

BEFORE THE
NEW YORK STATE
PUBLIC SERVICE COMMISSION

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

Case 09-E- ____

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

Case 09-G- ____

-----x

**DIRECT TESTIMONY OF THE
REVENUE DECOUPLING MECHANISM PANEL**

**James A. Lahtinen
Mark O. Marini
David W. Segal
Christine M. Stratakos**

September 17, 2009

REVENUE DECOUPLING MECHANISM PANEL

1 Q. Please state the names of the members on this Revenue Decoupling Mechanism
2 Panel (the "Panel").

3 A. The Panel members are James A. Lahtinen, Mark O. Marini, David W. Segal and
4 Christine M. Stratakos.

5 Q. Mr. Lahtinen, please state your current position and business address.

6 A. I am Vice President, Rates and Regulatory Economics of New York State Electric
7 & Gas Corporation ("NYSEG" or "Company") and Rochester Gas and Electric
8 Corporation ("RG&E," together, "the Companies"). My business address is
9 RG&E, 89 East Avenue, Rochester, New York 14649.

10 Q. Please summarize your educational background and work experience.

11 A. I graduated from the State University of Plattsburgh with a B.A. degree in
12 Economics. I also earned an M.A. in Economics from the State University of
13 New York at Albany. In my present position at NYSEG and RG&E, I am
14 responsible for all aspects of rate regulation. Before joining RG&E, I was
15 employed by Duquesne Light Company ("Duquesne") and one of its affiliates for
16 11 years. At Duquesne, I held the positions of Manager, Transmission Services
17 (1991-1996), General Manager – Rates and Regulatory Analysis (1996-1999),
18 and Vice President – Rates (2001-2002). From 1999-2001, I also held the
19 position of Vice President – Rates and Regulatory Affairs at AquaSource, Inc, an
20 affiliate of Duquesne. I was an economic consultant for Bower Rohr &
21 Associates from 1989-1991. From 1984-1989, I served as Director – Economic

REVENUE DECOUPLING MECHANISM PANEL

1 and Regulatory Analysis at Central Vermont Public Service. Before entering the
2 private sector, I was employed by the New York State Department of Public
3 Service from 1979-1984 and held the position of Principal Economist. From
4 1977-1979, I was an Economist at the New York State Consumer Protection
5 Board.

6 Q. Have you previously testified in other proceedings before the New York State
7 Public Service Commission ("PSC" or the "Commission") or any other state or
8 federal regulatory agency or court?

9 A. I have testified on several occasions before the Commission, including Cases 02-
10 E-0198, 02-G-0199, 05-E-1222, 07-E-0479, and 07-M-0906. I also sponsored
11 testimony in Cases 09-E-0082, 09-G-0083, 09-E-0084, and 09-G-0085. In
12 addition, I have testified before the regulatory commissions in Pennsylvania, New
13 Jersey, Vermont, Connecticut, Indiana, the District of Columbia, and the Federal
14 Energy Regulatory Commission ("FERC").

15 Q. Mr. Marini, please state your current position and business address.

16 A. I am Manager of Regulatory and Tariffs in the Rates and Regulatory Economics
17 Department for NYSEG and RG&E. My business address is RG&E, 89 East
18 Avenue, Rochester, New York 14649.

19 Q. Please summarize your educational background and work experience.

20 A. I graduated from Rochester Institute of Technology with a B.S. degree in Applied
21 Mathematics. In my present position at RG&E, I am responsible for regulatory

REVENUE DECOUPLING MECHANISM PANEL

1 and tariff related issues for NYSEG and RG&E. I was hired by RG&E in June
2 1985. My responsibilities have involved rates and regulatory areas, including
3 electric and gas pricing, development and preparation of cost of service studies
4 (both embedded and marginal), load research, revenue allocation, rate design,
5 tariff design, analysis and administration, and participation in regulatory
6 proceedings. During my tenure, I have increasingly gained supervisory and
7 management responsibilities.

8 Q. Have you previously testified in other proceedings before the Commission or any
9 other state or federal regulatory agency or court?

10 A. I have testified on several occasions before the Commission. Most recently, I
11 testified in Cases 03-E-0765, 03-G-0766, 05-E-1222, and 07-M-0906. I also
12 sponsored testimony in Cases 09-E-0082, 09-G-0083, 09-E-0084, and 09-G-0085.

13 Q. Mrs. Stratakos, please state your current position and business address.

14 A. I am Manager of Pricing & Analysis in the Rates and Regulatory Economics
15 Department for NYSEG and RG&E. My business address is NYSEG, 18 Link
16 Drive, P.O. Box 5224, Binghamton, New York 13902.

17 Q. Please summarize your educational background and work experience.

18 A. I graduated from Cornell University, with a B.S. degree in Natural Resources. I
19 also earned an M.B.A. from Syracuse University. I have been employed by
20 NYSEG for 32 years, the last 28 of which have been in the rate and regulatory
21 area, with increasing supervisory and management responsibilities. My

REVENUE DECOUPLING MECHANISM PANEL

1 responsibilities have involved rate and regulatory areas, including electric and gas
2 pricing, development and preparation of cost of service studies, both embedded
3 and marginal, revenue allocation, rate design, tariff design, analysis and
4 administration, and participation in regulatory proceedings. In my current
5 position, I am primarily responsible for cost of service and rate-related issues for
6 both NYSEG and RG&E.

7 Q. Have you previously testified in other proceedings before the Commission or any
8 other state or federal regulatory agency or court?

9 A. I have presented testimony before FERC and I have testified on several occasions
10 before the Commission, including Cases 01-E-0359, 05-E-1222, 07-E-0479, and
11 07-M-0906. In addition, I sponsored testimony in Cases 09-E-0082, 09-G-0083,
12 09-E-0084, and 09-G-0085.

13 Q. Mr. Segal, please state your current position and business address.

14 A. I am a Principal with The NorthBridge Group. My business address is 30
15 Monument Square, Suite 105, Concord, Massachusetts 01742.

16 Q. Please summarize your educational background and work experience.

17 A. I graduated from Brown University in 1985 with a Bachelor of Science degree in
18 applied mathematics and economics and obtained a Masters in Business
19 Administration from Harvard University in 1990. I have been employed by The
20 Northbridge Group, an economic and management consulting firm providing
21 advice to clients in the electric and natural gas industries since 1992. I have

REVENUE DECOUPLING MECHANISM PANEL

1 consulted with electric and gas utility clients regarding industry restructuring,
2 asset divestitures, stranded cost measurement, risk management, and general
3 industry strategy. Before joining The NorthBridge Group, I was an Associate
4 with Putnam, Hayes & Bartlett where I also advised electric and gas utility
5 clients.

6 Q. Have you previously testified in other proceedings before the Commission or any
7 other state or federal regulatory agency or court?

8 A. Yes. I have testified on several occasions before the Commission including Cases
9 01-E-0359, 02-E-0198, 01-G-0199, and 05-E-1222.

10 Q. What is the purpose of the Panel's testimony?

11 A. The Panel will provide the details of NYSEG's proposed Gas and Electric
12 Revenue Decoupling Mechanisms ("RDMs"). In particular, the Panel will
13 describe its proposals for the form of the mechanisms, the service classes covered,
14 the process for reconciliation of revenues, triggers for early reconciliation, and
15 resetting of revenue targets for years beyond the initial rate year.

16 Q. What are the Panel's conclusions regarding the RDM it proposes?

17 A. The Panel has reached four key conclusions. First, the Company proposes total
18 revenue per class ("TRC") targets for both electric and gas customers. Second,
19 the Company proposes that the RDM cover substantially all electric service
20 classes, and most firm sales and transportation gas service classes, representing
21 approximately 97% and 97% of base delivery revenues, respectively. Third, the

REVENUE DECOUPLING MECHANISM PANEL

1 Company proposes an annual reconciliation and surcharge or credit mechanism
2 for RDM-related revenues, with more frequent reconciliation if deferral balances
3 exceed certain trigger level amounts. Fourth, the Company proposes an inflation-
4 based index adjustment for post rate-year revenue targets.

5 Q. Is this Panel sponsoring any exhibits?

6 A. Yes. Exhibit __ (NYSEGRDM-1) summarizes the RDM programs for gas,
7 electric or both, that all the utilities in New York have now adopted, or are in the
8 process of implementing. Exhibit __ (NYSEGRDM-2) shows the customer
9 classes covered under the Company's proposed RDMs. Exhibit __
10 (NYSEGRDM-3) shows the monthly revenues, usage and customer counts for the
11 test year and the targets for the rate year for each service class covered under the
12 electric and gas RDMs. Exhibit __ (NYSEGRDM-4) shows the jurisdictions in
13 which an inflationary index is an element of the rate structure. Exhibit __
14 (NYSEGRDM-5) is a bibliography of the non-New York State Public Utility
15 Commission decisions cited in our Testimony. Exhibit __ (NYSEGRDM-6)
16 contains the testimony of Dr. Susan Tierney and exhibits recently filed on behalf
17 of National Grid in Massachusetts.

18 Q. Why is the Company proposing an RDM in this proceeding?

19 A. The Company proposes an RDM to comply with the Commission's requirements
20 set forth in its April 20, 2007 Order Requiring Proposals for Revenue Decoupling

REVENUE DECOUPLING MECHANISM PANEL

1 Mechanisms in Cases 03-E-0640 and 06-G-0746 ("RDM Order"), that each utility
2 adopt an RDM in its next rate proceeding.

3 Q. What is the Commission's reason for implementing an RDM?

4 A. On pages 2-3 of its RDM Order, the Commission stated that the purpose of an
5 RDM is to "significantly reduce or eliminate any disincentives caused by the
6 recovery of utility fixed delivery costs via volumetric rates or marginal
7 consumption blocks." The Commission stated, on page 2 of the RDM Order, that
8 such disincentives "may discourage utilities from actively promoting energy
9 efficiency, renewable technologies and distributed generation" because utilities'
10 revenues are directly tied to the throughput of electricity and gas sold on their
11 system.

12 Q. Does the Company support energy efficiency programs?

13 A. Yes. The Company has been, and continues to be, strongly supportive of energy
14 efficiency efforts in the State. To that end, the Company has actively participated
15 in:

- 16 • Working Groups I-VIII to help set the ground rules for the State
17 Energy Efficiency Portfolio Standard ("EEPS");
- 18 • the more recent Evaluation Advisory Group and Outreach and
19 Marketing Advisory Group;
- 20 • the Northeast Energy Efficiency Partnership Regional Evaluation,
21 Measurement and Verification Forum;

REVENUE DECOUPLING MECHANISM PANEL

- 1 • the Energy Efficiency Program Administrators Collaborative; and
- 2 • various utility collaborative activities.

3 The Company:

- 4 • assembled a diverse and capable project team to help achieve the
- 5 EEPS goals of 15% electric and 14.7% gas savings by 2015;
- 6 • developed, filed, and continued to update a full suite of electric and
- 7 gas efficiency programs for the Commission's consideration;
- 8 • successfully implemented the fast track Residential Gas HVAC
- 9 program;
- 10 • received approval for a Multifamily Program for which
- 11 implementation services procurement has begun;
- 12 • prepared to implement various additional residential and non-
- 13 residential programs;
- 14 • proposed a Block Bidding Program to integrate independent Program
- 15 Administrators into the EEPS framework; and
- 16 • continues to participate actively in the Commission's ongoing
- 17 proceeding addressing energy efficiency matters.

18 Q. Have other New York utilities implemented RDMs?

19 A. Yes. Almost all the utilities in New York have now adopted, or are in the process
20 of implementing an RDM for gas, electric or both. Exhibit __ (NYSEGRDM-1)
21 summarizes these programs.

REVENUE DECOUPLING MECHANISM PANEL

1 Q. Are the New York programs uniform or do they differ in certain aspects?

2 A. By and large the programs share common elements. The key parameters of RDM
3 programs are the type of mechanism, the classes covered, the timing of planned
4 and interim reconciliations, and whether there is any provision for changing the
5 targets for post rate-year revenues. Exhibit __ (NYSEGRDM-1) shows that all
6 electric RDM programs in the State use a TRC target for each service class
7 covered, while all gas RDM programs rely on a revenue-per-customer ("RPC")
8 target. Also, all but one program have an annual reconciliation of the difference
9 between allowed and actual revenues. Most of the programs have a mechanism
10 that allows for more frequent reconciliation if balances accumulate beyond a
11 trigger level. The size of the trigger varies as a percentage of revenues among
12 these different programs in the state.

13 Q. Are there other ways in which the programs can be distinguished from each
14 other?

15 A. Yes. Orange & Rockland's ("O&R") electric and gas, and National Grid's gas
16 RDM programs were negotiated as part of multi-year rate joint proposals. By
17 definition, these programs have explicit treatment of target revenues in years
18 beyond the first rate year – O&R electric and gas have specific multi-year targets,
19 while National Grid gas has fixed targets with subsequent filings to support
20 changes in allowance for certain cost items. To date, none of the RDM programs

REVENUE DECOUPLING MECHANISM PANEL

1 that have been approved in litigated one-year cases have mechanisms for multi-
2 year treatment.

CONCERN WITH OTHER NEW YORK RDM PROGRAMS

3
4 Q. What is the accepted rationale for adopting an RDM?

5 A. Ideally, an RDM should provide an opportunity for utilities to continue to recover
6 unavoidable costs as sales volumes decline due to the impact of energy efficiency
7 and conservation programs implemented in the State. The Commission clearly
8 recognized the need to reduce if not eliminate disincentives for utilities to
9 encourage economical energy efficiency in its RDM Order. The Commission
10 found current rate design provided for recovery of largely fixed operating costs
11 via volumetric rates. As a result, the more a customer uses, the more revenues the
12 utility receives. This rate structure presents a conflict between utility earnings
13 and lower costs for ratepayers achievable through the implementation of
14 economical efficiency programs. An RDM provides a means for the utility to
15 recover otherwise unavoidable costs and thereby reduces the existing tension
16 between earnings and more economical service for ratepayers. Removing the
17 positive correlation between revenues and sales leaves the utility indifferent to
18 reduced usage through the adoption of economical energy efficiency programs.

REVENUE DECOUPLING MECHANISM PANEL

1 Q. What concerns does the Company have with the structure of RDM programs
2 adopted by other New York gas and electric utilities?

3 A. There are two main concerns. The first concern is the lack of any mechanism to
4 adjust the RDM targets beyond the rate year in a litigated proceeding. The second
5 concern involves the design of triggers that provide for rate adjustments to ensure
6 deferrals are held to manageable levels.

7 Q. Please explain your first concern.

8 A. While cost components of the revenue requirement (Operations & Maintenance
9 ("O&M"), taxes, and return on and of ratebase) are likely to increase from one
10 year to the next, under an RDM, allowed revenues are held constant or only
11 allowed to grow due to customer growth in the case of a gas utility with an RPC
12 RDM. This fails to recognize that cost increases under a revenue cap will place
13 increasing pressure on the Company's margins and result in inadequate cash flows
14 and earnings.

15 Q. What are the possible implications for the Company if there were no provision for
16 a change in target revenues beyond the rate year?

17 A. The Company would be forced to file a new rate case for the subsequent year to
18 avoid a drop in earnings (a gas RDM with RPC could see higher revenues
19 consistent with any growth in customers).

REVENUE DECOUPLING MECHANISM PANEL

1 Q. Hasn't this always been the case for utilities that were not covered by a multi-year
2 agreement?

3 A. Yes. However, absent an RDM in an expanding economy, a utility could have
4 expected to offset normal cost increases with the increased revenue from sales
5 growth. A TRC RDM eliminates the ability to capture additional revenues from
6 increased usage per customer, and the electric RDMs in place in New York to
7 date provide no revenue growth.

8 Q. What is the Company's proposed solution to its first concern?

9 A. As we will explain in more detail later, the Company proposes to adopt an
10 inflation-based index mechanism to adjust revenue targets for both electric and
11 gas companies on an annual basis beyond the initial rate year being litigated.
12 Such a mechanism, invited by the Commission in its RDM Order, would enable
13 the Company to offset increased costs and avoid the time consuming and
14 expensive process of annual rate increase requests.

15 Q. What is the second concern the Company has with RDM programs as adopted in
16 New York?

17 A. Given the Company's financial condition, it is paramount that careful attention is
18 given to the design of the reconciliation mechanism. As we will explain in more
19 detail, we propose interim reconciliation triggers based on a comparable
20 percentage of revenues approved in other programs, and with more rapid
21 collection than those used elsewhere.

REVENUE DECOUPLING MECHANISM PANEL

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19

STRUCTURE OF RDM TARGETS

- Q. Please describe the Company's proposed RDM structure.
- A. NYSEG proposes that both its gas and electric companies adopt a TRC RDM. Our proposal is consistent with those adopted for the other electric utilities in New York but differs from those approved by the Commission for the gas businesses in the state.
- Q. What is the rationale for proposing a TRC as opposed to a RPC model for the gas company?
- A. There are two reasons. First, one mechanism for both (NYSEG gas and electric) businesses is consistent with the Company's goal of ease of rate and tariff administration. Second, the Company believes that system cost increases are driven more by inflation than by new customer additions, and is therefore seeking annual revenue adjustments tied to inflation.
- Q. What customer classes are covered under the Company's proposed electric RDM?
- A. Exhibit __ (NYSEGRDM-2), page 1 of 2, shows the classes covered by the electric RDM. The Company proposes that substantially all of the main service classes would be covered, except lighting, standby, buy-back and flex contract service classes. SC7-4 and SC3S would not be covered because these classes have too few customers.

REVENUE DECOUPLING MECHANISM PANEL

1 Q. How do you propose to treat Industrial/High load factor subclasses?

2 A. These subclasses will be merged together over a number of years. The RDM
3 Panel proposes to combine these classes with their non-industrial/high load factor
4 subclasses for purposes of the RDM.

5 Q. What percentage of the Company's electric revenues would be covered by the
6 RDM?

7 A. Approximately 97%.

8 Q. What type of electric revenues would be covered under the RDM?

9 A. All base delivery revenues (customer, demand per KW, reactive per rkvah, and
10 delivery per KWH) for applicable classes would be covered, as would non-New
11 York Power Authority ("NYPA") revenues of customers who have all or a portion
12 of their load supplied by NYPA. Renewable Portfolio Standard ("RPS"), System
13 Benefits Charge ("SBC"), Merchant Function Charge ("MFC"), Non-Bypassable
14 Charge ("NBC"), Deferral Recovery Mechanism ("DRM") and Temporary State
15 Assessment Surcharge ("TSAS") revenues, which have separate reconciliation
16 mechanisms, would not be covered by the RDM. Economic development
17 discounts and low income discounts would not be reflected in either the target or
18 actual RDM revenues. These also are subject to separate reconciliation
19 mechanisms.

REVENUE DECOUPLING MECHANISM PANEL

1 Q. What adjustments does the Panel propose if a flex-rate or NYPA customer returns
2 to its otherwise applicable service class?

3 A. The Panel proposes that the revenue target for the relevant class would increase to
4 reflect the base delivery revenues recovered from such a customer.

5 Q. What customer classes are covered under the Company's proposed gas RDM?

6 A. Exhibit __ (NYSEGRDM-2), page 2 of 2, shows the classes covered by the gas
7 RDM. The Company proposes that substantially all of the fixed sales and
8 transportation service classes with more than a few customers would be covered.
9 Customers with individually-negotiated agreements and those taking interruptible
10 service or taking only a service, such as balancing or standby for transportation
11 customers, would be excluded. SC9 would not be covered because this class has
12 too few customers.

13 Q. What adjustments does the Panel propose if a customer from an excluded class or
14 service moves back to a covered class?

15 A. The Panel proposes that the revenue target for the relevant class would increase to
16 reflect the base delivery revenues recovered from such a customer.

17 Q. What percentage of the Company's gas revenues would be covered by the RDM?

18 A. Approximately 97%.

19 Q. What type of gas revenues would be covered under the RDM?

20 A. All base delivery revenues (i.e., customer and delivery per therm) for applicable
21 classes would be covered. SBC, MFC, DRM and TSAS revenues would not be

REVENUE DECOUPLING MECHANISM PANEL

1 subject to RDM because they have separate reconciliation mechanisms.
2 Economic development discounts and low income discounts would not be
3 reflected in either the target or actual RDM revenues. These also are subject to
4 separate reconciliation mechanisms.

5 Q. Are there tariff changes necessary for RDM implementation?

6 A. Yes. Those changes will be addressed by the Revenue Allocation and Rate
7 Design Panel.

8 **RDM TARGETS FOR RATE YEAR AND**
9 **PROPOSED RECONCILIATION PROCESS**

10 Q. How have you developed the RDM targets?

11 A. Exhibit __ (NYSEGRDM-3), pages 1 and 2, show the monthly revenues, usage
12 and customer counts for the test year and the targets for the rate year for each
13 service class covered under the electric RDM. Pages 3 and 4 of that same exhibit
14 show test year actuals and rate year target revenues, usage and customer counts
15 for each service class covered under the gas RDM. The rate year targets are based
16 on the proposed allocation of delivery revenues to each service class made by the
17 Revenue Allocation and Rate Design Panel, and the corresponding delivery rates
18 and monthly sales forecasts developed by that Panel and the Deliveries and
19 Revenues Panel.

REVENUE DECOUPLING MECHANISM PANEL

1 Q. How does the Company propose to measure and reconcile any amounts due to or
2 from customers under the RDM?

3 A. The Company will calculate monthly, for each service class covered under the
4 RDM, the difference between target and actual RDM billed revenues. The
5 Company will sum the differences for all classes and defer the monthly amount
6 for return or recovery. The balance will accrue interest at the other customer
7 deposit rate.

8 Q. How will this annual balance be reconciled?

9 A. As long as the total electric or gas balance due (either from or to customers)
10 remains below an established trigger for that business, the balance will be
11 reconciled through an annual surcharge mechanism that is recovered beginning
12 with usage on the first day of the new rate year. While the balances will be
13 totaled for purposes of determining whether they have met the trigger, when they
14 are recovered or returned they will be made into unique rates for each covered
15 service class.

16 Q. What structure will the reconciliation surcharge or credit take?

17 A. The Panel proposes a per KW surcharge (or credit) for those electric service
18 classes that do not have a per KWH charge, and a per KWH surcharge (or credit)
19 for all other classes. The gas reconciliation will be structured as a per therm
20 surcharge (or credit) for all gas classes covered.

REVENUE DECOUPLING MECHANISM PANEL

1 Q. What are the trigger levels that the Panel proposes?

2 A. The Panel proposes a trigger of 1.25% of delivery revenues, which is
3 approximately \$8.5 million for NYSEG electric and approximately \$2.2 million
4 for NYSEG gas. These are slightly lower as a percentage of revenues than
5 provided for in the Central Hudson and O&R RDMs and substantially higher than
6 that provided in the Con Edison electric rate case (approximately 0.25% of
7 electric revenues).

8 Q. If triggered before the end of the rate year, how would a surcharge or credit be
9 implemented?

10 A. Any triggered surcharge or credit would be calculated in the same way as the
11 annual reconciliation, except that it would be recovered over the remaining term
12 of the rate year or four months, whichever was longer. The amount of the
13 surcharge or credit would be calculated to bring the deferral balance back to zero.

14 Q. Does the Panel propose any limit to the number of times early reconciliation
15 could be triggered?

16 A. No. Again, given the Company's financial condition, keeping deferral balances to
17 a minimum level is the primary design driver.

REVENUE DECOUPLING MECHANISM PANEL

1 Q. How would the RDM integrate with the weather normalization adjustment
2 ("WNA")?

3 A. The WNA would continue as is, except that the 2.2% deadband would be
4 eliminated. The RDM target would be compared to actual revenues adjusted for
5 the impact of the WNA.

6 **ANNUAL ADJUSTMENT MECHANISM**

7 Q. Does the Panel support a mechanism to adjust revenue targets after the first rate
8 year?

9 A. Yes. The Panel proposes that the revenue targets established for the initial rate
10 year be subject to an annual adjustment for inflationary cost increases.

11 Q. Why is there a need for such an adjustment?

12 A. Between rate cases, the primary drivers of the utilities' delivery costs are created
13 by inflationary cost pressures. The Company strongly believes that in order to
14 appropriately cover such inflationary costs, RDM targets should be subject to an
15 annual adjustment. The Commission suggests, on page 8 of its RDM Order, that
16 an inflation and productivity adjustment mechanism may be incorporated in the
17 RDM mechanism. An annual adjustment for inflationary costs will enable the
18 Company and other parties to avoid the regulatory costs associated with more
19 frequent rate cases. Currently, the Company is able to capture any revenue
20 growth, as system load and the number of customers increase, between rate cases.
21 Both this load and/or customer growth currently increase revenues directly based

REVENUE DECOUPLING MECHANISM PANEL

1 on average rates in effect at the time. Such revenue growth can help to offset
2 general cost increases over time in operations, maintenance, capital costs, and
3 certain taxes. An RDM mechanism eliminates or significantly restricts the
4 opportunity for the Company to increase revenues, providing no relief from
5 increased costs.

6 Q. What is the specific indexing method that the Panel proposes?

7 A. The Panel proposes that the revenue target for each service class be increased by
8 the change in the GDP implicit price deflator, less 0.5% for a productivity offset,
9 but in no case will there be a negative adjustment to the revenue targets.

10 Q. Why should the entire revenue target be subject to an index and not just the part
11 that recovers O&M costs?

12 A. There are three main components to the revenue requirement, and each is affected
13 by inflation – O&M, property taxes, and return of and on ratebase. O&M
14 increases with the general level of prices in the economy to support wage,
15 material and benefits cost increases. Property taxes are tied to inflationary
16 pressures for much the same reason. Ratebase related costs increase with
17 inflation since capital expenditures are subject to the same types of inflationary
18 pressures.

REVENUE DECOUPLING MECHANISM PANEL

1 Q. Is there any precedent for rates and RDM structures in particular to include an
2 inflationary adjustment mechanism?

3 A. Yes. Exhibit __ (NYSEGRDM-4) shows the jurisdictions in which RDM
4 structures included an inflationary index component. Until recently, California
5 employed such a structure with a 0% productivity offset for four different utilities
6 and with a 1% offset for one utility (see California Public Utilities Commission
7 Decisions 04-03-034, 06-05-016, 05-03-023 and 04-05-055). More recently it has
8 moved to a set of three-year periods with preset annual increases (see California
9 Public Utilities Commission Decisions 08-11-048, 09-03-025, 08-07-009 and 07-
10 03-044). Central Vermont Public Service has implemented such a mechanism
11 with a 1% productivity offset (see Vermont Public Service Board Decision on
12 September 30, 2008 in Docket No. 7336). The citations for these decisions are
13 listed in Exhibit __ (NYSEGRDM-5).

14 Q. Are there other companies that have an RPI-X structure outside of an RDM?

15 A. Yes, referring again to Exhibit __ (NYSEGRDM-4), there are several
16 jurisdictions that currently operate under RPI-X style ratemaking. These utilities
17 have productivity offsets that range from 0.4% to 1%.

18 Q. Is there any other evidence available regarding productivity factors?

19 A. Yes. Dr. Susan Tierney of the Analysis Group recently filed RDM testimony on
20 behalf of National Grid in Massachusetts (Case DPU 09-39). A copy of the
21 testimony with exhibits is included in Exhibit __ (NYSEGRDM-6). She

REVENUE DECOUPLING MECHANISM PANEL

1 documented recent studies of productivity performed for utilities across the
2 country, which appear on page 109 of Exhibit __ (NYSEGRDM-6). Based on
3 that evidence, she arrives at an appropriate productivity offset of 0.5% for the
4 National Grid subsidiaries in Massachusetts. Exhibit __ (NYSEGRDM-6), page
5 62.

6 Q. This Commission typically imputes a productivity offset of 1% on labor-related
7 costs when examining test year data. Why is this not the appropriate factor?

8 A. There are three reasons. First, the starting point for the Company's revenue
9 requirement does include the 1% factor. Second, that offset relates only to labor-
10 related costs and not the entire bucket of operating and capital-related costs.
11 Third, in previous and traditional rate cases, the Company would keep revenue
12 growth stemming from increased sales. That extra revenue helps produce the
13 productivity that is expected. Under an RDM, any extra revenue from load
14 growth would flow back to customers and would not be available to offset
15 increased costs.

16 Q. Is there another issue you would like to discuss before you conclude your
17 testimony?

18 A. Yes. In its Order Establishing Commodity Program in Case 07-E-0479, issued
19 August 29, 2007, the Commission approved a Joint Proposal allowing NYSEG to
20 offer an elective fixed price option ("FPO") for three years. As part of the Joint
21 Proposal, NYSEG agreed to address an RDM for delivery and its market-based

REVENUE DECOUPLING MECHANISM PANEL

1 fixed price supply service, as part of NYSEG's next major electric rate case.

2 While the Commission noted that the scope of the RDM was a positive feature of
3 the Joint Proposal, it expressed concern that, given the short timeframe in which
4 the parties collaborated and reached agreement, there was insufficient time for a
5 full development and consideration of an RDM. As a result, the Commission
6 initiated a new proceeding, Case 07-E-0996 (later changed to Case 07-M-0996),
7 to examine whether the linkage of sales and profits of sales under the FPO
8 commodity option may conflict with the philosophy of an RDM.¹

9 Q. Has the Company addressed this concern?

10 A. Yes. In the Iberdrola/Energy East merger proceeding (Case 07-M-0906), the
11 Company filed Rebuttal Testimony of the Revenue Decoupling Mechanism Panel
12 ("RDM Panel"). The RDM Panel found three main reasons why an RDM should
13 not be applied to the Company's commodity programs: 1) the economics of the
14 commodity and delivery business are fundamentally different; 2) the Company
15 has little incentive to increase sales; and 3) other program design features of the
16 commodity programs made application of an RDM inappropriate. We agree and
17 those reasons are still valid.

¹ On October 22, 2007, the Commission consolidated Case 07-M-0996 with the Iberdrola/Energy East merger proceeding (Case 07-M-0906). The Commission's January 6, 2009 Order Authorizing Acquisition Subject to Conditions adopted the Administrative Law Judge's Recommended Decision that the RDM be considered in the Company's next rate case.

REVENUE DECOUPLING MECHANISM PANEL

1 Q. Is there now an additional reason why application of an RDM to the Company's
2 commodity programs is inappropriate?

3 A. Yes. On March 2, 2009, NYSEG and RG&E, filed a Petition Regarding
4 Commodity Programs in Cases 07-E-0479 and 03-E-0765. In the petition,
5 NYSEG notified the Commission that it would not offer an FPO in 2010.
6 NYSEG also sought approval to make its market-based supply service and NBC
7 charges fully reconcilable on a monthly basis. The full reconciliation would
8 eliminate any profit potential on the sale of commodity service. Assuming the
9 revisions to the Company's market-based supply service are approved by the
10 Commission, such revisions should eliminate any remaining concerns the
11 Commission may have had regarding the linkage of sales and profits under the
12 commodity programs.

13 Q. Does this conclude the Panel's direct testimony at this time?

14 A. Yes.