STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE

CASE 05-G-1359 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Corning Natural Gas Corporation for Gas Service

CASE 05-G-1268 – Proceeding on Motion of the Commission as to the Acts, Practices and Adequacy of Service of Corning Natural Gas Corporation

CASE 04-G-1032 - Petition of Corning Natural Gas Corporation for Permission to Defer for Future Recovery Costs Remaining After Sale of Appliance Business, Filed in C 9218

SUMMARY OF JOINT PROPOSAL AND AMENDMENT

(April 19, 2006)

Overview

A Gas Rates Joint Proposal (Joint Proposal) was filed with the New York Public Service Commission on March 16, 2006, concerning:

- The amount of revenue Corning Natural Gas Corporation (the Company) should be able to recover annually for delivering gas through its system.

- The amount of revenue the Company should not be allowed to collect to compensate customers for assertedly excessive gas costs incurred in the recent heating season.

- The parameters of mechanisms to increase the probability that the projected delivery service revenue requirement will be met but not exceeded.

- The manner in which the delivery service revenue requirement should be allocated among the Company's three geographic service areas, among the customer classes in each area, and recovered in specific rate elements to ensure the total delivery service revenue requirement would likely be met on an annual basis.

- Specific steps the Company should take–-and "Best Practices" it should adopt--to improve future operations, along with comprehensive incentives intended to ensure such improvements will likely be made and that the best practices will likely be adopted.

- Studies the Company should prepare and collaborative efforts that should be undertaken to improve service quality and to foster further development of competition in the provision of gas supply.

The Joint Proposal suggested new rates for delivery service should take effect on October 1, 2006. However, in an Amendment filed April 14, 2006, it is proposed that new rates go in effect on June 1, 2006, to increase the probability that reasonable and adequate gas supply will be available to the Company in the coming year. The Amendment is discussed below.

The Joint Proposal is supported by the Company, the New York State Department of Public Service Staff, the Bath Electric, Gas & Water Systems, Multiple Intervenors, and, in part, by Fortuna Energy Inc. These are referred to as the "Signatories." The April 14, 2006 Amendment is supported by the same parties with the exception that Fortuna Energy Inc. states it does not oppose its adoption and that Multiple Intervenors' position is not yet known.

The Process

The New York State Public Service Commission alone has the power to decide if the terms of the Joint Proposal and the Amendment should be adopted, adopted with changes, or rejected. Before the Commission makes its decision, however, there will be a process designed to provide the Commission with all the information it needs.

The first part of the process involves the collection of relevant information. For example, testimony and exhibits have been submitted under oath by engineers, accountants, financial and policy analysts, and other experts who have participated actively to date in on-going Commission cases concerning the Company. Written arguments have been submitted by lawyers.

As another example, members of the general public will continue to have an opportunity to offer un-sworn comments via letters, telephone calls, and emails through May 5, 2006, and to make oral statements at public statement hearings to be held on May 3 and 4, 2006.

Another part of the process involves the organization and analysis of all the relevant information by the administrative law judges assigned to the cases. They, in turn, will make their recommendations to the Commission. Ultimately, the Commission makes its decision, taking into account all relevant information from the parties and the public, the judges' recommendations, and the advice of its most senior technical, policy and legal advisors. The Commission's decision will be explained in a written order that will be published.

The purpose of this document is to summarize the terms of the Joint Proposal and the Amendment so members of the general public will know what the Commission will be considering and be in a better position to comment should they elect to do so. This summary is intended to cover the topics in the Joint Proposal and Amendment that will most likely be of general interest. Those who want a more comprehensive understanding or who are interested in greater detail are invited to study the Joint Proposal and the Amendment.

Revenue Levels

The Signatories maintain that the Company needs total annual revenues of approximately $24.70 million. The total includes an estimate of approximately $14.56 million for the cost of natural gas that would be delivered to the Company's full service customers (those purchasing delivery and commodity from the Company). The Commission does not have authority to regulate the cost of natural gas, a commodity, and the actual level of revenue needed to purchase gas could be higher or lower than this estimate.[1]

The net balance of approximately $10.16 million is the projected cost for the Company to deliver gas safely and reliably for one year. That figure is approximately $2.7 million higher than what delivery service revenues would be if delivery rates the Commission set in December 2002 stayed in effect. The $2.7 million of additional revenue is needed in large part for the following specific reasons:[2]

[1] The Commission does have authority to regulate how the Company manages gas supply acquisition and storage. These and related issues are addressed below.

[2] All dollars are rounded to the nearest thousand. The figures presented were derived by comparing revenue requirement components in the Joint Proposal with those underlying the Commission's last delivery service rate order, dated December 23, 2002.

AMOUNT	**PURPOSE**
1. $997,000	Meet increased costs of pension and other post-employment benefits for Company employees. (This figure does not include any money for what some refer to as "golden parachutes" for Company officers.)
2. $614,000	Recover over two years the net of $2.63 million of reasonable and material expenses the Company incurred and will incur from October 2003 through September 2006, but did not previously recover in rates,[3] as offset by $1.4 million to recompense customers for assertedly excessive and unduly volatile gas costs the Company incurred as a result of its actions or failures to act prior to the winter of 2005-2006.[4]
3. $367,000	Reflect higher costs of medical insurance for Company employees.
4. $355,000	Adjust historic costs in numerous categories to account generally for inflation.
5. $331,000	Allow a reasonable rate of return (8.22% overall and 10.00% on equity) on new plant in service and on reasonable costs incurred in prior periods, pending their recovery from customers in rates.
6. $211,000	Meet higher levels of Company uncollectibles.
7. $199,000	Match increases in property taxes ($145,000) and in income and other taxes ($54,000).
8. $135,000	Cover increased depreciation expense.
$3,209,000	Total

[3] These are costs that had been allocated to unregulated affiliates of the Company in the past and that can no longer be so allocated given the sale of these affiliates in 2003.

[4] To avoid any overcollection in the event the new delivery rates remain in effect after September 30, 2008, revenues covering the net of these costs would thereafter be credited to customers through the Gas Adjustment Clause.

These are not all of the projected cost increases, but they are the most significant. There are also offsets such as decreases in labor expenses ($278,000), and other operation and maintenance costs ($207,000). The net of all the projected increases and decreases is $2.7 million.

Additionally, to the extent the Company's actual equity earnings exceed 11.0%, 50% would be held as a credit due customers in the future and 50% would be retained by Company shareholders.

Revenue Adjustments

The Company recovers through fixed customer charges and variable volumetric charges most of its costs of delivery service. Given this rate structure, it is proposed that a weather adjustment clause remain in effect. This would permit the Company to increase or decrease rates somewhat if actual temperatures vary by more that a couple of percentage points from historic average temperatures.

Similarly, to the extent delivery service revenues from some large customers who purchase their own gas are higher or lower than $921,607 per year, the extra or shortfall would be refunded to or collected from all customers except those with individual contracts. This is proposed to account for uncertainty concerning how much gas the Company will actually deliver to these large customers.

If actual revenue for sales to the Bath Electric, Gas & Water Systems is higher or lower than the forecast, the difference would be refunded to or collected from all customers except those with individual contracts.

The Company may receive revenues of an unknown amount as a result of the receipt of gas on its system from local gas wells. Such revenues are not built into the estimate of revenues before any rate increase because they are difficult to estimate accurately. Any such revenues actually received will be passed back to all customers except those with individual contracts.

Rates

The Company delivers gas in three geographic areas: Corning, Hammondsport, and Bath. Within each area, there are different customer classes. Each class of customers has a set of rates designed to ensure it generates its fair share of the delivery revenue needed by the Company, so the latter can provide safe and adequate service.

As to the different service areas, the Joint Proposal recommends that the Corning area's share of total delivery service revenue requirement increase slightly from 91.32% to 92.05% based in part on a study showing its share of historic revenues were slightly lower than the cost to provide delivery service there. Based on the same considerations, the proposal is to decrease Bath's share of the total from 5.58% to 4.81% and to keep the Hammondsport share virtually the same (3.10% now vs. 3.14% proposed).

Turning to the allocation of revenue requirement among the customer classes in each area (such as residential, industrial, or transportation), the Joint Proposal recommends that customer classes that have historically provided revenues close to the cost to serve them receive smaller increases and that customer classes that have historically not met the costs to serve them receive larger increases. The recommendations can be summarized as follows:

Customer Classes	Delivery Service Annual Revenue Increase	
	$(million)	%
Corning Area		
SC 1 and 5 Firm Service	1.624	50.08
SC 6 General Transportation[5]	.076	20.16
SC 14 Aggregation[6]	.567	48.05
SC 2 Industrial and SC 7 Industrial Transportation	.196	15.81[7]
All Classes	2.463	40.78
Bath Area		
SC 1 Firm Service	.043	20.19
SC 3 Transportation	.020	20.00
SC 4 Transportation	.012	21.43
All Classes	.075	20.32
Hammondsport Area		
SC1 Residential	.046	59.74
SC 2	.013	59.09
SC 4 Transportation	.019	20.43
SC 7 Aggregation	.007	56.33
All Classes	.084	40.78
All Areas	2.623[8]	39.64[9]

[5] Transportation refers to movement of customer-owned gas through the Company's system.

[6] Aggregation refers to a group of customers purchasing gas together.

[7] This would be approximately 20.2% except that some customers in these classes have individually negotiated contract rates that will not change.

[8] This figure reflects the $2.7 million increase, less revenues from individual contracts that will remain the same, and less revenue taxes.

[9] The percentage increase in customers' total bills would be smaller and is heavily dependent on the cost of gas commodity. The Joint Proposal states, for example, that overall class revenues would increase by 14.5% for SC 1 and 5 customers in the Corning area and by 17.0% for SC 1 residential customers in the Hammondsport area.

As to the rates to be charged to each customer class, the recommendation is to increase monthly minimum charges to move in the direction of the monthly minimum costs associated with delivery service and to align such charges in different areas served by the Company. Thus, for example, the current monthly minimum charge for residential customers in the Corning area, including the first 300 cubic feet of gas, would increase from $7.31 to $12.55, compared to an estimated monthly cost in excess of $20.00 per month. As another example, the current monthly minimum charge for residential customers in the Hammondsport service territory, including the first 300 cubic feet of gas, would increase from $6.16 to $12.55, compared to an estimated monthly cost in excess of $20.00 per month. (The Company has no comparable rate for service in the Bath area as Bath is a wholesale customer that in turn provides retail service to approximately 2,255 customers.) The balance of the class revenue requirements would generally be recovered by increasing usage rates on an equal percentage basis as necessary to generate the balance of the class revenue requirement.

The Amendment

The Joint Proposal filed on March 16, 2006 made clear that it remained to be seen if the recommended revenue increase would provide the Company with adequate cash flow. The Signatories anticipated they would be better able to evaluate the Company's cash flow after the latter filed a new contract for gas supply and management or arranged for further credit.

The Company filed a new contract for gas supply and management on March 31, 2006. The Amendment explains that there are a number of circumstances under which the Company's cash flow would be inadequate with the new contract in place and that this could interfere with the Company's ability to provide safe and adequate service if the proposed new delivery service rates become effective on October 1, 2006.[10] Accordingly, the Amendment proposes that:

- The previously recommended delivery service revenue increase become effective on June 1, 2006.
- The incremental revenues generated in the period June 1, 2006 through September 30, 2006, approximately $543,000, be deferred for the future benefit of customers in a manner to be determined by the Commission.
- The existing $1.50/Mcf Market Volatility Adjustment be terminated on May 31, 2006, allowing customers to avoid payment of approximately $188,000.

Operational Issues

The Joint Proposal includes numerous terms intended to (1) increase gas safety and service reliability, and (2) among other things, improve the Company's reporting, gas procurement, accounting, and financial position.

With respect to the gas safety and service reliability, part of the $2.7 million delivery service revenue increase is needed to provide the Company with the means needed to:

[10] One of the five analyses presented shows that if the delivery service revenue increase goes into effect on October 1, 2006 the Company would have only $79,380 of cash available at the start of the winter heating season. Another analysis shows that the cash level would increase to a more reasonable level of $433,992 in that month if new delivery service rates go into effect on June 1, 2006.

1. Replace 21,120 feet of uncoated or bare steel main per year.

2. Further protect against corrosion eight miles of coated steel main per year through the installation of cathodic protection.[11]

3. Replace 350 uncoated or bare steel services per year.

To the extent these improvements are not made, and to the extent the Company cannot establish that further protecting all eight miles of coated steel main is uneconomical, the associated revenues would be deferred for the future benefit of customers and could not be used by the Company to increase its earnings. As an incentive to ensure these improvements are made, the Company would also be obliged to credit customers with up to an additional $61,000 per year to the extent it fails to make them. Similarly, as an incentive to ensure the Company timely attends to the highest priority leaks on its system, the Company would be obliged to credit customers with up to $25,000 a year for failure to meet the target for eliminating such leaks.

Other reliability projects would also have to be undertaken by the Company, including annual system surveys and on-going information gathering concerning a type of pipe installed by the Company many years ago that is thought to have a manufacturing defect.

Turning to the other improvement categories, specific Company objectives are set forth for each. Examples include that the Company will follow its Natural Gas Supply and Acquisition Plan generally, purchase certain gas volumes at fixed prices to ameliorate bill volatility, meet specific gas storage injection and withdrawal

[11] Cathodic protection involves the use of electricity to reduce corrosive action on metal in contact with soil.

recommendations to help ensure adequate winter gas supply, closely monitor cash balances and provide rolling cash flow projections, seek to issue common stock, decline to issue dividends or repurchase stock, and restrict officer salary increases and bonuses to not greater than 3.55% of the prior year's total. There are many other similar provisions, all of which are intended to avoid a recurrence of problems experienced in past periods.

To the extent the Company does not meet these specific milestones it would incur a "deficiency." The total number of deficiencies would be converted into a regulatory liability or credit due customers, ranging from zero (no deficiencies) up to a maximum of up to $519,000 per year.

Future Studies and Collaboratives

The Company would be required to prepare a depreciation study within two years and would be allowed to defer for future recovery in rates up to $30,000 for this purpose. Among other things, such a study would clarify whether existing depreciation rates should be changed for different categories of plant and equipment.

The Company would be required to develop unbundled rates by April 2, 2007 so that customers selecting alternative suppliers of gas commodity can avoid paying twice for some elements of service. The Company would simultaneously develop a plan to purchase the receivables of energy service companies, to help encourage the further development of a competitive market for the retail provision of gas commodity. The Company would be allowed to defer for future recovery in rates a total of up to $30,000 for the unbundled rate development and purchase of receivables plan together.

Collaborative efforts would be made to improve billing to the Village of Bath, improve accounting for Bath and Hammondsport gas volumes and revenues, and ensure adequate delivery capacity for large customers at the western end of the Corning service area.

Other Matters

The Joint Proposal includes a proposed merger package that might be adopted in the event any entity proposes to acquire the Company. Such terms are not summarized here as there is no such pending request. These terms could be relevant in a proceeding under Public Service Law §70 in the event of a merger or acquisition petition.

The Joint Proposal does not address one pending issue, pertaining to whether the Company should be permitted to recover up to $346,653 and interest for lost and unaccounted for gas in the year ending August 31, 2005.