

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-0715

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-0716

Proceeding on Motion of the Commission as to the  
Rates, Charges, Rules and Regulations of  
Rochester Gas and Electric Corporation  
for Electric Service

Case 09-E-0717

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

Case 09-G-0718

**REBUTTAL TESTIMONY OF  
THE POLICY PANEL**

**Steven R. Adams  
Joseph J. Syta**

February 12, 2010

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

**TABLE OF CONTENTS**

<b>I.</b>	<b>INTRODUCTION.....</b>	<b>1</b>
<b>II.</b>	<b>COMPANIES' REBUTTAL OF STAFF'S CASE .....</b>	<b>2</b>
<b>III.</b>	<b>STAFF'S RECOMMENDATION REGARDING AMORTIZATION OF DEPRECIATION SHOULD BE REJECTED.....</b>	<b>5</b>
<b>IV.</b>	<b>THE COMMISSION SHOULD ADOPT THE COMPANIES' PBA IMPLEMENTATION PROPOSAL.....</b>	<b>8</b>
<b>V.</b>	<b>STAFF'S ANALYSIS OF THE COMPANIES' CREDIT RATINGS WOULD REQUIRE SUBSIDIZATION, RATHER THAN SUPPORT, FROM THEIR PARENT COMPANIES.....</b>	<b>9</b>
<b>VI.</b>	<b>STAFF'S PROPOSED PRODUCTIVITY AND AUSTERITY ADJUSTMENTS ARE EXCESSIVE, INCONSISTENT WITH RECENT PRECEDENT AND SHOULD BE REJECTED.....</b>	<b>13</b>
<b>VII.</b>	<b>CAPITAL EXPENDITURE ISSUES.....</b>	<b>18</b>
<b>VIII.</b>	<b>STAFF'S PROPOSED EARNINGS SHARING MECHANISM IS UNPRECEDENTED, SENDS THE WRONG SIGNALS, AND SHOULD BE REJECTED .....</b>	<b>20</b>
<b>IX.</b>	<b>THE COMMISSION SHOULD IMPLEMENT THE COMPANIES' REQUESTS FOR DEFERRAL/RESERVE ACCOUNTING AND THEIR PROPOSED DEFERRAL RECOVERY MECHANISM. ....</b>	<b>23</b>
<b>X.</b>	<b>PREMATURE TREATMENT OF COSTS ASSOCIATED WITH INCOMPLETE ASSET SALES.....</b>	<b>26</b>
<b>XI.</b>	<b>STAFF'S PROPOSED DISALLOWANCE FOR RG&amp;E'S HEDGE LOSSES FROM RG&amp;E'S COST OF DEBT IS INAPPROPRIATE AND SHOULD BE REJECTED.....</b>	<b>28</b>
<b>XII.</b>	<b>STAFF'S PROPOSED ADJUSTMENT RELATED TO THE WIND INVESTMENT COMMITMENT IS PREMATURE AND BASELESS .....</b>	<b>30</b>
<b>XIII.</b>	<b>OTHER GENERAL COMMENTS ON STAFF'S TESTIMONY.....</b>	<b>32</b>

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 **I. INTRODUCTION**

2 Q. Please state the names of the members of this Policy Panel for the record.

3 A. Our names are Steven R. Adams and Joseph J. Syta.

4 Q. Are you the same Steven R. Adams and Joseph J. Syta who submitted Direct  
5 Testimony in these proceedings on September 17, 2009?

6 A. Yes.

7 Q. What is the overall purpose of your testimony?

8 A. The purpose of this testimony is to respond to certain portions of the direct  
9 testimony of the Department of Public Service Staff (“Staff”) Policy Panel, the  
10 Staff Finance Panel, the Staff Electric Infrastructure Panel, and the Staff Revenue  
11 Requirement Panel that raise major policy issues. Other witnesses and panels also  
12 rebut these portions of Staff’s direct testimony on behalf New York State Electric  
13 & Gas Corporation (“NYSEG”) and Rochester Gas and Electric Corporation  
14 (“RG&E” and together with NYSEG, the “Companies”).

15 Q. Does the Panel’s testimony address Staff’s responses to information requests  
16 submitted by the Companies that are related to the Staff Policy Panel’s direct  
17 testimony?

18 A. Yes. We have reviewed several such responses by Staff and have specifically  
19 addressed some of the responses in our rebuttal testimony.

20 Q. Is this Panel sponsoring any exhibits?

21 A. Yes. Exhibit \_\_ (PPR-1) contains of a copy of the interrogatory responses and  
22 workpapers referenced in this Panel’s testimony. Exhibit \_\_ (PPR-2) compares  
23 the Companies’ rebuttal revenue requirements to Staff’s testimony and highlights

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 the instances in which the Companies have accepted Staff’s recommendations.

2 Exhibit \_\_ (PPR-3) shows the Companies’ revisions to the cash flow metrics  
3 calculated by Staff in response to NYSEG-RGE-51. Exhibit \_\_ (PPR-4) provides  
4 a comparison of the productivity and austerity adjustments proposed by Staff and  
5 the Companies. Exhibit \_\_ (PPR-5) is a January 8, 2010 Press Release from  
6 Governor Paterson’s office that references Iberdrola Renewables’ Hardscrabble  
7 wind project.

8 **II. COMPANIES’ REBUTTAL OF STAFF’S CASE**

9 Q. Please provide an overall summary of the Companies’ rebuttal testimony in these  
10 proceedings.

11 A. As shown on Exhibit \_\_ (PPR-2), the Companies are accepting a number of  
12 Staff’s recommendations in their rebuttal testimony in order to narrow the  
13 differences among the parties in these proceedings. In particular, the Companies  
14 are accepting appropriately modified versions of Staff’s proposed productivity  
15 and austerity adjustments, many of Staff’s proposed reductions to their capital  
16 expenditure budgets and operational staffing levels, Staff’s proposed transfer of  
17 certain revenues and expenses from delivery rates to the Companies’ non-  
18 bypassable charges (“NBC”), and Staff’s proposed use of variable rate debt cost  
19 (provided it is subject to reconciliation). The Companies are now requesting rate  
20 increases designed to produce a total annual revenue increase of approximately  
21 \$281.6 million collectively for the Companies, which represents an additional  
22 \$131.4 million for NYSEG Electric (\$46.4 million in NBC revenues and \$85.0  
23 million in delivery revenues), an additional \$45.0 million for NYSEG Gas, an

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 additional \$57.2 million for RG&E Electric, and an additional \$48.0 million for  
2 RG&E Gas, as shown on Exhibit \_\_ (PPR-2). The Companies are still proposing  
3 a new, enhanced low income program for its electric and gas businesses,  
4 consisting of bill reductions, arrears forgiveness and referrals of energy efficiency  
5 measures.

6 Q. Do you have any remarks about Staff’s overall presentation of its case?

7 A. Yes. The Companies appreciate the moderate tone of Staff’s testimony. The  
8 Companies look forward to continuing to work cooperatively with Staff and the  
9 Commission during these proceedings. There are, however, a number of Staff’s  
10 proposals that the Companies believe are incorrect, reflect unrealistic and one-  
11 sided assumptions, are inconsistent with past Commission practice, and in some  
12 instances reflect retroactive ratemaking. Some of these positions are listed below:

- 13 - **Credit Ratings Improvement:** While Staff agrees that the Companies  
14 should improve their credit ratings at least to the “BBB+/Baa1” level,  
15 Staff’s rate proposals would produce weak credit metrics and would  
16 impose downward pressure on the Companies’ existing credit ratings and  
17 preclude any rating improvement.
- 18 - **Excess Depreciation Reserves:** Staff attempts to apply an objectionable  
19 new depreciation accounting method, which is inconsistent with generally  
20 accepted depreciation methods, to reduce rates by approximately \$40  
21 million per year. It is inappropriate for Staff to convert a non-cash  
22 accounting entry like excess depreciation reserves to lower rates in this  
23 manner, which could, in turn, create future rate shock for customers.  
24 Staff’s suggestion that the Commission should use the excess depreciation  
25 reserve amounts to offset the Companies’ proposed rate increase is  
26 particularly inappropriate when another fund was created in the merger  
27 proceeding for this purpose, *i.e.*, the Positive Benefit Adjustments  
28 (“PBAs”). John Reed’s rebuttal testimony explains the adverse financial  
29 impact that this unusual Staff proposal would have on the Companies, why  
30 this would be bad regulatory policy, and the potential impact that Staff’s  
31 proposal could have on future rates.

## REBUTTAL TESTIMONY OF THE POLICY PANEL

- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10
- 11
- 12
- 13
- 14
- 15
- 16
- 17
- 18
- 19
- 20
- 21
- 22
- 23
- 24
- 25
- 26
- 27
- 28
- 29
- 30
- 31
- 32
- 33
- 34
- 35
- 36
- 37
- 38
- 39
- 40
- 41
- 42
- **Earnings Sharing**: Staff’s proposed earnings sharing mechanism (“ESM”) is unsupported by Commission precedent and eliminates incentives for the Companies to operate efficiently. Furthermore, ESMs accompany multi-year settlements, but are not part of one-year litigated rate decisions for delivery service.
  - **Productivity/Austerity**: Staff proposes to implement both a productivity and an austerity adjustment that would impose two significant hits to the Companies’ revenue requirements, with no opportunity to defer any unrealized portion of the austerity adjustment or recover the costs to achieve those efficiencies. Staff’s productivity adjustment also improperly includes an incremental retroactive component that produces a 5.1% adjustment. Staff inappropriately applies its austerity adjustment to costs over which the Companies have no control, and fails to take into account austerity savings that have already been achieved by the Companies.
  - **Deferrals/Reconciliations**: Staff opposes the Companies’ requests for deferral accounting or annual reconciliation of uncontrollable costs (*e.g.*, storms, property taxes, variable rate debt, etc.), while at the same time recommending downside-only reconciliations of controllable costs (*e.g.*, staffing, capital expenditures, low income programs, vegetation management).
  - **Use of Commission Precedent**: Throughout the presentation of its case, Staff selectively and inconsistently relies upon Commission precedent. For example, Staff uses litigated one-year rate precedent to support its recommendation on certain issues (*e.g.*, austerity), while ignoring that very same precedent when it seeks to depart from traditional practices (*e.g.*, earnings sharing mechanisms and deferral accounting for uncontrollable costs).
  - **Positive Benefit Adjustments**: While Staff appears to agree with the concept of utilizing the PBAs to offset one-time regulatory assets, Staff inappropriately rejects the Companies’ proposal to utilize the PBAs to offset certain deferral balances and regulatory assets.
  - **Merger Order CapEx Requirements**: Staff recommends inappropriate adjustments related to the Companies’ request for a limited capital expenditure deferral in these proceedings, even though the Commission has already determined that these issues shall be addressed in a separate proceeding.
  - **Premature Removal of Asset Costs**: Staff prematurely removes the rate base, costs and expenses associated with certain assets that may be sold by the Companies at some point in the future.
  - **Iberdrola’s Wind Investment Commitment**: Staff inappropriately imposes a \$25 million adjustment that would offset the Companies’

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 economic development revenue requirements based upon Iberdrola’s  
2 alleged failure to satisfy its \$200 million wind investment commitment  
3 from the merger proceeding, despite the fact that: (a) the timeframe for  
4 such wind development has not lapsed; and (b) Iberdrola Renewables has  
5 indicated that it plans to develop the \$200 million Hardscrabble project  
6 this year.

7 **III. STAFF’S RECOMMENDATION REGARDING AMORTIZATION OF**  
8 **DEPRECIATION SHOULD BE REJECTED**

9 Q. What does Staff recommend with respect to the Companies’ depreciable lives and  
10 net salvage rates, and then to the Companies’ resulting theoretical excess  
11 depreciation reserves?

12 A. Staff proposes adjustments to decrease RG&E Electric, RG&E Gas and NYSEG  
13 Gas depreciation expenses through a combination of increased service lives and  
14 decreased net salvage rates. Staff’s adjustments to service lives and salvage rates  
15 would decrease the Companies’ annual depreciation accruals by approximately  
16 \$25 million. Staff’s service life and salvage rate adjustments would also decrease  
17 RG&E Electric’s theoretical depreciation reserve more than \$80 million below the  
18 theoretical reserve that would result from the Company’s proposed adjustments to  
19 service lives and salvage rates. Staff’s adjustments would move the excess of  
20 book over theoretical reserves from an appropriate 10% level to nearly 30%, with  
21 theoretical excess depreciation reserves of \$125 million for RG&E Electric. Staff  
22 also claims that NYSEG Electric has an excess depreciation reserve of  
23 approximately \$304 million, because of similar changes to service lives and  
24 salvage rates Staff made in NYSEG Electric’s last rate case. Staff recommends  
25 that the Companies completely amortize the full amount of their excess  
26 depreciation reserves over ten years for NYSEG Electric at \$30.4 million per

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 year, and amortize \$9.6 million in the rate year and amortize the remainder over  
2 nine years for RG&E Electric in order to reduce rates during the rate year and  
3 ameliorate any rate increases.

4 Q. How do you respond to Staff’s proposal?

5 A. Many of the Companies’ concerns are discussed in the rebuttal testimonies of Earl  
6 M. Robinson, John J. Reed and Susan D. Abbott. These witnesses have explained  
7 how Staff’s proposed approach is inconsistent with traditional depreciation  
8 methods and will have a significant negative impact on the Companies’ cash  
9 flows. This will put downward pressure on their credit ratings and make it  
10 extremely difficult to fund their upcoming capital programs. Staff’s proposal to  
11 use the excess depreciation reserve in this manner inexplicably ignores the fund  
12 reserved for this express purpose – namely, the \$275 million in PBAs that the  
13 Commission’s Order Authorizing Acquisition Subject to Conditions in Case 07-  
14 M-0906 (the “Merger Order”) required the Companies to set aside for disposition  
15 in these rate proceedings. Staff’s depreciation methodology is also wrong in  
16 many other respects. While Earl Robinson’s rebuttal testimony addresses each of  
17 these issues in detail, there are some particularly troubling aspects of Staff’s  
18 proposed depreciation treatment that deserve emphasis here.

19 Q. Please explain.

20 A. Staff’s analysis is based upon a snapshot in time that ignores changes in the  
21 amount of the theoretical reserve that will occur over time. Furthermore, Staff’s  
22 Depreciation Panel selectively proposes adjustments to service lives, survivor  
23 curves, and net salvage rates for certain of the Companies’ electric accounts (*i.e.*,

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 generally only for accounts with *longer* service lives, which has the effect of  
2 reducing depreciation expense and the theoretical reserve). As Staff knows, all  
3 depreciation analyses assume a length of life of facilities that may be shorter or  
4 longer than the actual lives of those facilities over time. Any theoretical reserve  
5 analysis must consider both facilities with longer and shorter expected lives as  
6 compared to their book value. Selectively focusing on facilities with longer than  
7 expected service lives is one-sided, inequitable and could result in future rate  
8 shock. Furthermore, as discussed in Earl Robinson’s rebuttal testimony, Staff  
9 failed to address the fact that, for NYSEG Gas, the theoretical reserve of \$301  
10 million exceeded the Company’s book depreciation reserve by \$32 million or  
11 11.9% and, for RG&E Gas, the theoretical reserve of \$272 million exceeded the  
12 Company’s book depreciation reserve by \$48 million or 21.4%.

13 Q. Do you have other fundamental concerns with Staff’s approach to depreciation?

14 A. Yes. First, Staff’s discussion of a 10% reserve band appears to be inconsistent.  
15 On the one hand, Staff acknowledges the importance of a 10% reserve band to  
16 recognize the potential changes between theoretical reserve and book reserve.  
17 Staff explicitly recognizes in its response to NYSEG-RG&E-130 that “[t]he 10%  
18 reserve variance is a tolerance band used to trigger a reserve excess or  
19 deficiency.” The Staff Depreciation Panel also states that “[a] reserve *in excess* of  
20 10% may be used for other ratemaking purposes other than a reduction to rate  
21 base” and that, in comparing book reserve with theoretical reserve, “[i]f the  
22 resulting difference is *greater than 10%*, an amortization may be needed in the  
23 next filed rate case to maintain the integrity of the Reserve for Depreciation”

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 (emphasis added). However, Staff’s recommended rate adjustment would  
2 inconsistently result in the amortization of the full amount of excess reserves, and  
3 not simply the amount in excess of the 10% band. Thus, Staff’s proposal would  
4 effectively eliminate the 10% band down to a 0% reserve margin for these  
5 selective facilities. Second, Staff’s proposed ten-year amortization period for  
6 excess reserve amounts would inappropriately benefit existing customers to the  
7 detriment of future ratepayers, creating obvious intergenerational equity concerns.  
8 As Earl Robinson testifies, excess reserve amounts should be appropriately  
9 amortized over the average remaining life of the plant, which alleviates this  
10 concern.

11 **IV. THE COMMISSION SHOULD ADOPT THE COMPANIES’ PBA**  
12 **IMPLEMENTATION PROPOSAL**

- 13 Q. What does Staff recommend with respect to the disposition of the PBAs from the  
14 merger proceeding?
- 15 A. Staff claims that the Companies did not properly preserve the PBAs for  
16 disposition in this rate proceeding because the Companies submitted a separate  
17 petition seeking to utilize the PBAs to offset certain deferral balances. Thus,  
18 although Staff clearly states “we would not oppose the utilization of one-time  
19 regulatory assets to offset one time regulatory liabilities because it promotes rate  
20 stability and allows the companies to streamline [their] accounting records,” Staff  
21 recommends that the Companies’ proposal be rejected as inconsistent with the  
22 Merger Order.

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 Q. Have the Companies complied with the PBA implementation requirements in the  
2 Merger Order?

3 A. Yes. The Companies have fully complied with all of the PBA implementation  
4 requirements in the Merger Order. The Companies submitted testimony  
5 describing the PBA offset petition in these rate proceedings, and proposed that the  
6 remaining PBA balances be used to offset other regulatory assets at the start of the  
7 Rate Year. The Commission has taken no action on the Companies' PBA deferral  
8 petition at this time, and therefore, the full amount of the PBAs remain available  
9 for disposition in these rate proceedings.

10 Q. Do you have concerns with Staff's position on the Companies' proposal to use the  
11 PBAs to offset deferrals?

12 A. Yes. As noted above, Staff states that it "would not oppose the utilization of one-  
13 time regulatory assets to offset one-time regulatory liabilities because it promotes  
14 rate stability and allows the companies to streamline [their] accounting records."  
15 Notwithstanding this policy statement, Staff opposes the Companies' outstanding  
16 PBA offset proposals, without any real explanation for its divergence from Staff's  
17 general policy approach to allow such offsets.

18 V. **STAFF'S ANALYSIS OF THE COMPANIES' CREDIT RATINGS**  
19 **WOULD REQUIRE SUBSIDIZATION, RATHER THAN SUPPORT,**  
20 **FROM THEIR PARENT COMPANIES**

21 Q. How do you respond to Staff's suggestion that Iberdrola and Iberdrola USA could  
22 do more to improve the Companies' credit ratings?

23 A. Iberdrola and Iberdrola USA have already taken aggressive actions to improve the  
24 Companies' credit ratings and overall financial health, including foregone

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 dividends, equity infusions, temporary loans and Iberdrola’s assumption of  
2 Iberdrola USA’s debt. Iberdrola USA has foregone any dividend from NYSEG  
3 and RG&E since September 2008 in order to allow the Companies to retain all  
4 earnings and bolster equity levels, which is the same as an equity infusion. Based  
5 upon the Companies’ historical dividend payout amounts, the Companies estimate  
6 that their parent companies have foregone in excess of \$250 million in dividends  
7 during 2008 and 2009. As discussed in this Panel’s Direct Testimony, all the  
8 credit rating agencies have recognized the strong support that the Companies have  
9 received from their parent companies. This Panel’s Direct Testimony also  
10 anticipated that an additional \$25 million equity infusion into RG&E would be  
11 forthcoming. As the Companies indicated in their response to NYRC-0785,  
12 RG&E’s parent company indeed made that equity infusion in November 2009.  
13 These foregone dividends and the equity infusion allowed the Companies to  
14 improve their equity ratios to 48%, even though the Companies are not currently  
15 allowed to earn a return on this additional equity.

16 Q. How do you respond to Staff’s references to “promises” Iberdrola allegedly made  
17 during the merger proceeding that it would use its financial strength to benefit the  
18 Companies?

19 A. Staff vaguely refers to such “promises,” but does not specifically point to any  
20 such commitments that have not been fulfilled. Indeed, Iberdrola stated in the  
21 Section 70 application that joining the Iberdrola Group would provide the  
22 Companies with financial stability and greater access to both U.S. and global  
23 financial markets than they would have in the absence of the merger. That has

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 indeed occurred, and may be one of the reasons that RG&E has successfully  
2 accessed the credit markets during the financial crisis. Iberdrola never promised,  
3 however, that it would act as an unlimited capital resource for the Companies.  
4 Iberdrola has met and exceeded the commitments that it made in the merger  
5 proceeding with respect to parent company support, and Staff should not suggest  
6 otherwise. It would be inappropriate to convert statements of parent company  
7 strength and support into broad promises of limitless subsidization.

8 Q. How do you respond to Staff's further suggestion that Iberdrola could guarantee  
9 or assume the Companies' debt to improve the Companies' credit ratings?

10 A. Guarantees or assumptions of debt are an unusual measure that should not be  
11 assumed or approached lightly. Debt at the NYSEG and RG&E operating utilities  
12 was incurred by each operating utility to provide regulated services to utility  
13 customers. The Companies, as standalone entities, must maintain their own debt  
14 responsibilities. As Susan Abbott describes in her rebuttal testimony, Staff's  
15 suggestion that Iberdrola could guarantee the Companies' debt is inconsistent  
16 with the extensive ring-fencing measures proposed by Staff, approved and  
17 implemented to separate the Companies from their parents. In short, the  
18 Companies must be able to earn enough to meet their own debt obligations.  
19 Referencing the unusual move that Iberdrola undertook last year to assume certain  
20 debt at the Iberdrola USA level is inapposite. Iberdrola USA is an intermediate  
21 holding company and not a standalone utility operating company with an  
22 independent source of revenue. Moreover, as Susan Abbott testifies, even an

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 assumption of debt would not help the Companies improve their cash flow, which  
2 is critical to their credit quality.

3 Q. Could Iberdrola and Iberdrola USA improve the Companies’ credit ratings on  
4 their own?

5 A. No. Despite the strong level of parent company support that NYSEG and RG&E  
6 have received from their parent companies, Iberdrola and Iberdrola USA cannot  
7 unilaterally improve the Companies’ cash flow and credit metrics. As Susan  
8 Abbott testifies, all of the major rating agencies have stated that regulatory  
9 support will be a key factor in determining the Companies’ future ratings. In fact,  
10 Moody’s new rating methodology for utilities clarifies that 50% of a utility’s  
11 credit rating is determined by regulatory factors. As such, instead of focusing on  
12 hypothetical and limitless parent company subsidies, the Commission should  
13 work with the Companies to improve their cash flows so that they are no longer  
14 forced to rely solely upon foregone dividends, parent company equity infusions  
15 and other forms of parent company support.

16 Q. Does Staff agree that the Companies should work to improve their current credit  
17 ratings?

18 A. Yes. Staff states that it would be preferable for the Companies to achieve at least  
19 “BBB+/Baa1” credit ratings, and notes that it may also be worthwhile to consider  
20 the net benefits of pursuing an “A” level credit rating at some point in the future.  
21 As shown in Exhibit \_\_ (PPR-3), the Companies have reviewed the cash flow  
22 metrics that Staff calculated in response to NYSEG-RGE-51 and made certain  
23 necessary adjustments. In particular, we have adjusted Staff’s cash flow metrics

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 to (i) subtract interest payments from the Companies’ operating income figures;  
2 and (ii) remove the impact of certain imputations and disallowances proposed by  
3 Staff. According to Susan Abbott, Staff’s credit metrics need to be adjusted in  
4 this manner in order to reflect the way in which the credit rating agencies would  
5 evaluate the Companies. As Susan Abbott further testifies, these cash flow  
6 metrics would make it difficult for the Companies to maintain, much less  
7 improve, their credit ratings. Given Staff’s stated goal for the Companies to  
8 improve their credit ratings, the Commission should only approve rates in these  
9 proceedings that would improve the Companies’ credit ratings.

10 **VI. STAFF’S PROPOSED PRODUCTIVITY AND AUSTERITY**  
11 **ADJUSTMENTS ARE EXCESSIVE, INCONSISTENT WITH RECENT**  
12 **PRECEDENT AND SHOULD BE REJECTED**

13 Q. What adjustments does Staff propose for productivity and austerity?

14 A. Staff proposes a so-called 2% productivity adjustment for each Company’s labor,  
15 benefits and payroll-related expense. Staff’s productivity adjustment for all  
16 companies is \$13.4 million (\$9.6 million at NYSEG and \$3.8 million at RG&E).  
17 In addition, Staff recommends a so-called 2% austerity adjustment on non-fuel  
18 Operation and Maintenance (“O&M”) expenses with no opportunity to defer any  
19 austerity-related expense reduction that cannot realistically be achieved. Staff’s  
20 austerity adjustment for all Companies is \$14.8 million (\$10.0 million at NYSEG  
21 and \$4.8 million at RG&E).

22 Q. How do you respond to Staff’s proposed productivity and austerity adjustments?

23 A. As an initial matter, Staff has mischaracterized and miscalculated its proposed  
24 productivity and austerity adjustments. Staff’s rate year productivity adjustment

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 is actually 5.1% of the Company’s rate year payroll and benefits, a level that is  
2 over two times the level that Staff claims it is adjusting. Staff’s austerity  
3 adjustment is also a manufactured calculation. Staff has actually proposed an  
4 austerity adjustment of 4.9%, and not the 2% it alleges. Staff’s total rate year  
5 productivity and austerity imputation for both Companies is \$33.3 million. The  
6 amount is staggering, having an impact equal to 127 basis points in return on  
7 equity (“ROE”).

8 Q. Please explain the flaws in Staff’s productivity adjustment.

9 A. First, Staff offers no sound justification for its departure from a 1% productivity  
10 adjustment, which Staff states is “traditional or standard” for the Commission to  
11 implement. While Staff notes that the Commission recently approved a similar  
12 2% productivity adjustment in Case 08-E-0539 to reflect Consolidated Edison  
13 Company of New York, Inc.’s (“ConEd”) “greatly increased capital investment  
14 levels,” in these rate cases, Staff’s testimony recommends a significant reduction  
15 of the Companies’ capital spending plans. Furthermore, the computation of  
16 Staff’s productivity adjustment includes multiple compounding calculations back  
17 to the Test Year (which started 26 months prior to the start of the actual Rate  
18 Year). Finally, as shown on Exhibit \_\_ (PPR-4), this compounding is then  
19 exacerbated by a Staff cost base that includes pension and OPEB expenses (which  
20 are fully reconcilable). The combination of the compounding and incorrect cost  
21 base results in a total Staff productivity imputation of \$13.41 million annually or  
22 5.1% of the Companies’ payroll and medical benefits in the rate year. Staff’s  
23 productivity imputation of \$13.41 million is delineated by business on the

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 attached Exhibit \_\_ (PPR-4). The individual amounts by business are also  
2 indicated in the Staff Exhibits \_\_ (SRRP-2, SRRP-3, SRRP-4, and SRRP-5);  
3 Schedule C.

4 Q. What should be done about Staff’s proposed level of imputed productivity?

5 A. Staff’s so-called 2% productivity adjustment, which is actually 5.1% of rate year  
6 payroll and benefits, is wholly unsupported and must be rejected. The Companies  
7 already included a total of \$3.9 million in its filings for productivity, which  
8 amounted to 1.4% of rate year payroll and benefits. In an effort to resolve this  
9 issue fairly, the Companies are now proposing in rebuttal to increase the rate year  
10 productivity allowance to 2.0% of labor and benefits (\$5.3 million annually).

11 Q. How do you respond to Staff’s proposed austerity adjustment?

12 A. Staff makes two significant errors in calculating its austerity adjustment. First,  
13 Staff’s proposed austerity adjustment ignores the substantial austerity savings that  
14 were already incorporated into each Company’s Test Year revenue requirement  
15 data. As the Companies’ stated in their response to NYRC-0022 (which is  
16 attached hereto as part of Exhibit \_\_ (PPR-1)), the Companies already  
17 experienced significant austerity savings in its test year and calendar year 2009  
18 totaling \$5.1 million, which have effectively already been included in the rate  
19 year in these proceedings. Since the savings associated with the Companies’  
20 austerity measures have already been reflected in the Companies’ rate request,  
21 Staff’s full austerity adjustment cannot be adopted. Second, Staff has  
22 inappropriately included over \$330 million of uncontrollable costs in its non-fuel  
23 O&M base to which it applies its proposed 2% austerity adjustment. Staff’s base

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 non-fuel O&M level includes \$175 million associated with “pass-through”  
2 Surcharges (*e.g.*, the Temporary State Assessment Surcharge, the Renewable  
3 Portfolio Standard (“RPS”), the Energy Efficiency Portfolio Standard and System  
4 Benefits Charge), over \$100 million associated with reconcilable costs (*e.g.*,  
5 pension, OPEB, environmental, vegetation management and economic  
6 development) and over \$51 million of other uncontrollable costs (*e.g.*,  
7 uncollectibles, regulatory commission assessment, storms and Department of  
8 Energy liability). By including these uncontrollable costs in its non-fuel O&M  
9 base, Staff has overstated its austerity imputation by \$6.6 million (\$330 million x  
10 2%).

11 Q. How does Staff’s proposed austerity adjustment compare with similar adjustments  
12 the Commission has imposed in other recent rate proceedings?

13 A. Staff’s proposed austerity adjustment imposes significantly greater penalties on  
14 the Companies than were imposed in recent precedent without justification. Staff  
15 incorrectly claims that its proposed austerity adjustment is “slightly lower” than  
16 what the Commission required of Central Hudson Gas & Electric Corporation  
17 (“Central Hudson”), *i.e.*, a 1.8% downward adjustment of non-fuel O&M  
18 expenses. In fact, however, Staff’s proposed 2% downward adjustment of non-  
19 fuel O&M in these rate cases is higher than what the Commission required of  
20 Central Hudson in Cases 08-E-0887 and 08-G-0888. Furthermore, the  
21 Commission allowed both ConEd and Central Hudson the opportunity to seek  
22 deferral treatment for all or a portion of the austerity adjustment if they could not  
23 realize the required level of expense reductions despite their best efforts. In this

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 case, Staff proposes that the Companies should have no ability to seek deferral  
2 treatment because Staff is recommending a supposedly lower adjustment  
3 percentage. Staff's austerity adjustment is in fact *higher* than what the  
4 Commission required of Central Hudson. Staff's proposal to preclude the  
5 Companies from seeking deferral treatment for any unrealized levels of expense  
6 reductions is unjustified and must be rejected.

7 Q. What type of austerity adjustment are the Companies willing to accept?

8 A. The Companies original rate filings already reflected embedded austerity savings  
9 of 1.1% or \$5.1 million annually. In an effort to resolve this issue fairly, the  
10 Companies are now proposing in rebuttal to increase its austerity allowance to the  
11 1.8% level imposed on Central Hudson in Cases 08-E-0887 and 08-G-0888 (\$8.1  
12 million annually for the Companies). The Companies' total rate year adjustment  
13 for productivity and austerity combined is \$13.2 million, which equates to a  
14 daunting 51 basis points in ROE.

15 Q. Has Staff recognized any costs to achieve the levels of productivity and austerity  
16 savings that Staff imputes?

17 A. No. Staff has not recognized any costs to achieve any level of imputed  
18 productivity or austerity savings.

19 Q. Why is that inappropriate?

20 A. It is commonly known that efficiency savings (including productivity and  
21 austerity measures) have costs that companies must incur to achieve such levels of  
22 savings. Simply because Staff has not identified the specific methods of creating

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 productivity or efficiency savings, does not mean that costs to achieve such  
2 savings do not exist and should not be recovered.

3 **VII. CAPITAL EXPENDITURE ISSUES**

4 Q. Does Staff make any proposals related to the Companies' capital expenditure  
5 targets under the Merger Order?

6 A. Staff states that it does not appear the Companies will meet the 2009-2010 capital  
7 expenditure targets from the Merger Order. As a result, Staff proposes that the  
8 Commission should defer the revenue requirement associated with any shortfall  
9 below the capital expenditure levels specified in the Commission's Merger Order  
10 for the benefit of ratepayers. Staff further recommends that the Commission  
11 should drastically increase the revenue adjustments associated with the  
12 Companies' reliability performance mechanisms.

13 Q. Is Staff's proposal consistent with how the Commission has decided to address  
14 this issue?

15 A. No. The Commission already held that the Companies' limited deferral request  
16 related to capital expenditures must be addressed in Case 07-M-0906, and not in  
17 these rate proceedings. In its November 18, 2009 Order Regarding Compliance  
18 with or Modification of Capital Expenditure Requirements in Case 07-M-0906,  
19 the Commission removed the Merger Order capital expenditure requirements  
20 issues, and all related revenue adjustments, from these rate proceedings. As a  
21 result of the Commission's decision, this issue may no longer be heard in this  
22 case. Therefore, Staff's proposal for additional revenue adjustments should not  
23 be evaluated or addressed in these rate proceedings.

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 Q. Did the Companies address the revenue adjustments proposed by Staff in their  
2 December 14, 2009 submittal in Case 07-M-0906?

3 A. Yes. In that submittal, the Companies demonstrated that their proposed limited  
4 capital expenditure deferral would not have an adverse impact on their ability to  
5 provide safe and reliable service to customers in the near term. The Companies  
6 also explained that Staff’s proposed doubling of the revenue adjustments  
7 associated with the Companies’ CAIDI and SAIFI performance targets is not  
8 justified, particularly because both Companies are providing safe and reliable  
9 service to customers and have satisfied their annual CAIDI and SAIFI  
10 performance targets. Moreover, the revenue adjustments associated with the  
11 Companies’ CAIDI and SAIFI performance targets already include doubling (and  
12 re-doubling) if the Companies fail to satisfy those targets for two or more  
13 consecutive years, which provides significant incentives for the Companies. The  
14 Companies’ filing also demonstrated that it would be inappropriate for the  
15 Commission to defer the revenue requirement associated with the limited capital  
16 expenditure deferral, since the approximately \$71 million in capital expenditures  
17 that the Companies are seeking to defer are not reflected in the Companies’ rates.  
18 Staff tries to justify its proposal by suggesting that the Commission indirectly  
19 imputed the revenue requirement associated with the incremental capital  
20 investment as one of the intangible benefits of the merger, but this justification is  
21 without merit. Deferring revenue requirement amounts that were never included  
22 in rates would effectively penalize the Companies for not spending monies they  
23 never received in rates. This is particularly troubling where, as here, the

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 Companies are currently not even earning their allowed returns on equity. The  
2 Capital Expenditures, Reliability and Operations Panel also explains that Staff's  
3 increased CAIDI and SAIFI penalties are inconsistent with Staff's proposed  
4 productivity and austerity adjustments and the resulting reduction in available  
5 resources associated with these measures.

6 **VIII. STAFF'S PROPOSED EARNINGS SHARING MECHANISM IS**  
7 **UNPRECEDENTED, SENDS THE WRONG SIGNALS, AND SHOULD BE**  
8 **REJECTED**

9 Q. What earnings sharing mechanism ("ESM") does Staff propose for the  
10 Companies?

11 A. Staff proposes a multi-tiered ESM for the Companies' one-year rate plan. In  
12 Staff's proposed ESM, any earnings above Staff's proposed allowed ROE would  
13 be allocated 80% with ratepayers and 20% with shareholders for earnings above  
14 Staff's proposed allowed ROEs for the Companies (9.60% for NYSEG, and  
15 9.80% for RG&E) up to 11.5%. In the next tier of the ESM, ratepayers and  
16 shareholders would share 50%/50% in the event that earnings are above 11.5%,  
17 but less than 13.5%. In the third tier of the ESM, ratepayers would retain 100%  
18 of any earnings above 13.5%.

19 Q. Does the Commission implement ESMs in the context of one-year litigated cases  
20 for delivery service, as proposed by Staff?

21 A. No. We are unaware of any ESM like Staff's proposal in the context of setting  
22 one-year rates. In its response to NYSEG-RGE-40, Staff states that it did not rely  
23 upon any litigated decisions in the last ten years in which the Commission  
24 implemented an ESM in a one-year litigated case for delivery service. In fact, the

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 Commission has expressly rejected attempts to apply an ESM in a one-year rate  
2 case. For example, in Case 08-E-0539, the Commission declined to impose  
3 Staff’s recommended ESM on ConEd, and granted the company’s request to  
4 reject the ESM on exceptions because the Commission has not adopted such a  
5 mechanism in the context of a one-year rate case. The Commission explained  
6 why an ESM is inappropriate in the one-year context, finding that Staff’s  
7 proposed ESM would minimize ConEd’s “incentives to operate efficiently” and  
8 “be contrary to the interests of ratepayers in the short- and long-run.” Based upon  
9 this precedent, the Commission should similarly decline to adopt any ESM in the  
10 one-year rate case context in these proceedings. Furthermore (as discussed in  
11 Section VI above), the Companies are already accepting appropriately modified  
12 versions of Staff’s recommended austerity and productivity adjustments, which  
13 allocates to ratepayers the first \$13.2 million in efficiency and cost savings  
14 achieved by the Companies. Staff’s proposed ESM is duplicative and punitive in  
15 light of these austerity and productivity adjustments.

16 Q. Does Staff’s multi-tiered ESM allocation conform to the Commission’s past  
17 treatment of ESMs in other rate proceedings?

18 A. No. The allocation in the three tiers is unusual and illogical. In its response to  
19 NYSEG-RGE-48, Staff admits that it did not rely on any Commission precedent  
20 for its ESM allocation approach. Commission-approved ESMs traditionally  
21 include a “cushion” between a company’s allowed ROE and the first tier of  
22 earning sharing, in which all earnings above the allowed ROE until the first tier of  
23 sharing is triggered are retained by the company and its shareholders.

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 Commission-approved ESMs also traditionally include a first-tier earnings  
2 sharing (above the “cushion”) of 50%/50% between ratepayers and shareholders.  
3 Here, however, Staff eliminates the “cushion” above the Companies’ allowed  
4 ROEs and proposes that the first tier of earnings sharing be allocated 80% to  
5 ratepayers and 20% to shareholders. This sends an illogical signal that  
6 discourages efficiencies. Just as the Commission rejected Staff’s proposed ESM  
7 for ConEd in Case 08-E-0539 because it would minimize ConEd’s incentives to  
8 operate efficiently, the Commission should similarly reject Staff’s unusual multi-  
9 tier ESM allocation in these rate cases.

10 Q. Does Staff’s proposed ESM treat over-earnings and under-earnings similarly?

11 A. No. Staff’s proposed ESM is unfairly asymmetrical. Staff’s one-sided ESM  
12 allocation approach would only be appropriate if the ESM were to apply equally  
13 in the event that the Companies under-earn. In other words, any under-earnings  
14 below the Companies allowed ROEs must be shared between ratepayers and  
15 shareholders according to the same allocation percentages.

16 Q. Do the Companies have any other comments on Staff’s ESM proposal?

17 A. The Companies note that Staff’s ESM proposal is preceded by a lengthy and, at  
18 times, inaccurate discussion of the Companies’ past performance under their  
19 previous multi-year rate plans. First, Staff does not take into account the  
20 Companies’ earnings levels for 2008, 2009 or the Test Year, which were  
21 significantly below their allowed ROE levels. Second, Staff inflated its over-  
22 earnings calculations by including separate commodity earnings that were not part  
23 of the Companies’ multi-year delivery rate plans. Commodity earnings were used

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 to subsidize the delivery businesses under those prior plans. The Companies’  
2 delivery earnings during this period, however, were significantly lower than the  
3 figures Staff misleadingly cites. Third, Staff also ignores the fact that much of the  
4 Companies’ earnings under those prior multi-year rate plans reflected their 50%  
5 share of synergy savings related to the Energy East/RGS merger. Finally, the  
6 Companies note that their past earnings levels are irrelevant to the task of setting  
7 the Companies’ rates in the current proceedings. The Commission should ignore  
8 Staff’s irrelevant and incomplete discussion regarding past earnings.

9 **IX. THE COMMISSION SHOULD IMPLEMENT THE COMPANIES’**  
10 **REQUESTS FOR DEFERRAL/RESERVE ACCOUNTING AND THEIR**  
11 **PROPOSED DEFERRAL RECOVERY MECHANISM**

12 Q. Staff recommends that the Commission should reject many of the Companies’  
13 requests for deferral or reserve accounting. How do you respond?

14 A. The Companies object to Staff’s inconsistent treatment of the Companies’ deferral  
15 accounting requests. While Staff opposes the Companies’ proposals for deferral  
16 or reconciliation of uncontrollable costs (*e.g.*, storms, property taxes, variable rate  
17 debt), Staff also recommends downside-only reconciliations of controllable costs  
18 (*e.g.*, staffing, capital expenditures, low income programs, vegetation  
19 management). Staff’s inconsistent treatment of the Companies’ deferral and  
20 reconciliation proposals is described in more detail in the Rebuttal Testimony of  
21 the Revenue Requirements Panel. The Commission should reject Staff’s  
22 contradictory and one-sided approach to these issues.

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 Q. Why does Staff recommend that the Commission should reject the Companies’  
2 deferral, reconciliation and reserve accounting proposals?

3 A. Staff recommends that the Commission should reject many of the Companies’  
4 deferral proposals because: (i) they are not appropriate in a one-year rate case; (ii)  
5 the Companies can supposedly file new rate cases if costs rise as compared to  
6 forecasts; and (iii) the deferral proposals would reduce the Companies’ incentive  
7 to control these costs. Staff further states that the Companies’ deferral and  
8 reserve accounting proposals are not consistent with their alleged history of  
9 under-spending in those areas. Finally, Staff suggests that credit rating agencies  
10 do not recognize the benefits of deferral accounting or other reconciliation  
11 mechanisms.

12 Q. Are Staff’s proposals consistent with the Commission’s recent one-year litigated  
13 rate decisions for delivery service?

14 A. No. While Staff suggests that the Companies’ deferral proposals are not  
15 appropriate in the context of a one-year rate case, Staff’s own recommendations  
16 on deferral and reserve accounting issues are inconsistent with its testimony in  
17 ConEd’s and Central Hudson’s ongoing rate cases, as well the Commission’s  
18 most recent litigated precedent. Staff’s positions on deferral, reserve and  
19 reconciliation issues in these proceedings contradict the Commission’s findings  
20 on these very same issues in its recent one-year litigated rate decisions. For  
21 example, the Commission recently approved property tax and variable rate debt  
22 reconciliations for ConEd in Case 08-E-0539, and a variable rate debt  
23 reconciliation for Central Hudson in Cases 08-E-0887 and 08-G-0888.

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 Q. Are Staff’s other concerns valid?

2 A. No. The minimal administrative burden associated with deferral accounting and  
3 annual reconciliations would be significantly lower than the time and expense  
4 associated with annual rate case litigation. With respect to Staff’s third concern,  
5 the Companies already have ample incentive to minimize all controllable costs in  
6 the current economic environment. Staff’s suggestion that deferral accounting  
7 and reconciliations are not necessary due to the Companies’ history of under-  
8 spending is also without merit, since many of the Companies’ proposals relate to  
9 areas in which the Companies have been forced to exceed rate allowances (*e.g.*,  
10 storm costs, environmental remediation), which is precisely why deferral  
11 accounting is needed. Finally, as Susan Abbott explains in her rebuttal testimony,  
12 Staff’s assertion that credit rating agencies do not recognize the benefits of  
13 deferral accounting or other reconciliation mechanisms is incorrect, and Staff  
14 provides no justification for their elimination.

15 Q. Why does Staff recommend that the Commission reject the Companies’ proposed  
16 Deferral Recovery Mechanism (“DRM”)?

17 A. Staff states that the Commission should reject the Companies’ DRM due to: (i)  
18 the inappropriateness of such a mechanism in a one-year rate case; (ii) the  
19 administrative burden associated with an annual reconciliation process; and (iii)  
20 the alleged inconsistency of the mechanism with the Companies’ attempt to clean  
21 up their balance sheets (as described in the Companies’ PBA offset petition that  
22 Staff rejects).

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 Q. Are Staff’s concerns valid?

2 A. No. As an initial matter, it is interesting that many of Staff’s proposals reflect  
3 significant departures from Commission precedent for one-year litigated rate  
4 decisions (*e.g.*, Staff’s proposed ESM), while Staff attempts to use this very same  
5 rationale to propose a rejection of the DRM. The Companies object to Staff’s  
6 selective use of Commission precedent on one-year litigated rate decisions.  
7 Staff’s second concern regarding the burden associated with administering the  
8 DRM would have no merit in a multi-year rate plan context, where the significant  
9 costs of annual rate case litigation could be avoided through a simple annual  
10 reconciliation process. Finally, Staff’s statement that deferrals are somehow  
11 contrary to the Companies’ desire to clean up their balance sheets reflects a  
12 misunderstanding of the Companies’ position. Deferrals are certainly necessary  
13 in many instances, and the DRM would ensure that the Companies and their  
14 customers receive timely and predictable recovery/passback of deferred costs  
15 such that Companies can operate their businesses and manage their cash flows  
16 effectively and customer rates more accurately reflect the cost of service.

17 **X. PREMATURE TREATMENT OF COSTS ASSOCIATED WITH**  
18 **INCOMPLETE ASSET SALES**

19 Q. Does Staff make any ratemaking adjustments with respect to RG&E’s upcoming  
20 fossil generation auction process?

21 A. Yes. Staff proposes to remove prematurely certain rate base, O&M expenses, and  
22 property taxes associated with RG&E’s fossil generation assets from RG&E’s  
23 revenue requirement.

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 Q. Is Staff's proposal appropriate at this time?

2 A. No. It is premature to address issues associated with adjustments for fossil  
3 generation divestiture in these rate cases. RG&E is just beginning to initiate the  
4 auction process for its fossil generation assets at this time and, while RG&E is  
5 hopeful that the auction process moves quickly and smoothly, it remains unknown  
6 what portions of RG&E's fossil generation portfolio, if any, will be sold in the  
7 current market conditions, and when that might occur. Therefore, it would be  
8 inappropriate for the Commission to assume any reduction in costs of the fossil  
9 generation assets at this time.

10 Q. Does Staff recommend any similar adjustments associated with the proposed sale  
11 of NYSEG's Seneca Lake gas storage assets?

12 A. Yes. Staff also prematurely proposes to remove certain rate base, costs and  
13 expenses associated with the Seneca Lake assets from NYSEG's revenue  
14 requirement.

15 Q. Is Staff's proposal appropriate at this time?

16 A. No. It is premature to address ratemaking issues associated with the proposed  
17 sale of Seneca Lake gas storage assets as part of these rate cases. NYSEG has  
18 just entered into a signed agreement regarding the asset sale, and has not yet  
19 submitted any of its applications for authorization to consummate the transaction  
20 (including the Section 70 application that will be filed with the Commission). It  
21 would be inappropriate to consider or implement any adjustments to NYSEG's  
22 revenue requirements on the basis of that proposed transaction, which remains  
23 subject to governmental approvals and third party consents, at this time. Instead,

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 the Commission should address the impacts of that proposed transaction as part of  
2 that separate Section 70 proceeding. NYSEG and Inergy have until the first week  
3 of March 2010 to submit a Section 70 application under their Asset Purchase  
4 Agreement, and NYSEG is currently targeting the end of February 2010 to submit  
5 that application.

6 Q. Do the Companies have any additional comments on these issues?

7 A. Yes. The Companies also note that the rate base, costs and expenses associated  
8 with both the proposed Seneca Lake transaction and the future fossil divestiture  
9 auction easily could be passed back to customers through the Companies'  
10 proposed DRM.

11 **XI. STAFF'S PROPOSED DISALLOWANCE FOR RG&E'S HEDGE LOSSES**  
12 **FROM RG&E'S COST OF DEBT IS INAPPROPRIATE AND SHOULD**  
13 **BE REJECTED**

14 Q. What does Staff recommend with respect to hedge losses experienced by the  
15 Companies?

16 A. Staff's Finance Panel estimates that RG&E's losses from its two recent debt  
17 issuances amounted to \$120 million and recommends a 25% disallowance of that  
18 hedge loss in RG&E's cost of debt, alleging that RG&E has not demonstrated that  
19 the losses incurred through the use of the derivatives were reasonable.

20 Q. How do you respond to Staff's assertions?

21 A. As discussed in more detail in the Rebuttal Testimony of Howard Coon, the  
22 Companies have provided ample evidence that the hedges were reasonable  
23 transactions entered into to reduce interest rate risk for ratepayers, and that the  
24 hedge losses were an unpredictable and unpreventable result of recent market

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 anomalies. Staff inappropriately uses hindsight to criticize the impacts of the  
2 hedge loss as compared to the reasonableness of the hedging position. The  
3 Commission should instead evaluate the reasonableness of the hedge position  
4 based upon information reasonably available in 2005 and 2006 (*i.e.*, when the  
5 Company decided to enter into the hedge positions). RG&E entered into this  
6 hedge to protect ratepayers from sharp increases in interest rates. Staff agrees that  
7 this hedge position was the only feasible method at the time to hedge interest rates  
8 and agrees that the anomalies in the marketplace that gave rise to the out-of-the  
9 money results from the hedge could not have been predicted. As Howard Coon  
10 explains, RG&E entered into the hedge to protect ratepayers from increases in  
11 interest rates.

12 Q. Is Staff's position consistent with the Commission's practice with respect to the  
13 rate treatment for gains and losses from hedge transactions?

14 A. No. Both the gains and losses associated with hedge transactions are included in  
15 rates. This means that ratepayers benefit from any gain experienced by reducing  
16 the interest rate costs in a new financing, similar to the gain associated with  
17 RG&E's July 2007 financing. The Companies agree with Chairman Brown's  
18 statements at the October 2008 General Session supporting the overall use of  
19 hedging practices, and his recognition that, by their nature, individual hedge  
20 positions do not always result in ratepayer savings, where he noted:

21 But we, as regulators, just need to be very cognizant if we are going to  
22 encourage the utilities to do hedging, which is the proper thing to do, that  
23 we are completely fair with them when things don't go the direction that  
24 we had hoped, but it was still the right thing to do.

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

**XII. STAFF’S PROPOSED ADJUSTMENT RELATED TO THE WIND INVESTMENT COMMITMENT IS PREMATURE AND BASELESS**

1 Q. What is Staff’s proposal related to Iberdrola’s \$200 million wind investment  
2 commitment from the merger proceeding?

3 A. Staff proposes that the Commission implement a \$25 million adjustment (\$15  
4 million to NYSEG; \$10 million to RG&E) that would offset the Companies’  
5 economic development revenue requirements. Staff alleges that this adjustment is  
6 warranted because Iberdrola will fail to fulfill its commitment to make \$200  
7 million of incremental wind-related capital investments in New York State by  
8 September 16, 2010. In response to NYSEG-RGE-49, Staff further suggests that  
9 even if Iberdrola were to satisfy the \$200 million wind investment commitment in  
10 time, the Commission should still implement the adjustment or a portion thereof,  
11 but the Companies should then be allowed to accrue a carrying charge to be  
12 recovered in the future.

13 Q. What is your response to Staff’s proposed adjustment?

14 A. Staff’s proposal is premature and unjustified. As Staff has acknowledged, the  
15 Merger Order provides that the wind investment “may be satisfied by new  
16 investments in wind projects within New York State that are made during the  
17 initial two years following the acquisition’s closing date” (*i.e.*, by September 16,  
18 2010). Staff also acknowledges that the Commission would consider a petition  
19 from Iberdrola requesting an extension of the two-year timeframe. Therefore, it is  
20 premature and inappropriate to consider any consequences for failure to comply  
21 with the Merger Order at this time. Furthermore, Staff’s proposal to impose the  
22  
23

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 adjustment regardless of whether Iberdrola satisfies the wind investment  
2 commitment in time would prematurely penalize the Companies unfairly.

3 Allowing the Companies to accrue a carrying charge that might be recoverable in  
4 the future does not make Staff's proposal less irrational. Finally, as the  
5 Companies' response to NYRC-0058 states, Iberdrola's wind commitment was  
6 contingent upon there being no material adverse change to the fundamental  
7 economics of wind development in New York State, as well as permitting  
8 contingencies. As that response described, both the dramatic drop in NYISO  
9 market prices and the lack of RPS subsidies for at least a year following the  
10 merger closing represent such material adverse changes, and Iberdrola  
11 Renewables has not yet been able to obtain all of the necessary permits and  
12 authorizations for projects in its New York State development pipeline.

13 Q. Despite the fact that this deadline has not yet passed, is Staff correct to assume  
14 Iberdrola has no wind investment on the horizon?

15 A. No. According to its response to NYSEG-RGE-49, Staff has admittedly ignored  
16 the Companies' response to NYRC-0896 in these proceedings, in which the  
17 Companies relayed certain information about Iberdrola Renewables' 74 MW  
18 Hardscrabble wind project. As shown on Exhibit \_\_ (PPR-5), a press release  
19 from Governor Paterson's office on January 8, 2010 also referenced the  
20 Hardscrabble wind project. The Companies have been informed that the  
21 Hardscrabble project has successfully completed its New York State  
22 environmental quality review recently and continues to move forward.

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 Q. What is the expected capital outlay for the Hardscrabble project?

2 A. The Companies understand that the expected capital outlay for Hardscrabble is  
3 \$200 million in 2010, which is the level of Iberdrola's wind investment  
4 commitment.

5 **XIII. OTHER GENERAL COMMENTS ON STAFF'S TESTIMONY**

6 Q. Does the Panel have any other general thoughts about Staff's presentation of its  
7 case?

8 A. As the Rebuttal Testimony of the Revenue Requirements Panel discusses in  
9 further detail, certain new issues raised by Staff for the first time in these rate  
10 cases (*e.g.*, alleged irregularities associated with NYSEG's Storm Reserve  
11 Accounting) may be better addressed in separate proceedings. Addressing Storm  
12 Reserve Accounting in a separate proceeding would ensure that the Companies  
13 have ample opportunity to investigate and respond to Staff's allegations. In the  
14 event that the Commission does not elect to address these issues in separate  
15 proceedings, however, the Companies have attempted to respond as thoroughly as  
16 possible in their rebuttal in the limited time since receiving Staff's testimony.

17 Q. Are there any other issues raised by Staff that may be better addressed in a  
18 separate proceeding?

19 A. Yes. Staff raises several other audit issues related to the Companies' Annual  
20 Compliance Filings ("ACF"), which are extensive, complex, and involve a great  
21 level of detail that may be best dealt with in a separate proceeding. The  
22 Companies are offering rebuttal testimony on these issues as well, but they hope

**REBUTTAL TESTIMONY OF THE POLICY PANEL**

1 that these matters do not distract the parties from the key issues in these rate  
2 proceedings.

3 Q. Did Staff provide all of its workpapers on compliance filing issues with its  
4 testimony as required by the October 23, 2009 Ruling on Procedure, Schedule and  
5 Protective Order?

6 A. No. While Staff provided some workpapers with its testimony, it did not provide  
7 detailed schedules supporting its ACF adjustments. The Companies sought the  
8 workpapers via informal and formal discovery and not having received the  
9 workpapers, the Companies requested an immediate technical conference with  
10 Staff. After the technical conference, Staff provided workpapers and materials  
11 sufficient for analysis of Staff's NYSEG ACF positions, although approximately  
12 half of the rebuttal period had run. The Companies still have not received all of  
13 the necessary workpapers regarding Staff's RG&E ACF adjustments. As a result  
14 of the limited time available with Staff's NYSEG ACF workpapers and  
15 incomplete information regarding Staff's RG&E ACF positions, the Companies  
16 have not had a complete opportunity to respond fully to each of the ACF issues.

17 Q. Does this complete the Policy Panel's rebuttal testimony at this time?

18 A. Yes, it does.