)	-			-
EBD PTRA	335		-	335			335
Enterprise GIS	625		-	625			625
Conservation Incentive Program	12,000	(7)	(12,000)	-			-
Mete Maintenance Fees	(789)		-	(789)			(789)
PSC Assessment	2,368		-	2,368			2,368
Rate Case	85		-	85			85
Research and Development	1,267		-	1,267			1,267
Site Remediation Costs	1,731	(8)	(1,731)	-			-
Billing	3,008	(9)	(153)	2,855			2,855
Contract Administration	974	(10)	(199)	775			775
Control Group	266	(10)	(14)	252			252
Gas Transportation	1,601	(10)	(109)	1,492			1,492
Information Services	6,617	(10)	(363)	6,254			6,254
Messenger Expense	59		-	59			59
Meter Shop	756	(10)	(38)	718			718
Remittance Processing	298	(10)	(22)	276			276
Telephone	484	(10)	(26)	458			458
Transportation	4,364	(10)	(38)	4,326			4,326
Contractors & Outside Services	10,630	(11)	(433)	10,197			10,197
Dues	542	(11)	(3)	539			539
Environmental	29	(11)	(0)	29			29
Equipment Rentals	1,738	(11)	(19)	1,719			1,719
Injuries & Damages	2,608	(11)	(358)	2,250			2,250
Material	2,854	(11)	(25)	2,829			2,829
Office Employee Expense	1,613	(11)	(19)	1,594			1,594
Other Expense	(1,981)	(11)	12	(1,969)			(1,969)
Other Insurance	1,725	(11)	(11)	1,714			1,714
Postage	201	(11)	(1)	200			200
Promotional Expense	1,001	(11)	(390)	611			611
Rents	2,288	(11)	(14)	2,274			2,274
Revenue - Income	(1,846)	(11)	12	(1,834)			(1,834)
Transportation Expense	261	(11)	(2)	259			259
UNICAP	(1,174)	(11)	7	(1,167)			(1,167)
Utilities	1,846	(11)	(14)	1,832			1,832
Royalty	-	(12)	(1,531)	(1,531)			(1,531)
Productivity Adj	(650)	(13)	(73)	(723)		-	(723)
	$ 158,206		$ (34,865)	$ 123,341		$ (369)	$ 122,972

National Fuel Gas Distribution Corporation
New York Division
Income Statement and Rate of Return Computation
For the Twelve Months Ended December 31, 2008
($000 omitted)

	Company Forecast TME 12/31/08		Staff Adjs	As Adj by Staff		Revenue Requirement	As Adjusted TME 12/31/08
Depreciation Expense	$ 37,979	(14)	$ (9,152)	$ 28,827			$ 28,827
Taxes Other Than Income Taxes							
FICA	3,502	(15)	(268)	3,234			3,234
Federal & State Unemployment	166			166			166
Property Taxes	32,068	(16)	(425)	31,643			31,643
Sales & Use	62			62			62
Miscellaneous	18			18			18
Total	35,816		(693)	35,123		-	35,123
Federal Income Taxes	5,830	(17)	13,539	19,370	(19)	(6,455)	12,915
Deferred Income Taxes							
Tax Depreciation	792		-	792			792
Capitalized Overheads	(971)			(971)			(971)
Contributions in aid of Construction	(389)		-	(389)			(389)
Reserve for bad debts	(55)		-	(55)			(55)
Miscellaneous	-		-	-			-
Total	(623)		-	(623)		-	(623)
Investment Tax Credit	-			-			-
State Income Taxes	712	(17)	3,136	3,848	(19)	(1,495)	2,353
Deferred State Income Tax	481			481			481
Total	1,193		3,136	4,329		(1,495)	2,834
Total Operating Revenues Deductions	238,401		(28,034)	210,367		(8,319)	202,048
Utility Operatin Income	$ 34,626		$ 26,784	$ 61,410		$ (11,987)	$ 49,423
Rate Base	$ 710,962	(18)	$ (45,768)	$ 665,194			$ 665,194
Rate of Return	4.87%			9.23%			7.43%
Return on Equity	3.50%			12.81%			8.75%

National Fuel Gas Distribution Corporation
New York Division
Explanation of Adjustments
For the Twelve Months Ended December 31, 2008
($000 omitted)

	Operating Revenues		
(1)	Increase LICAAP Program. - Consumer Service Panel		$ (1,000)
	Other Revenues		
(2a)	Eliminate late payment charges on Deferred Payment Arrangements. - Consumer Service Panel	$ (4,250)	
(2b)	Include overcollections of revenues for State Income Tax. - Witness Wojcinski.	4,000	$ (250)
	Labor		
(3)	Forecast compliment level, reduce management wage increases & eliminate lump sum payments and tophat. - Witness Luthringer		$ (3,701)
	Employee Benefits		
(4a)	Decrease Hospitalization & PCS using inflation. - Witness Luthringer	$ (1,440)	
(4b)	Reduce executive benefits. - Witness Luthringer	(948)	
(4c)	Update Pension & OPEBs for latest known information. - Witness Luthringer	(3,077)	
	Total		$ (5,465)
	Uncollectibles		
(5a)	Reduce rate year uncollectible expense. - Witness Wojcinski	$ (3,565)	
(5b)	Eliminate late paymeny charges on Deferred Payment Arrangements. - Consumer Service Panel	(4,250)	
(5c)	Eliminate uncollectibles on the commodity portion of the customer's bill. - Gas Rates Panel	-	
	Total		$ (7,815)
	Avian Flu Response		
(6)	Eliminate Company's request. - Witness Wojcinski		$ (329)
	Conservation Incentive program		
(7)	Eliminate program from base rate increase. - Gas Energy Effficiency Panel		$ (12,000)
	Site Remediation Expense		
(8)	Eliminate Company's request by using insurance proceeds. - Witness Luthringer		$ (1,731)
	Billing		
(9)	Eliminate additional cost of billing paper. - Witness Luthringer		(153)
	Clearing Accounts		
(10a)	Reduce clearings as a result of lower gross payroll. - Witness Luthringer	$ (393)	
(10b)	Reduce clearings as a result of lower gross benefits. - Witness Luthringer	(286)	
(10c)	Adjust allocation factor.	(130)	
	Total		$ (809)
	Inflation Elements		
(11)	See (Exhibit__GRW-1, Page 4).		$ (1,258)
	Royalty		
(12)	Include 1% royalty adjustment. - Witness Wojcinski		$ (1,531)
	Productivity		
(13)	Include 1% of staff labor,benefits and payroll taxes expense. - Witness Luthringer		$ (73)
	Depreciation		
(14)	Change depreciation rates. - Gas Rates Panel		$ (9,152)
	FICA		
(15)	Include staff payroll to calculate Taxes. - Witness Wojcinski		$ (268)
	Property Taxes		
(16)	Increase property taxes using methodology in Case 94-G-0885. - Witness Wojcinski		$ (425)
	Federal Income Taxes & State Income Taxes		
(17)	See (Exhibit__(GRW-1), Page 5.		$ 16,676
	Rate Base		
(18)	See (Exhibit__(GRW-1), Page 7.		$ (45,768)
	Revenue Requirement		
(19)	See revenue requirement Exhibit__(GRW-1), Page 8.		$ (20,711)

National Fuel Gas Distribution Corporation
New York Division
Misc Schedule
For the Twelve Months Ended December 31, 2008
($000 omitted)

	Per Company	Eliminate Co Inflation 5.829%	Net of Inflation		Staff Adjustments	As Adjusted	Staff Inflation 5.166%	After Inflation	Staff Adjustments
Contractors	$ 10,630	$ 585	$ 10,045	A	$ (348)	$ 9,697	$ 501	$ 10,197	$ (433)
Dues	542	30	$ 512			512	26	539	(3)
Environmental	29	2	$ 27			27	1	29	(0)
Equipmen Rentals	1,738	96	$ 1,642	A	(8)	1,634	84	1,719	(19)
Injuries & Damages	2,608	144	$ 2,464	B	(325)	2,139	111	2,250	(358)
Materials	2,854	157	$ 2,697	A	(7)	2,690	139	2,829	(25)
Office Employee	1,614	89	$ 1,525	A	(8)	1,517	78	1,595	(19)
Other Expense	(1,981)	(109)	$ (1,872)			(1,872)	(97)	(1,969)	12
Other Insurance	1,725	95	$ 1,630			1,630	84	1,714	(11)
Postage	201	11	$ 190			190	10	200	(1)
Promotional Expense	1,001	55	$ 946	C	(365)	581	30	611	(390)
Rents	2,287	126	$ 2,161			2,161	112	2,273	(14)
Revenue Income	(1,846)	(102)	$ (1,744)			(1,744)	(90)	(1,834)	12
Transportation	261	14	$ 247			247	13	259	(2)
UNICAP	(1,174)	(65)	$ (1,109)			(1,109)	(57)	(1,167)	7
Utilities	1,846	102	$ 1,744	A	(2)	1,742	90	1,832	(14)
	-	-	-			-	-	-	-
Total	$ 22,335	$ 1,230	$ 21,105		$ (1,063)	$ 20,042	$ 1,035	$ 21,077	$ (1,258)
Rate of Return Panel							5.166%		

A. Normalize to eliminate System Enhancement Cost. - Gas Rates Panel

B. Three year average of historic Injuries & Damages and 10% reduction of worker's compensation. - Witness Wojcinski

C. Eliminate expenditures to be made under the Conservation Incentive Program. - Consumer Service Panel

National Fuel Gas Distribution Corporation
New York Division
Calculation of Federal Income Taxes
For the Twelve Months Ended December 31, 2008
($000 omitted)

	Company Forecast TME 12/31/08		Staff Adjs	As Adj by Staff	Revenue Requirement	As Adjusted TME 12/31/08
Operating Income Before Income Taxes	$ 41,026	[a]	$ 43,460	$ 84,486	$ (19,938)	$ 64,548
Operating Income Adjustments:						
Interest Expense	21,969	[b]	1,640	23,609		23,609
Cost of Retiring Property	2,100		-	2,100		2,100
Book Depreciation	(37,979)	[c]	9,152	(28,827)		(28,827)
Income Tax Depreciation	48,768	[d]	(9,152)	39,616		39,616
Meal/Entertainment/Dues	(71)		-	(71)		(71)
Contributions in Aid of Construction	(1,200)		-	(1,200)		(1,200)
Bad Debts - Net	(171)			(171)		(171)
Capitalized Overheads	(3,000)		-	(3,000)		(3,000)
Medicare Subsidies Received	1,120		-	1,120		1,120
	-		-	-		-
	-		-	-		-
	-		-	-		-
	-		-	-		-
	-		-	-		-
	-		-	-		-
	-		-	-		-
			-			
Total Operating income Adjustments	31,536		1,640	33,176	-	33,176
Taxable Income	9,490		41,820	51,310	(19,938)	31,372
State Income tax @ 7.50%	712		3,136	3,848	(1,495)	2,353
Tax Depreciation	7,880		-	7,880		7,880
Income subject to Federal Income Tax	16,659		38,683	55,342	(18,442)	36,899
Federal Income Tax @ 35%	5,830		13,539	19,370	(6,455)	12,915
Specific Exemption	0		-	0		0
Investment Tax Credit	0		-	0		0
Federal Income Tax	$ 5,830		$ 13,539	$ 19,370	$ (6,455)	$ 12,915

[a] Increase operating income for staff adjustments.

[b] Increase Interest deduction (See Exh__(GRW-1), Page 6)

[c] Include Staff Book Depreciation.

[d] Adjust Tax Depreciation consistent with Book Depreciation

National Fuel Gas Distribution Corporation
New York Division
Computation of Interest Deduction
For the Twelve Months Ended December 31, 2008
($000 omitted)

	Company Projected TME12/31/08	Staff Projected TME 12/31/08
Adjusted Rate Base	$ 710,962	$ 665,194
Interest Bearing CWIP	0	0
Total	710,962	665,194
Cost Component	3.09%	3.55%
Interest Deduction	$ 21,969	$ 23,609
(1) Debt Component		
Long Term Debt	2.59%	2.99%
Short Term Debt	0.47%	0.53%
Customers Deposits	0.03%	0.03%
Total	3.09%	3.55%

National Fuel Gas Distribution Corporation
New York Division
Statement of Rate Base at Mid-Point (June)
For the Twelve Months Ended December 31, 2008
($000 omitted)

	Company Forecast TME 12/31/08		Staff Adjs	As Adj by Staff TME 12/31/08
Net Plant	$ 741,677	[a]	$ 4,622	$ 746,299
Working Capital				
Operating & Maintenance Expense	19,776	[b]	(4,358)	15,418
Earniings Base in Excess of Capitalization	30,083			30,083
Total Cash Allowance	49,859		(4,358)	45,501
Prepayments	10,793		-	10,793
Materials & Supplies	6,101	[c]	(379)	5,722
Gas Storage Inventory	(27,567)	[d]	-	(27,567)
Accrued Liability for Annuity				
Total Working Capital	39,186		(4,737)	34,449
Deferred Income Taxes-Liberalized Deprec	(112,577)		-	(112,577)
Deferred Income Taxes-ITC	(3,212)		-	(3,212)
Deferred HIECA Costs	-		-	-
Deferred NY PSC Assessment	1,648		-	1,648
Deferred Management Audit	-		-	-
Deferred R,D&D	(168)		-	(168)
Deferred Sales Tax	-		-	-
Deferred Site Remediation Costs	4,942	[e]	(9,523)	(4,581)
TRA Impacts Uncollestibles	4,987	[f]	(1,558)	3,429
Internal Pension Reserve	34,572	[g]	(34,572)	-
Deferred Gas Planning	-		-	-
Deferred LIRA	-		-	-
Elimination Reorganization Costs C 27934	(93)		-	(93)
	-		-	-
Rate Base at Mid-Point	$ 710,962		$ (45,768)	$ 665,194

[a] Net Plant forecast - Gas Rates Panel	$ 4,622
[b] Include Staff O&M working capital.	$ (4,358)
[c] Adjust Material and Supplies - Gas Rate Panel	$ (379)
[d] Eliminate Gas Storage Inventory - Gas Rate Panel	$ -
[e] Adjust Deferred Site Remediation Costs - Witness Luthringer	$ (9,523)
[e] Adjust TRA impact for staff uncollectible adjustments - Witness Wojcinski	$ (1,558)
[f] Eliminate Internal Pension Reserve from Rate base.- Witness Wojcinski	$ (34,572)

National Fuel Gas Distribution Corporation
New York Division
Revenue Requirement
For the Twelve Months Ended December 31, 2008
($000 omitted)

	Company YE 12/31/08	Staff YE 12/31/08
Adjusted Rate Base	$ 710,962	$ 665,194
Rate of Return	9.03%	7.43%
Required Utility Operating Income	64,214	49,423
Utility Operating Income before increase	34,626	61,410
Over/Under Operating Income	29,588	(11,987)
Retention Factor	56.92040%	57.39622%
Revenue Requirement	$ 51,981	$ (20,885)
Less Late payment factor	$ 435	$ (175)

	YE 12/31/08	YE 12/31/08
Increase in Rates	$ 51,981	$ (20,885)
Less Revenue Taxes	1,349	(579)
Uncollectible Accounts	1,422	(369)
Informational Advertising	-	-
Conservation Program	-	-
Taxable Income for SIT	49,210	(19,936)
SIT	3,691	(1,495)
Taxable Income for FIT	45,520	(18,442)
Federal Income Tax @ 35%	15,932	(6,455)
Net	$ 29,588	$ (11,987)

(1) Retention Factor	YE 12/31/08	YE 12/31/08
Revenue	100.0000%	100.0000%
Less Revenue Taxes	2.59442%	2.77000%
Uncollectible Accounts	2.73547%	1.76851%
Informational Advertising	0.00000%	0.00000%
Conservation Program	0	0
Total	94.67011%	95.46149%
Reciprical of State Tax Rate	0.925	0.925
Net	87.56985%	88.30188%
Reciprical Of Tax Rate	65%	65%
Retention Factor	56.92040%	57.39622%
Staff Retention Factor - Uncollectibles		
Uncollectibles per staff		14,243
Staff Adjustment		(1,000)
Total Retail Sales (Exh RLT 1, Sh 1)		736,852
Total Transp Revenues (Exh RLT 1, Sh1)		69,517
Total Revenues		805,369
Factor		1.76851%

	Company Rate of Return YE 12/31/08 Ratios	Cost	Weighted Cost	Staff Rate of Return YE 12/31/08 Ratios	Cost	Weighted Cost
Long Term Debt	39.36%	6.57%	2.59%	45.53%	6.57%	2.99%
Short Term Debt	8.76%	5.31%	0.47%	9.33%	5.67%	0.53%
Customer Deposit	0.79%	3.65%	0.03%	0.79%	3.65%	0.03%
Common Equity	51.09%	11.65%	5.95%	44.35%	8.75%	3.88%
	100.00%		9.03%	100.00%		7.43%

NORTHEAST GAS ASSOCIATION

B.

2006 NGA Survey of Natural Gas Customers
(for year ending 12-31-06)

Company National Fuel Gas Distribution Corp. (New York)
Respondent Joanne Zablonski
Telephone 716-857-7880 Email: zablonskij@natfuel.com

Residential *	**2006**
Multiple Applications (excluding space heating)	13,993
Multiple Applications (including space heating)	465,589
Total Residential	479,582
Commercial & Industrial	**2006**
Firm	23,950
Interruptible	1
Transportation	10,387
Total C & I	34,338
TOTAL CUSTOMERS SERVED	513,920

* Includes residential transportation customers

PLEASE RETURN VIA FAX TO:
Stephen Leahy - Northeast Gas Association
781-455-6828 (fax)
by July 25, 2007

NORTHEAST GAS ASSOCIATION

B.

2005 NGA Survey of Natural Gas Customers

(for year ending 12-31-05)

Company KeySpan - Long Island
Respondent
Telephone

Residential	**2005**
Multiple Applications (excluding space heating)	140,278
Multiple Applications (including space heating)	329,527
Total Residential	469,805

Commercial & Industrial	**2005**
Firm	50,292
Interruptible	358
Transportation	6,515
Total C & I	57,165
TOTAL CUSTOMERS SERVED	526,970

PLEASE RETURN VIA FAX TO:
Stephen Leahy - Northeast Gas Association
781-455-6828 (fax)
by June 23, 2006

Appendix B

NORTHEAST GAS ASSOCIATION

B.

2005 NGA Survey of Natural Gas Customers

(for year ending 12-31-05)

Company KeySpan - New York
Respondent
Telephone

Residential	**2005**
Multiple Applications (excluding space heating)	608,135
Multiple Applications (including space heating)	454,799
Total Residential	1,062,934
Commercial & Industrial	**2005**
Firm	38,542
Interruptible	Ø
Transportation	74,123
Total C & I	112,665
TOTAL CUSTOMERS SERVED	1,175,599

PLEASE RETURN VIA FAX TO:
Stephen Leahy - Northeast Gas Association
781-455-6828 (fax)
by June 23, 2006

Appendix B

NORTHEAST GAS ASSOCIATION

B.

2006 NGA Survey of Natural Gas Customers
(for year ending 12-31-2006)

Company: **Consolidated Edison Company of New York, Inc.**
Respondent: **Alan Schain - Manager**
Telephone: **212-460-6826**

Residential	**2006**	
Multiple Applications (excluding space heating)	635,054	
Multiple Applications (including space heating)	226,001	
Residential Transp (non heating & heating)	79,351	56,355 Non-heating 22,996 Heating
Total Residential	940,406	
Commercial & Industrial		
Firm	99,654	
Interruptible	1,320	
Transportation	17,299	
Total Commercial & Industrial	118,273	
TOTAL CUSTOMERS SERVED	1,058,679	