STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 07-M-0906 - Joint Petition of Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation for Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A.

Evidentiary Hearing
3 Empire State Plaza
Albany, New York

Monday, March 17, 2008
10:00 a.m.

PRESIDING:

RAFAEL A. EPSTEIN,
Administrative Law Judge

Appearances:

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JUDGE EPSTEIN: I call case 07-M-0906, Petition of Iberdrola, et.al. for approval of the acquisition of Energy East Corporation by Iberdrola. I am Rafael Epstein. I am the Administrative Law Judge.

I have a number of housekeeping matters before we get to the first witness, but I think what we will do first is take appearances for the record, first, from the people that are in the room, and then from any active parties that may be on the telephone.

Can we start with those of us who are here.

MR. VAN RYN: Your Honor, for Staff of the Department of Public Service, Leonard Van Ryn and Sean Mullaney, Staff counsel.

MR. BREW: Your Honor, for Nucor Steel Auburn, the law firm of Brickfield, Burchette, Ritts & Stone, James Brew.

MR. MAGER: For Multiple Intervenors, the law firm of Couch White by myself, Michael Mager, and my colleague, Jay Goodman.

MR. DUTHIE: Strategic Power Management, Dan Duthie.

MR. PRESTEMON: For the New York State Consumer Protection Board, David Prestemon.

MR. FOGEL: For Retail Energy Supply

Association and Small Customer Marketers Coalition, Usher Fogel.

MS. KINSCH: For Energy East, Noelle Kinsch, Dewey & LeBoeuf.

MR. FITZGERALD: On behalf of Energy East Corporation, law firm of Dewey & LeBoeuf, by Brian FitzGerald.

MR. SCHWARTZ: For Iberdrola, David Schwartz, from the law firm of Latham & Watkins.

I would also like to enter appearances for Mike Gergen from Latham & Watkins, Jared Johnson, George Cannon and Rebecca Malcolm.

MR. MUELLER: Scott Mueller, on behalf of Energy East, Dewey & LeBoeuf.

MR. WIDGER: For Iberdrola, the firm of Nixon Peabody LLP by Andrew Gansberg and myself, Stanley W. Widger, Jr.

MR. CONNOLLY: Paul Connolly, Energy East.

MR. JOHNSON: David Johnson, from the law firm of Read and Laniado, for Independent Power Producers of New York.

MS. SAIA: On behalf of AES and Coral Energy, the law firm of Greenberg Traurig, by Doreen Saia.

JUDGE EPSTEIN: And folks on the telephone who are calling in by telephone, we are picking up a lot of extraneous conversation, radio broadcasts, things like that, typing. I am going to have to ask you to somehow move that activity away from your telephones.

With regard to people that are on the telephone, are there any active parties that want to note their appearance?

MR. GENZER: Yes, Your Honor. This is Jeff Genzer, representing the New York Association of Public Power and the New York State Rural Electric Cooperative Association, from the law firm of Duncan, Weinberg, Genzer & Pembroke.

MR. HANKS: Your Honor, this is Marc Hanks with Strategic Energy LLC. Thank you.

MR. PETERSON: Your Honor, this is Mark Peterson and Dennis Mullen from the Greater Rochester Enterprise.

MR. SAMPSON: David Sampson, Department of Environmental Conservation.

MR. CORNEAU: Keith Corneau, New York State Department of Economic Development.

JUDGE EPSTEIN: Any other active parties?

MR. DOUGLAS: Benjamin Douglas, Manager of Contract Services, City of Rochester.

JUDGE EPSTEIN: Okay. Miscellaneous housekeeping matters in no particular order.

Let me start with the fact that we are, I believe, broadcasting on the Internet, and that means that -- for one thing, occasionally, when I go off the record, usually it's to have some kind of procedural discussion about things that are too mundane to go on the transcript.

So, "off the record" means we are off the transcript but we are on the world wide web at every moment, I think, and we are broadcasting also to anyone in the general public who wanted to call in by telephone.

So, there is no such thing -- there is such a thing here as "off the record," but there's no such thing as confidentiality.

Also in terms of your privacy and your attorney-client privilege, you are equipped with a set of really sensitive microphones, and if you want to consult with your experts, consult with your witness, or anything like that, those mics are pretty sure to pick it up.

I am told that someone else's mic further down the table might not, but yours has a switch on the base, and if you want it to be off, you need to turn it off.

The other thing is that if we are getting a lot of feedback in here, feedback noise, it's probably either because of cell phones being on or, more likely, Blackberries being on. I don't hear any right now, but if that starts to become a problem, you know what you have to do is switch off some of that equipment until it seems to be solved. Cell phone alarms should be on silent.

If you are not accustomed to litigating from this plush leather seating, at the next break, if you want to switch the furniture around, feel free. Whatever makes you more comfortable.

In terms of creature comforts, also, the main cafeteria downstairs is open until 2:30. There are other options available after that.

In this room all food and beverages are strictly prohibited except for water. That means no Starbucks, no McDonald's, none of that stuff. If you've already made an investment this morning, fine, but that's your last chance. When you come back from break, please, if you would, limit yourself to water as the only sustenance.

Rest rooms on this floor are kind of limited, but you can travel from one floor to another freely and look for other facilities.

I am going to try to make some smaller conference rooms available from day to day, and today -- all the time, there is a conference room directly in the back there. And today, also, on the third floor, the small so-called ADR room, small conference room, is available until 2 o'clock and from 3 to 5. And the video conference room also on the third floor is available all day except 11 to 12 and 2 to 3.

Part of the reason we moved to this room is because this group itself is too large to fit comfortably in the third-floor hearing room, and also there is some prospect of the general public coming into observe.

I think that's relatively unlikely now that we have the webcast going and the telephone going, but if people do come in, I have asked them to notify me in advance. They might want to engage in other activities like public statements, this kind of thing. All I can say I will try to arrange things so that there is a minimum of disruption in terms of the schedule, whether we are doing public statements as opposed to evidentiary hearings and in terms of the location.

The webcasting, contrary to what was stated in the notice that was issued Friday, it can be viewed on both Windows and RealPlayer. Some corporate or government or private computer systems have difficulty downloading one or the other of those, but they are both available. Again, that's not what the notice issued Friday stated.

Now, regarding the schedule, on a day-to-day basis, because of the webcasting contract, I am going to make more of an effort to -- than I usually would -- to break at predictable times. And essentially, what I am thinking of is a 20-minute break in the morning, and a 20-minute break in the afternoon, and a one-hour lunch break.

I realize that may strike you as kind of leisurely, but we might step it up if it starts to look like we could save some days by stepping it up. I have kind of been telling people that we are not going to make superhuman efforts and turn this into a marathon, but if it does mean we can save some actual days we will reconsider the pace.

And today, I am shooting for a 20-minute break at 12 o'clock, another one at 4:00, and lunch from 1:30 to 2:30. However, I am not going to break the continuity of the cross-examination in order to achieve those targets. We will just use those targets to the extent they fit whatever is going on on the witness stand.

In terms of different days, Wednesday -- contrary to what I may have indicated by e-mail Friday -- Wednesday is shaping up as an all-or-nothing kind of a day. Either we are adjourned Wednesday and we don't come back until Thursday morning, or if it's possible to move the webcasting to the third-floor hearing room, I anticipate that we are probably going to be able to do that, although I don't have definite word on that. I'll have definite word on that later on this morning, but this group is not going to fit into the third-floor hearing room.

So, I would be interested in your preference but the thing is, if there are a goodly number of people here who could forego going in to the hearing room and use these wonderful capabilities we now have of telephone monitoring -- you can speak on the telephone also and be heard through this PA system.

With the availability of that -- which, I guess, you can access anywhere using a cell phone -- and the availability of webcasting, which you can access wherever you have access to a personal computer, if enough people could drop out on Wednesday from being in the actual hearing room, we could move there and have a full day of hearings.

I think there is some enthusiasm for not losing a day of hearings at least until you find yourself like sardines in that hearing room.

But if you would think about that while I am waiting to hear whether or not we can do it. As I have stated in e-mails, I am loathe to proceed without the webcasting capability because it's pretty much been promised to the public in one form or another at this point.

We had a -- and I apologize. You probably noticed that I received a note from one of the parties about what are we doing about Good Friday? And I overlooked that part of his question. So I don't know. I don't have anything specific in mind. I was just assuming that we'd run a regular schedule. I don't know whether the concern is about running late or about running a regular schedule.

Mr. Mager, do you want to speak to that?

MR. MAGER: Your Honor, I am okay with whatever you decide. I just wanted to know for planning purposes.

JUDGE EPSTEIN: Does anybody have any problem with basically a 9-to-5 schedule on Friday?

MR. VAN RYN: Your Honor, so long as 5:00 is time certain, I am all right with it.

JUDGE EPSTEIN: That should solve it, I guess. Just have a firm cut off at 5:00. If it looks like we are getting toward 5:00 and we don't really have time to finish the next witness, we will probably break at that point.

MR. FOGEL: Your Honor, is the web access and the call-in, will that be available for the entire duration of the hearings?

JUDGE EPSTEIN: As long as nothing goes wrong and with the possible exception of Wednesday.

Now, we had a discussion at the dais here this morning. It was about the process for putting information into the record that's already been determined to be either trade secret or highly sensitive trade secret, and it may have been a little inconclusive.

The material can be dealt with by having it properly filed here in the Department's files as confidential material. The question comes up with cross-examination, and it seems like there is probably no way to consolidate all the confidential cross-examination into one block of time.

So we may have intervals when we will go into executive session -- I don't know if that's the technical name for it -- but anyway, we will be excluding from the hearing room people who have no reason to be participating in that part of the cross or perhaps we will leave the hearing room, and I think that will happen. The conclusion that we more or less reached is that we need to do that intermittently, as witnesses concerned get called.

MR. MAGER: Is there a way we can not allow sound coming in from the phone?

JUDGE EPSTEIN: I have a switch, but what it does is -- as I understand it, I can switch it off both ways. So I am going to try to minimize that, but let me confirm that later this morning. It does work, whatever it's doing.

Let me just make this announcement: If your sound on the telephone was interrupted just now, it's because we are getting too much random conversation at your end of the phone. People calling in here have to mute their conversations, their radios, their keyboards, or we are going to have to cut it off.

Okay. Those are all the housekeeping matters I have as opposed to preliminary matters that are not housekeeping. Does anybody have any other housekeeping questions or concerns?

Okay. In terms of preliminary matters, the first thing that I have in mind is putting in testimony by a few witnesses that are adopting their testimony by affidavit. Is there anything before we get to the testimonial phase? Is there anything preliminary that anybody wishes to raise?

Okay, Mr. Brew?

MR. BREW: Yes, Your Honor. With respect to that, we decided not to do cross-examination for Mr. Gupta after all. So we are amenable to have him entering his testimony by affidavit.

JUDGE EPSTEIN: Now there was a misunderstanding about that early on.

Well, does anybody else have cross for Mr. Gupta? This brings me to my first preliminary question which I wasn't really planning to bring up until later but we had an impromptu, off-the-record prehearing conference at the end of November when the parties informed me the negotiations at that time were being discontinued, and I was told at that time that the parties wanted to return to the litigation track except that some separate disposition would be developed about the issues that had been rolled into this case by the Secretary's notice closing down the -- I guess it was NYSEG -- RDM case and putting the RDM issues into this case.

Just for clarification, was the arrangement that was made, was it to put in the testimony that's here now? Or did the parties have something different in mind? Is there another phase of this case that's expected to be going on somewhere about RDM, or this is it?

MR. VAN RYN: Presumably, Your Honor, the Commission will address the RDM issue when the record is presented to them, and they will decide whether there should be another phase to address that issue or whether they want to adopt the RDM at that time.

JUDGE EPSTEIN: But there is some testimony about it?

MR. VAN RYN: Yes.

JUDGE EPSTEIN: All right. As far as the parties are concerned, that's all you intend to do is put in this testimony at this time in the hope or expectation that it will satisfy whatever the Commission's needs are?

MR. MAGER: My understanding, Your Honor, is the RDM issues have been raised in testimony, but there is no settlement or agreement among the parties as to how RDM should be ruled upon in this case or any subsequent case.

JUDGE EPSTEIN: Okay. And there is nothing -- there is no effort toward getting a separate settlement on that? Okay.

So, Mr. Genzer, are you there?

MR. GENZER: I am, Your Honor.

JUDGE EPSTEIN: I understand that you want to put in the testimony of your witnesses, Moyle, Rinell, and Starheim, by affidavit, there being no cross for them; is that correct?

MR. GENZER: That is correct, Your Honor.

JUDGE EPSTEIN: I have a copy of those which I am providing to the reporter.

(The following is the prefiled testimony of Moyle, Rinell and Starheim:)

INTERVENOR TESTIMONY OF
RICHARD A. MOYLE
STEUBEN RURAL ELECTRIC COOPERATIVE, INC.
ON BEHALF OF THE
NEW YORK ASSOCIATION OF PUBLIC POWER AND THE
NEW YORK STATE RURAL ELECTRIC COOPERATIVE ASSOCIATION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Richard A. Moyle. My business address is 9 Wilson Avenue, Bath, New York, 14810.

Q. WHAT IS YOUR BUSINESS?

A. I am the General Manager of Steuben Rural Electric Cooperative, Inc.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I received an A.B. in Physics from Franklin and Mashall College in Lancaster, Pennsylvania in 1969. I received a M.S. in Physics from Georgetown University in 1974 and a Ph.D. in Physics from Georgetown University in 1975.

Q. PLEASE DESCRIBE YOUR WORK PRIOR TO JOINING STEUBEN RURAL ELECTRIC COOPERATIVE, INC.

A. I worked at the Naval Research Laboratory from 1971-1975. I was in the Department of Chemistry at the University of Maryland from 1975-1976. I was employed by BDM Corporation from 1976-1978. Immediately prior to joining Steuben, I was a Manager and Project Manager at Science Applications International Corporation (SAIC) from 1978-1987. My work at SAIC involved managing 15 professionals and included work as a Project Manager for wind energy and photovoltaic energy systems.

Q. HAVE YOU EVER AUTHORED ANY PUBLICATIONS?

A. I have authored over twenty publications on a variety of subjects ranging from solar energy publications for the Department of Energy to publications concerning nuclear physics. I would be happy to provide a list of publications, if requested.

Q. HOW LONG HAVE YOU BEEN ASSOCIATED WITH STEUBEN RURAL ELECTRIC COOPERATIVE, INC.?

A. I have been General Manager of Steuben since 1987.

Q. PLEASE DESCRIBE THE STEUBEN RURAL ELECTRIC COOPERATIVE SYSTEM.

A. The Steuben Rural Electric Cooperative, Inc. was formed in 1941 by rural residents in Steuben County, who were told by the local power company that it was uneconomical to serve them. The cooperative used funds from the Rural Electrification Administration (REA), Washington, D.C., to build electric lines and provide service on a not-for-profit basis. We are a customer-owned Cooperative. Each member has an ownership share in their electric company.

In 1970, our members in Cherry Creek joined the Cooperative when the Chautauqua-Cattaraugus Electric Cooperative and the Steuben Rural Electric Cooperative, Inc. merged. Today, Steuben Rural Electric Cooperative, Inc. serves in Steuben (5,000 members), Chautauqua (573 members), Cattaraugus (433 members) and Schuyler (152 members) counties.

Steuben has a long history of implementing cost-effective solutions to deliver reliable electricity at as low a price as possible. These programs and their savings value to our members include:

a. Water Heater Control: This continuing program saves our members over $150,000 each year.

b. Free Energy Audits: The program resulted in over $47,000 in savings. Free energy audits are still offered to members.

c. Farm Efficiency Program: Since 1997, Steuben has offered free farm energy audits and 50% cost-sharing on improvements to dairy farm equipment that makes the farm more efficient. Over 30 farms have taken advantage of this program.

d. Efficient Air Conditioners: Since 2000, Steuben has offered $50 rebates for the installation of high efficiency air conditioners. An Energy Star rating is required.

e. Efficient Electric Water Heaters: Since 2001, Steuben has offered discounted prices on Marathon™ Water Heaters. They are highly insulated and light weight for easy installation.

f. Efficient Lighting: Since 2006 SREC has provided Compact Florescent Lights (CFLs) to members at one dollar off our wholesale price. Quantity allowed is unlimited. An additional discount of 50% is given to members who replace 100% of their light bulbs with CFLs. Free recycling is provided for all CFLs returned to us by members.

g. Automatic Intelligent Meters: Since 2003, SREC has been in the process of installing an AIM system. 80% of the system is operational and installation will be complete in 2008. This system is providing accurate readings and has reduced the measured system losses by 2 percentage points from 9% to 7%.

h. Electric Thermal Storage: SREC has started a demonstration program for electric thermal storage combined with air to air heat pumps. The results of this program will be used to develop rates that will promote the use of this technology to increase off peak usage.

Q. PLEASE STATE YOUR EXPERIENCE RELATIVE TO THE TESTIMONY YOU ARE NOW PRESENTING.

A. I have the day-to-day management control of our entire system. I have had over twenty years of experience in electric utility management. I have been responsible for electric utility system planning and financing. I have been in charge of all systems operations. In addition, I have been in charge of load management planning, energy efficiency and energy conservation planning and all staff management. My prior experience includes renewable energy technology R&D planning, data base management, computer modeling, professional staff management, physics research and engineering design. I have limited rate increases on the system, developed multiple work plans, negotiated our Union contracts, developed our Rural Utility Service (RUS) loan applications, implemented a water heater control load management project, a secure internet connection, implemented a AMR system, developed and supervised a rural TV subsidiary, implemented system renovations, implemented staff development, encouraged and implemented training programs and implemented extensive lineman apprenticeship and skills development programs.

Q. PLEASE STATE THE PURPOSE OF YOUR TESTIMONY.

A. For many years Steuben Rural Electric Cooperative, Inc., has experienced increasing numbers of outages caused by failures in the New York transmission and sub-transmission system. Most of these outages occur on the sub-transmission lines that are owned and operated by New York State Electric and Gas Corporation (NYSEG), a subsidiary of Energy East, Inc. I do not believe the proposed merger between Energy East and Iberdrola should be approved, because we expect no improvement in service and in fact may see a further erosion in service.

Q. PLEASE PROVIDE YOUR VIEW ON WHY THIS REDUCTION IN SERVICE QUALITY FROM NYSEG HAS OCCURRED.

A. Many of the transmission outages are extended because NYSEG service personnel are located at a substantial distance from the outage and cannot respond in less than two hours. This is particularly true in our Western District, with our headquarters in Cherry Creek, New York. Typical transmission outage duration in this district is over two and one half hours. Many times, our crews have identified the location of the fault before the NYSEG workers have arrived. For example, on Christmas Eve (December 24, 2007) at 11:00 a.m. a tree fell on a NYSEG transmission line. The energized end of that line fell on our distribution line and destroyed 26 of our meters, one transformer and three disconnect collars. A number of our members had damage to their electronic equipment. Additional damage was prevented by a fuse on a tap and a recloser on our line. It took until 5:00 p.m. to re-energize the line. Adequate tree trimming by NYSEG was simply not done. Trees should not be able to fall on transmission or sub-transmission lines, where adequate maintenance should have been conducted.

Q. WHAT HAS BEEN THE NYSEG REACTION TO THE VERY SLOW RESPONSE TIMES?

A. When we query NYSEG response center personnel about the response times, we have been told that we count as "only one customer" out of power, rather than counting the thousands of customers that we serve in rural upstate New York as individual customers. According to the NYSEG response center personnel, this gives a lower priority to our service area than areas with more than "one customer." In reality, there are thousands of customers that remain out of power through no fault of our own. NYSEG does not count these outages in their outage statistics, which provides a false impression to the Public Service Commission of the true state of the outage statistics. Our outage statistics caused by NYSEG system problems are attached as an Exhibit to my testimony – Exhibit 1 (RAM-1).

Q. WHAT HAS BEEN YOUR EXPERIENCE WITH NYSEG IN THE EVENT OF STORMS?

A. When extreme storms cause extended outages, we usually wait for hours after our own lines have been restored before the damage to NYSEG's lines have been repaired. Much of the delay is the extensive damage that is done to NYSEG's old equipment. In the 1991 ice storm, many cross-arms on the NYSEG sub-transmission line serving our Connor Hill Substation broke in half at the center bolt. The broken cross-arms were eventually replaced and we were waiting for over twenty-four hours for power. It appears that no follow-up replacements have been done on the remaining cross-arms in the past sixteen years.

Q. ARE THERE ANY OTHER EXAMPLES OF PROBLEMS WITH NYSEG RELIABILITY OR PROCEDURES?

A. Yes. NYSEG has a habit of assigning too few line workers to switching requirements during planned outages. In a scheduled outage for us to cut-in a new transformer at our Marshall Warriner Substation at 10:00 a.m. on October 4, 2007, we were able to perform all work on our transformer in one hour. NYSEG had scheduled work at the site at the same time. NYSEG did not complete their switching and have their power off until our work was complete. They eventually completed their work in approximately one and one-half hours, and took an additional two hours to restore power. To restore power, line workers were driving from switch to switch and back again to follow the procedures. Most of the restoration time could have been eliminated by starting at the appropriate time and by assigning the required number of workers to be located at the appropriate switches. This operation had been scheduled several weeks in advance. A similar situation occurred in 2003 when we energized a reconstruction of the same substation.

Q. ARE THEIR OTHER UNFORTUNATE PATTERNS THAT YOU HAVE OBSERVED?

A. Two years ago we requested an attachment for a new substation in Erwin on the NYSEG sub-transmission line from Bath to Corning. We were told by NYSEG in their facilities study that the line had been derated to 30 MW and was loaded at 29

MW, utilizing a single contingency. They indicated that our connection would require Steuben to pay the entire cost to upgrade the sub-transmission line. As a result, we were required to find an alternative solution. Subsequently, NYSEG has started to re-conductor this sub-transmission line.

Q. DO YOU HAVE ANY OTHER POINTS YOU WOULD LIKE TO MAKE?

A. Yes. A detailed audit of the age and condition of the NYSEG sub-transmission lines serving Steuben will reveal that the NYSEG conductors are virtually all old and many of the poles have been in place long enough for the date brand to be obscured by weathering. Steuben has some poles that are over fifty years old, though the date brand is still visible. We maintain and inspect them on a regular basis. Unfortunately, these aged NYSEG sub-transmission lines are weak and vulnerable to conditions that normally should not cause outages. There is no indication from the petition filed by the parties seeking the merger that they have planned or will do anything to improve the deteriorating situation. As a result, we oppose the merger.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

INTERVENOR TESTIMONY OF
STEPHEN T. RINELL
OTSEGO ELECTRIC COOPERATIVE, INC.
ON BEHALF OF THE
NEW YORK ASSOCIATION OF PUBLIC POWER AND THE
NEW YORK STATE RURAL ELECTRIC COOPERATIVE ASSOCIATION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Stephen T. Rinell. My business address is 3192 County Highway 11, Hartwick, New York 13348.

Q. WHAT IS YOUR BUSINESS?

A. I am the CEO/General Manager of Otsego Electric Cooperative, Inc.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND?

A. I received a B.A. in Management and a B.A. in Accounting from Minot State University, Minot, North Dakota.

Q. PLEASE DESCRIBE YOUR WORK PRIOR TO JOINING OTSEGO ELECTRIC COOPERATIVE.

A. From 1983-1987, I worked as an accountant at Burke-Divide Electric Cooperative, Columbus, North Dakota. In that role I was involved in all general ledger, payroll, work orders, materials, transportation and interface with federal and state authorities. From 1987-1989, I served as a senior accountant with Mid-Rivers Telephone Cooperative in Circle, Montana. In that role I was responsible for accounts payable, general ledger as well as all functions of the cooperatives cable and communications subsidiary. From 1989 – 2006, I served as Director of Finance and Accounting for North Western Electric Cooperative, Bryan, Ohio. In that capacity I directed all functions of the general ledger, payroll, work orders, materials, transportation, accounts payable, capital credits, billing and accounts receivable. I also supervised employees to accomplish these tasks. I was also responsible for directing a variety of administrative operations including budgeting, financial forecasts, Board of Directors reporting, equipment purchasing, etc. This also included work with the Rural Utilities Service (RUS) and other federal, state and local authorities, as required.

Q. WHEN DID YOU BEGIN WORK AT OTSEGO ELECTRIC COOPERATIVE AND WHAT ARE YOUR RESPONSIBILITIES?

A. I started working for Otsego as the CEO/General Manager in October 2006. In that capacity I am responsible for all day-to-day management of the entire system. I am responsible for all electric utility system planning and financing, as well as utility operations. We have implemented innovative staff development plans, operational efficiencies and we have expanded our work to include more robust financial systems.

Q. PLEASE DESCRIBE THE OTSEGO ELECTRIC SYSTEM?

A. The Otsego Electric Cooperative serves approximately 4,500 member/customer accounts throughout Otsego, Herkimer, Madison and Chenango Counties. The cooperative provides the membership of mostly residential accounts and family farms, with reliable, low-cost power. Since we are owned by those we serve, our nine member board is elected from the membership, by the membership and for the membership. We are very proud of our local control. We operate over 750 miles of distribution system and 8.5 miles of transmission line.

Q. PLEASE STATE THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to describe the lack of reliable service that Otsego has received and the lack of responsiveness of New York State Electric and Gas

Corporation (NYSEG). I am very concerned that if the proposed merger between Energy East and Iberdrola is consummated then service on the sub-transmission system owned by NYSEG will not be improved, and, in fact, may be further diminished.

Q. PLEASE DESCRIBE SOME OF THE SERVICE PROBLEMS YOU HAVE EXPERIENCED.

A. At the New Berlin substation there have been fifteen outages since January, 2006. The other six substations have had seven outages combined. The number of outages is rising. Our total system substation outages caused by NYSEG service problems have been:

2002	2
2003	4
2004	3
2005	5
2006	12
2007	9

Q. HAVE THERE BEEN ANY ADDITIONAL RECENT PROBLEMS?

A. The New Berlin substation was down again on January 2, 2008 as a result of NYSEG problems.

Q. WHAT ARE THE IMPACTS OF THESE OUTAGES?

A. We are greatly concerned with our rural service territory. There are many farmers and other rural residents, many of them elderly, that suffer greatly without power. Unfortunately, we have no control over the NYSEG outages and the extensive time it takes NYSEG to respond to these outages. Our primary concern is the health and safety of our customers. In addition, the loss of revenue due to the outages is increasing. The expenses to our members (who are our owners) is also increasing.

Q. DO YOU HAVE ANY OTHER POINTS YOU WOULD LIKE TO MAKE?

A. Yes. On the basis of the information we have received, it simply does not appear that NYSEG has developed a consistent and sufficient program of transmission and sub-transmission line patrol. Nor does it appear that there is a sufficient program for right-of-way maintenance that would reduce the occurrence of outages. In my work with other cooperatives over the past twenty-four years, the reliability situation here, due to the NYSEG problems, is the worst I have seen. I do not see how New York can approve this merger in light of the diminished reliability that we have experienced as a result of the NYSEG problems.

INTERVENOR TESTIMONY OF
GREGORY J. STARHEIM
DELAWARE COUNTY ELECTRIC COOPERATIVE, INC.
ON BEHALF OF THE
NEW YORK ASSOCIATION OF PUBLIC POWER AND THE
NEW YORK STATE RURAL ELECTRIC COOPERATIVE ASSOCIATION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Gregory J. Starheim. My business address is 39 Elm Street, Delhi, New York 13753.

Q. WHAT IS YOUR BUSINESS?

A. I am the Chief Executive Officer & General Manager of Delaware County Electric Cooperative, Inc. (Delaware or DCEC).

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I received an M.B.A. from Rensselaer Polytechnic Institute. I received a B.S. in Mechanical Engineering from Clarkson University. I received an A.A.S. in Engineering Science from Mohawk Valley Community College. I am also a licensed Professional Engineer in the State of New York.

Q. PLEASE DESCRIBE YOUR WORK PRIOR TO JOINING DELAWARE COUNTY ELECTRIC COOPERATIVE.

A. I worked for General Electric from 1984-2003, in various capacities. I worked in the GE Corporate Technical Marketing Program (1984-1987) in virtually all departments of GE power generation business. During this time, I became a Nuclear Power Plant Senior Reactor Operator. I was a Technical Sales Manager for GE Power Systems, responsible for $500 million in orders for new power plant equipment (1987-1991). I was also Manager, Business Development for GE Power Systems (1991-1995) where I worked closely with technology partners in the development, design and construction of numerous Integrated Gasification

Combined Cycle Projects globally. Also for GE Power Systems, I was a Product Line Marketing Manager (1995-1996) responsible for the development and management of several GE heavy-duty combustion turbine engine platforms. I was also Manager, Power Systems Programs, within the Corporate R&D Division (1996-1999) where I was responsible for $40 million of annual technology research and development in support of GE Power Systems. I was also Technical Director, Corporate R&D (1999-2001) where these responsibilities were expanded to include $100 million annual R&D in support of the GE Power Systems, Aircraft Engine, Transportation and Medical Systems businesses. Within GE Plastics, I was a Manager of Global e-Sourcing, leading a global technology team in the implementation of corporate-wide enterprise software platform (2001-2002) and then Global Six Sigma Manufacturing "Black Belt" where I was responsible for global manufacturing productivity and automation initiatives (2002-2003).

Q. WHEN DID YOU JOIN DELAWARE COUNTY ELECTRIC COOPERATIVE?

A. I have been CEO & General Manager since 2003.

Q. PLEASE DESCRIBE THE DELAWARE ELECTRIC COOPERATIVE SYSTEM.

A. DCEC serves approximately 5,100 member accounts throughout Delaware, Schoharie, Otsego and Chenango counties. In addition to serving approximately one-third of Delaware County residents, DCEC serves numerous commercial and industrial accounts who are major employers in our area, including DMV International, Clark Companies, Sportsfield Specialties, Dean Foods/Ultra Dairy, SUNY Delhi and the Delaware-Chenango-Madison-Otsego BOCES. DCEC prides itself on providing exceptional electric service reliability to its members and works closely with the area industrial and economic development authorities to attract and retain new business ventures. In addition to serving its membership as a distribution utility, DCEC has become active in developing renewable energy distribution projects to mitigate risks of transmission outages and volatility in power supply and as part of our goal to supply 100% of our membership's electrical needs from renewable sources.

Q. PLEASE STATE YOUR EXPERIENCE RELATIVE TO THE TESTIMONY YOU ARE NOW PRESENTING.

A. I manage thirty full-time employees and several part-time staff. We have, in addition, to making significant improvement in internal financial and budgeting processes, made major commitments to system reliability improvements to our plant. This work has included successful implementation of AMI (completed in 2004). Through implementation of a new SCADA system and load control program (completed in 2005), DCEC has been actively managing peak demand of its system with the capability of instantaneously reducing system peak demand by up to 12% through remote, power-line carrier control of member appliances, significantly reducing purchased power costs and associated demand charges. We have also made a major commitment to system reliability improvement programs, including a proactive 8-year "Right-of-Way" (vegetation management) clearing and herbicide treatment program, an 8-year Line Inspection Program and a major financial investment in long-term New Construction and Modernization Plant

Work plan. We have seen significant benefits to these investments in system reliability and member-service. We are currently implementing several other projects further demonstrating our commitment to member service and system reliability, including the implementation of an automated Outage Detection/Management System, and investment in improved engineering and system analysis tools, upgrades to our SCADA/AMI system and (in partnership with NYSERDA) installation of a Energy (Battery) Storage System and 1,000 kw Landfill Gas Power Plant Project. We strongly believe that these actions and investments are critical to improving a high quality of service to our membership. We would like to see the same level of commitment by our investor-owned utility neighbors as transmission reliability issues are now becoming a limitation on our ability to deliver a high quality of service to our members.

Q. PLEASE STATE THE PURPOSE OF YOUR TESTIMONY.

A. In short, it is not at all apparent that NYSEG has maintained an adequate commitment or investment to their transmission and sub-transmission infrastructure and we believe our members are suffering the consequences. Outages are inconvenient to our customers and potentially hazardous and life-threatening. These outages create unnecessary lost revenue for DCEC and uncompensated costs associated with responding to NYSEG-induced outages. Most importantly, however, is the inconvenience, hazards and economic hardship that they cause, particularly to our commercial and industrial members who are vital business to our local economy. We believe that these outages are heavily caused by failure by NYSEG to embrace adequate investment in plant maintenance. Lately, we have seen a dramatic increase in outages, as noted in Exhibit No. 2 (GJS – 1), which heightens our concern.

Q. CAN YOU GO INTO GREATER DETAIL ON WHY THIS REDUCTION IN SERVICE QUALITY FROM NYSEG HAS OCCURRED.

A. Yes. Despite our investment and commitment, DCEC (including its members) have grown increasingly concerned and frustrated over the very different philosophy that appears to be the basis of operations at NYSEG. In addition to NYSEG's obvious disregard to right-of-way clearing (we are prepared to provide photographs of sample areas where, we believe, lines have not been cleared of brush for decades) and investment in modernization programs, we have experienced an unacceptable and deteriorating reliability because of NYSEG's transmission and sub-transmission system, which DCEC relies on for delivering power to each of our substations. Unplanned transmission outages on the NYSEG system are a major source of outages after storm damage. I would like to present a list of those unplanned transmission outages that have occurred to our system over the last few years. We also believe that NYSEG (in a misleading manner) reports outage data to the PSC treating DCEC substations as a single customer outage. In fact, each substation outage can cause 2,000+ of our members to lose electric service.

In addition to NYSEG's inadequate investment in reliability and maintenance, we have experienced the negative effects of NYSEG's major staffing reductions, particularly in line-staff, over the past 5-10 years. Facilities that were built 20 years ago to staff NYSEG offices are now nearly vacant. Further, of special concern to DCEC, is the lack of responsiveness by NYSEG when restoring outages. This is due, in large part, to lineman getting dispatched from distant locations due to local staffing limitations.

Q. ARE THERE SOME SPECIFIC EXAMPLES OF PROBLEMS WITH NYSEG?

A. Yes. A scheduled November 8, 2007 planned outage at our Dryden Brook Substation had to be postponed on that exact day. The attending NYSEG line crew did not apparently know that they had to operate their own switches on the 44 KV transmission line to our substation despite previous arrangements which DCEC had made with NYSEG on preparing for this scheduled outage. The NYSEG crew thought they only needed to operate "our" air break switch. We informed them that if we wanted to operate our switch, then we would have done it ourselves without their help. The outage had to be rescheduled for the end of December of 2007, which resulted in cost and inconvenience to DCEC members including labor and associated arrangements DCEC had made with members to schedule the outage (postage, materials and associated labor) to send out another 744 mailings to our members for the new planned outage date and time. There was significant inconvenience to our members that expected an outage on November 8, 2007, that never occurred.

As another example, in July of 2006, DCEC had a primary lightning arrestor fault at our South Kortright Substation. This fault tripped the NYSEG, 115 KV switch gear, thereby causing added down-time for DCEC members and for many NYSEG customers fed off that same transmission line. After further investigation, it was determined that NYSEG was working on their own 115 KV transmission line and had purposely fed the DCEC South Kortright Substation from another source, creating a lack of fusing coordination between our substation and the next set of switches on NYSEG's 115 KV transmission line.

We also have numerous examples of excessively delayed outage restoration due to insufficient staffing. Often, due to insufficient local staffing, NYSEG crews from remote locations travel to our area to respond to outages which contributes to outage time. Further, crews from outside our local area are occasionally unfamiliar with the local NYSEG service territory and plant design. Recently, a DCEC staff member was approached by an "out-of-area" NYSEG crew that was dispatched to an outage in the Hamden area. The NYSEG lineman was requesting directions to certain NYSEG plant locations and devices since they were not familiar with area landmarks or local NYSEG plant. The crew had no idea where their own open switch was located and it required the DCEC employee to direct the crew to the remote location of their open switchgear.

DCEC's Jefferson Substation experienced a NYSEG outage on Christmas Eve (December 24, 2007) from 7:00 p.m. – 2:00 a.m., and then again on Christmas Day (December 25, 2007). This was caused by problems on the NYSEG system.

Yet again, another NYSEG outage occurred on January 4, 2008 from about 1:30-3:00 pm. Once again, this took out one of our substations, eliminating service for approximately 1,200 DCEC members. During this particular outage, DCEC staff finally made contact with a NYSEG operations employee approximately 20-30 minutes into the outage. The NYSEG employee informed us that their closest linemen was 45-60 minutes away and that it would be the better part of an hour before they would arrive on-site. This outage could have been restored promptly if adequate and appropriate staffing were locally available. The delays of the outages, and duration until restoration, limit DCEC in delivering high-quality electric service to our members due to repeated and frequent interruption in power supply.

Q. DO YOU HAVE ANY OTHER COMMENTS YOU WISH TO MAKE?

A. At DCEC, we are proud of our commitment to service reliability and the level of service reliability we have been able to achieve. We believe that New York consumers, whether members of a rural electric cooperative or customers of an investor-owned utility, deserve exceptional reliability in their electric supply. Unfortunately, we believe that inaction and lack of commitment by NYSEG is limiting both types of consumers from realizing this quality of service.

It is common knowledge that NYSEG has, over a period of years, systematically reduced staff, closed offices, reduced tree-trimming and the results are completely predictable: service quality has diminished. NYSEG maintenance of their transmission and sub-transmission system is completely out of our control. We have followed all procedures and have done what we can to protect our members – to make prudent and appropriate investment in our own plant and staffing while communicating our concerns and experiences to the proper authorities. While this has been an ongoing issue with NYSEG for many years, we are hopeful that the potential new owners will address these issues with a clear, concise and well-funded plan and commit to execute on that plan with resulting demonstration of improved system performance. We must insist on an improved situation not the unacceptable status quo.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

MR. GENZER: There are two exhibits -- one for Mr. Starheim and one for Mr. Moyle -- hopefully attached to what you have, Your Honor.

JUDGE EPSTEIN: If your phone service was cut off it was because of radio noise coming over and I will cut it off again.

Mr. Genzer, I am going to proceed with this. We will take them in this order: Moyle, Rinell, and Starheim. And Mr. Moyle's exhibit will be Exhibit 1. And Starheim's exhibit will be Exhibit 2.

(Exhibits 1 and 2 marked for identification.)

We are marking exhibits for identification only and they will be moved into evidence at the close of the hearings. At that time, we will consider any objections and argument regarding any objections to the admission of any exhibits.

Number 1 is testimony of Moyle; No. 2 is testimony of Starheim; No. 3 is reserved for an affidavit in which Mr. Moyle will attest that he adopts his testimony as if given orally; and No. 4 is reserved for an affidavit of Mr. Starheim to the same effect.

(Exhibits 3 and 4 reserved.)

Mr. Sampson?

MR. VAN RYN: Your Honor, what about

Mr. Rinell?

(Brief off the record discussion.)

JUDGE EPSTEIN: Excuse me. Thank you. Exhibit 5 will be the affidavit of Rinell. Thank you.

(Exhibit 5 marked for identification.)

MR. SAMPSON: This is the testimony of Jared Snyder on behalf of DEC. I have two copies.

(The following is the prefiled testimony of Jared Snyder:)

Q. Please state your name, address and current position.

A. My name is J. Jared Snyder and I am the Assistant Commissioner for Air Resources, Climate Change and Energy at the New York State Department of Environmental Conservation. My office is at 625 Broadway, Albany, N.Y.

Q. Please summarize your background.

A. Prior to starting at DEC in May 2007, I spent 17 years as an environmental attorney in Federal and State government. In the NYS Attorney General's office from 1995 until May 2007, I was responsible for litigation of a variety of air pollution and climate change cases, many of which involved the power industry. I am a graduate of Harvard Law School (1984) and Cornell University (1981), where I majored in economics.

Q. What is the purpose in your testimony in this proceeding.

A. I am testifying on behalf of DEC, which is a party to this proceeding. My purpose in giving testimony is to encourage the Commission to help fulfill Gov. Spitzer's energy policies in New York State, and to advocate policies that will facilitate the reduction of emissions that contribute to global climate change.

Q. What are the energy policies that you reference?

A. In April of 2007, Gov. Spitzer set forth a road map to a comprehensive energy strategy for New York State. He cited three "seemingly intractable" challenges faced by the state: rising energy bills, rising global temperatures and a rising tide of young people leaving New York. His answer, in part, is to: First, reduce electricity use by 15 per cent by the year 2015. Among the means identified by Gov. Spitzer were the creation of new appliance efficiency standards and setting more rigorous building codes. Second, Gov. Spitzer has emphasized the need to promote renewable energy, including investing $295 million for renewable energy projects throughout the state. Third, proposing last year power plant siting legislation that would create an expedited review process for, among other things, new wind power projects.

Q. How do those policies relate to the petition by Iberdrola?

A. Iberdrola has substantial expertise and experience concerning the development of wind energy. Iberdrola, for example and by its own account, is the largest producer of wind energy in the world, and has invested more than $1.32 billion in renewable resources throughout the world. Iberdrola has also committed to a strong interest in helping to achieve New York State's goal of 25% more energy generated by renewable resources. "We hear loudly and clearly that expansion of renewable resources is a major agenda item in New York State," Iberdrola said in its petition.

Q. Is DEC then endorsing Iberdrola's application?

A. We support an outcome that would take full advantage of the potential offered by Iberdrola for the siting of clean and renewable energy in New York. In its determination, we call on PSC to give due consideration to Iberdrola's experience exercise in developing renewable energy.

Q. Why is wind energy so important as an energy resource?

A. As the New York State Energy Research and Development Authority notes, wind energy is a key component of a clean energy future for New York. Wind turbines can be used to produce electricity for a single home or they can be connected to an electricity grid. They can be combined with other renewable energy technologies. New York State is responsible for about 1% of the world's carbon emissions. New York is taking many steps to reduce these emissions, including Governor Spitzer's program to reduce energy use by 15% by 2015, and the proposed 6 NYCRR Part 242 and 21 NYCRR Part 50, which will implement our commitment to the Regional Greenhouse Gas Initiative.

Q. How does promoting wind power contribute to the fulfillment of the State's climate change policies?

A. Fighting climate change is without question the most substantial environmental challenge facing this State, this nation and the world today. Governor Spitzer and Commissioner Grannis have made the fight against climate change a top priority. Taken together with our other initiatives, development of wind energy is vital to the reduction of greenhouse gases. For each 100 megawatts (MW) of electricity generated from fossil fuels that is displaced by wind power, approximately 500,000 to one million tons of carbon dioxide emissions are avoided annually, depending on whether that power would otherwise be generated by natural gas or coal.

The latest assessment of the International Panel on Climate Change (IPCC) describes the technical and economic potential for stabilizing atmospheric concentrations of heat-trapping gases near the CO2 equivalent of 450 ppm. To achieve this stabilization level, scientists estimate that global CO2 emissions will need to peak by 2015, and then be reduced 50-85% below year 2000 emissions levels, by 2050. Global climate models suggest that achieving this atmospheric CO2 equivalent concentration will limit the future global mean temperature increase to 2.0-2.4 degrees above pre-industrial temperatures, a temperature increase that many scientists believe significantly reduces the likelihood of the most severe impacts of climate change.

A dramatic increase in wind energy capacity is a necessary component of a strategy to meet this climate stabilization goal. Princeton University scientists Pacala and Socolow, developers of the "stabilization wedges" concept that illustrates the scale of emissions cuts needed to stabilize future atmospheric CO2 concentrations, suggest that for wind energy to supply approximately 10% of the clean energy needed to stabilize global

CO2 emissions at *current* levels, worldwide deployment of more than 2 million large capacity wind turbines will required by 2050. However, because reductions in global CO2 emissions in the range of 50-85% are needed by 2050 to achieve the desired atmospheric CO2 equivalent stabilization level of 450 ppm, much additional wind capacity will required beyond that level.

Q. Are there other environmental benefits attributable to the expansion of wind power?

A. The expansion of wind power has multiple environmental and public health benefits. Generating electricity from non-emitting sources of renewable power rather than the combustion of fossil fuels reduces the emission of pollutants that cause ground level ozone and fine particulate matter, pollutants that lead to elevated levels of illness and death from respiratory and heart disease. For example, every 100 megawatts of energy generated annually from wind turbines rather than modern coal burning technology reduces annual emissions of sulfur dioxide by approximately 500 tons, and emissions of nitrogen oxides by approximately 175 tons annually. In addition to contributing to adverse health effects, emissions of sulfur dioxide contribute to acid rain.

Furthermore, the combustion of coal in coal-fired plants produces mercury emissions that contribute to the elevated levels of mercury in fish found in New York's waters. Finally, natural gas production operations result in the leakage of methane, a potent greenhouse gas. In contrast, wind power is a clean source of energy with no emissions.

Q. How much of a role does wind energy play in the state today?

A. New York State is currently home to 6 windmill farms producing about 424 megawatts of power. At least three more are in the planning stages. As Gov. Spitzer has said, "We're not coal country, like West Virginia. And we may not have the oil fields of Texas and Alaska. But we have an abundance of wind, water and solar, positioning us to develop renewables as a greater part of our domestic energy supply."

Q. What is DEC's main point to be made through this testimony?

A. We would like to suggest that the PSC not automatically foreclose Iberdrola's development and ownership of wind energy holdings in New York State and that it find a way to work with Iberdrola in encouraging more wind energy projects. We ask that you consider Iberdrola's outstanding record of promoting renewable energy in the context of the Governor's 2007 call for a holistic and comprehensive approach to an energy strategy and the need to reduce greenhouse gas emissions substantially, and explore alternatives that would allow the state and its citizens to take advantage of Iberdrola's vast wind energy experience.

Q. Does this complete your testimony?

A. Yes, it does.

JUDGE EPSTEIN: The affidavit of Mr. Snyder, which is the top page of that package, that will be Exhibit Number 6.

(Exhibit 6 marked for identification.)

JUDGE EPSTEIN: I think we might as well do Mr. Gupta now. Is there a representative here from NRDC?

MR. BREW: I haven't had a chance to talk to Mr. Martinez about waiving my cross, so, I didn't hear him make an appearance on the line. He was still expecting that we'd be crossing Mr. Gupta next week.

JUDGE EPSTEIN: Then let's hold off on Mr. Gupta's testimony until we can get in touch with Mr. Martinez.

With that, as far as I know, we're ready to start with questions and answers.

MS. KINSCH: Your Honor, joint petitioners have two panels that we'd like to move in by affidavit. Would you like to do that now or during the slot for that panel?

JUDGE EPSTEIN: Okay, fine. Let's do that now.

MS. KINSCH: We'll start with the service quality panel.

Originally Multiple Intervenors was the only party that reserved time for cross-examination of that panel, and Multiple Intervenors since notified us they have no cross-examination. Therefore, I would like to offer the testimony and the exhibits of the joint petitioner quality service panel into the record with an affidavit from the witnesses Patricia Nilsen and Theresa Van Brooker.

At this point, I have a copy of the executed and notarized affidavit. Will that suffice?

Okay. Your Honor, for the record, the service quality panel prepared testimony entitled "The Rebuttal Testimony of the Service Quality Panel" which consisted of a cover page followed by 24 pages of questions and answers, I ask that the testimony of the service quality panel be incorporated into the record as if given orally today.

JUDGE EPSTEIN: Yes.

(The following is the prefiled testimony of the service quality panel:)

SERVICE QUALITY PANEL

Q. Please state the names of the members on this Service Quality Panel (the "Panel").

A. Our names are Patricia Nilsen and Theresa Van Brooker.

Q. Ms. Nilsen, please state your current position and business address.

A. My title is Manager of Public Affairs at New York State Electric & Gas Corporation ("NYSEG"). My business address is Corporate Drive, Kirkwood Industrial Park, Binghamton, New York 13909.

Q. Please summarize your educational background and work experience.

A. I graduated from Alfred University with a B.A. degree. I also received an M.A. in English from Syracuse University and an M.S. in Adult Education from Elmira College. I have been employed by NYSEG for sixteen years in multiple roles including communications, customer service training, customer outreach, complaint resolution and satisfaction measurement, and currently manage advertising and customer communications. I also oversee NYSEG's customer communications for special projects, including *Voice Your Choice*. In 2004, I also assumed responsibility for Rochester Gas & Electric Corporation's ("RG&E") customer service activities, which have included customer satisfaction measurement, complaint resolution and outreach and education for special projects and, in 2006, responsibility for advertising and customer communication.

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

SERVICE QUALITY PANEL

A. Yes. I submitted testimony in NYSEG's recent supply service proceeding,Ca se 07-E-0479.

Q. Ms. Van Brooker, please state your current position and business address.

A. My title is Director of Customer Service for NYSEG and RG&E. My business address is 89 East Avenue, Rochester, New York 14649.

Q. Please summarize your educational background and work experience.

A. In 1999, I received an M.B.A. from the William E. Simon School of Business in Rochester, New York. I received a B.S. degree from the State University of New York, Empire State College in 1992. I have worked for RG&E for the past 25 years, most of that time in Customer Service. I have had multiple roles at RG&E. Since the merger with Energy East, I have been part of the Customer Service organization that supports both NYSEG and RG&E.

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

A. Yes. I submitted testimony in RG&E's last two rate proceedings, Cases 02-E-0198 and 02-G-0199, and Cases 03-E-0765 and 03-G-0766. I also testified in NYSEG's most recent electric rate proceeding, Case 05-E-1222.

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

A. The purpose of this testimony is to respond to the direct testimony of the Department of Public Service Staff ("Staff") Consumer Services Panel, which is comprised of the testimony of Martin Insogna and Leonard Silverstein. In

SERVICE QUALITY PANEL

particular, we address issues related to the Consumer Services Panel's recommendations to: 1) modify NYSEG's and RG&E's Customer Service Performance Incentive metrics and increase the associated amounts at risk; 2) modify NYSEG's and RG&E's low income programs; and 3) require NYSEG and RG&E to develop and file an outreach and education plan.

Q. Does this Panel testimony address Staff interrogatory responses that are related to the Staff's direct testimony?

A. Yes. We have reviewed several such responses by Staff and have specifically addressed some of the responses in our rebuttal testimony. However, additional analysis will be required as there was insufficient time to complete our review of these responses in the time provided to submit this Panel testimony,and we reserve the right to modify this Panel testimony at hearing to address any changes to Staff's exhibits.

Q. Is this Panel sponsoring any exhibits?

A. Yes. Exhibit __ (SQP-1) contains a copy of the interrogatory responses and workpapers referenced in this Panel's testimony. Exhibit __ (SQP-2), "NYSEG and RG&E Customer Satisfaction Index Summary Performance," demonstrates NYSEG's and RG&E's excellent service quality.

Q. Does the Panel have any preliminary comments concerning the Consumer Services Panel's proposals?

A. Yes. As more fully discussed later, NYSEG and RG&E have always been committed to excellent customer service and do not need extra incentives to do so. The Consumer Services Panel has arbitrarily assumed that the proposed transaction would cause NYSEG and RG&E to deliver a diminished level of service to customers. Staff appears to justify its recommendations on perceived risks of the proposed transaction and based on an inappropriate comparison to the National Grid/KeySpan merger. There is no basis for this assumption. As Dr. Makholm's testimony discusses in detail, Staff overstates the risks of the proposed transaction and inappropriately compares it to the National Grid/KeySpan merger. Staff also ignores the fact that the Commission in the National Grid/KeySpan proceeding imposed service quality conditions due to the fact that Niagara Mohawk's quality of service had declined since its merger with National Grid. Iberdrola has extensive transmission and distribution experience (approximately 100 years), which we understand to be significantly more than National Grid's. Moreover, in light of NYSEG's and RG&E's excellent customer service record, which will not change, there is no need to change NYSEG's and RG&E's customer service performance incentive metrics or associated revenue adjustments. Unlike Niagara Mohawk, NYSEG and RG&E have consistently provided high-quality customer service and their service quality has not declined since the merger with Energy East. As we discuss in more detail later, Staff's proposals are unnecessary and excessive, and in some instances redundant. For example, Staff is recommending that the maximum amount at risk for failure to achieve customer service targets be increased by $6.8 million per year at NYSEG and $3.2 million per year at RG&E. If approved, these amounts would be more than double the maximum amounts NYSEG and RG&E currently have at risk under their respective customer service performance incentive programs. These proposed "maximum at risk" amounts are extreme, not necessary as an incentive to the provision of adequate customer service, cannot be supported on the basis of inadequate attention to good customer service at either company, and cannot be supported as a risk of the proposed merger. Finally, the Consumer Services Panel's low income program and outreach and education plan recommendations are equally unsupported and unwarranted.

CUSTOMER SERVICE PERFORMANCE INCENTIVE

Q. Do you agree with the recommendation at page 7 of the Consumer Services Panel's testimony that a Customer Service Performance Incentive ("CSPI") is necessary for NYSEG and RG&E to have an incentive to provide satisfactory customer service?

A. No. Both NYSEG and RG&E have always had a very strong commitment to providing excellent customer service, as is evident from the companies' high performance levels. This commitment will not change after the proposed transaction, since both NYSEG and RG&E will continue to be locally managed and customer service is and has always been a top priority of Iberdrola's. Even if the companies needed an incentive, which they do not, the existing service quality measures and associated amounts at risk would provide it.

Q. Does the proposed transaction create any service quality issues?

A. No, it does not. The proposed transaction does not present any relevant service quality issues.

Q. What are the Consumer Services Panel's CSPI recommendations?

A. The Consumer Services Panel proposes that NYSEG's and RG&E's service quality measures should be modified and the amounts at risk for both companies should be increased dramatically.

Q. What service quality measures are currently in place for NYSEG electric and gas?

A. The existing service quality measures for NYSEG electric and gas include: PSC Complaints; Overall Customer Satisfaction; and Contact Satisfaction Index. These measures are comprehensive enough, because they cover all customers and adequately address interactions between customers and the company.

Q. What are the Consumer Services Panel's specific recommendations regarding service quality measures for NYSEG?

A. As identified on Exhibit __ (CSP-1), the Consumer Services Panel proposes that the following measures be added for NYSEG: Escalated Complaint Response Time; Appointments Kept; Calls Answered; Billing Accuracy; and Estimated Meter Reads.

Q. What service quality measures are currently in place for RG&E electric and gas?

SERVICE QUALITY PANEL

A. The existing service quality measures for RG&E electric and gas include: PSC Complaints; Customer Interaction Service Index; Appointments Kept; Calls Answered; Billing Accuracy; and Estimated Meter Reads.

Q. What are the Consumer Services Panel's specific recommendations regarding service quality measures for RG&E?

A. As identified on Exhibit __ (CSP-1), the Consumer Services Panel proposes that the following measures be added for RG&E: Escalated Complaint Response Time and additional PSC Complaints metrics.

Q. Do you agree with the Consumer Services Panel's recommendations for NYSEG and RG&E?

A. No. Staff's recommendations are unnecessary. Data shows that RG&E has consistently exceeded all its current CSPI measures, other than the performance standard that measures calls answered within thirty seconds ("Service Level"). NYSEG has consistently exceeded targets on all the proposed measures except for Service Level and the Contact Satisfaction Index, which did not meet the performance standards. Otherwise, the company has consistently met these targets for several years. NYSEG's performance on customer satisfaction indicators such as Appointments Kept, Billing Accuracy and Estimated Reads is reflected in Overall Satisfaction, Contact Satisfaction and PSC Complaint Rates. RG&E and NYSEG's excellent customer service is demonstrated in Exhibit __ (SQP-2) attached hereto. In particular, NYSEG's PSC complaint rate has remained less than 1 per 100,000 customers, even during 2006 after a new customer information system and integrated voice response systems were implemented and the complaints doubled. Maintaining less than 50 complaints per year under normal conditions should be considered outstanding customer satisfaction. In addition, estimated meter readings have remained low for both companies, even below 6% at RG&E, a particularly impressive achievement given that the majority of RG&E customers have an inside meter. Billing accuracy has consistently remained above the PSC target at RG&E (the lowest score in the 98th percentile) and well above 98% at NYSEG with the lone exception of 1996.

Q. You mention RG&E Service Level (calls answered within thirty seconds) as an exception. Please explain.

A. RG&E did not meet its Service Level Target in 2006 or 2007.

Q. What about NYSEG?

A. NYSEG did not meet its target for Contact Satisfaction in either of those same years.

Q. Is there a reason why NYSEG and RG&E did not meet the referenced targets?

A. Yes, in both cases the inability to meet the measures is primarily due to the implementation of new technology. Both NYSEG and RG&E recently implemented a new Customer Information system, SAP CCS, and a new Interactive Voice Response ("IVR") system. As is to be expected, both

SERVICE QUALITY PANEL

companies have experienced growing pains associated with the implementation of these new technologies. It is not unusual for a utility implementing a new CIS to experience a "period of inefficiency." Based on experience from other utilities, we expect these "growing pains" to continue to diminish over time after the completion of the proposed transaction. Representatives from RG&E and NYSEG met with Staff before, during,and after the system implementations, and the meetings continue quarterly. During these meetings, NYSEG and RG&E discuss with Staff any issues impacting customer service and actions to improve performance. Staff has indicated that it is pleased with the progress of these meetings. In addition to the regularly scheduled meetings, specific issues are addressed with Staff on an as needed basis.

Q. What were the specific circumstances at NYSEG?

A. NYSEG implemented its new systems in February 2006. Certain implementation issues at NYSEG resulted in a drop in our contact satisfaction scores. NYSEG has worked diligently to perform root cause analysis and execute actions to improve these scores. These actions have included further changing the IVR system – this improvement is based on contact satisfaction responses and other customer input, not service level tracking. NYSEG's actions in this area have resulted in consistent improvement in these scores over the past year. NYSEG is confident that this trend will continue in 2008 and that NYSEG will meet the desired level of contact satisfaction.

Q. What were the specific circumstances at RG&E?

A. RG&E implemented CCS and the new IVR in October 2006, which resulted in lower than desired Service Levels due to the learning curve for staff on the new system. RG&E is confident that these issues are in the past and that it will meet its 2008 goal.

Q. How does NYSEG's and RG&E's performance compare to other utilities?

A. According to the Consumer Services Panel's response to I/E (DPS)-111, a copy of which is included in Exhibit __ (SQP-1), there are only two companies in New York State that have had a Service Level higher than 70% for 2007, as shown on the following chart:

Company	Average
Keyspan Long Island*	31.84
NYSEG	52.50
RGE	53.00
Con Ed	59.08
Central Hudson	61.00
O&R	65.00
Keyspan*	69.84
Ni Mo	80.03
National Fuel	82.42

*Percent of calls answered in 45 seconds as opposed to 30 seconds

Neither NYSEG's nor RG&E's "Calls Answered" is out of line when compared with other utilities. NYSEG and RG&E understand that customers are most concerned about the quality of the customer service contact, rather than the speed at which the companies answer calls.

SERVICE QUALITY PANEL

Q. Doesn't NYSEG already report on Staff's proposed metrics with the exception of the Escalated Complaint Response Time?

A. Yes. NYSEG reports on these measures to Staff regularly as part of the monthly CSPI report. The implementation of additional service quality metrics for items that NYSEG already reports to the Commission and consistently meets is unnecessary and will not lead to enhanced consumer benefits. Customers are already benefiting from NYSEG's excellent performance, and NYSEG's commitment to high-quality service will not change. There is no reason to impose more formal requirements on NYSEG, and more importantly no reason to increase the maximum amounts at risk for failure to achieve targets.

Q. Are there other aspects of the Consumer Services Panel's recommendations with which you disagree?

A. Yes. Staff recommends that NYSEG and RG&E provide a detailed annual report on methodology, results, and conclusions of the Contact Satisfaction Surveys. Staff's proposal is unnecessary and administratively burdensome for the companies and Staff. NYSEG and RG&E are motivated to meet the existing contact satisfaction targets and implement action plans if targets are not met (as can be seen by the actions being taken to improve the NYSEG contact satisfaction scores). Detailed, formal reporting is unnecessarily burdensome and may delay corrective action. Methodologies, results and corrective or additional actions are regularly discussed at quarterly meetings with the Office of Consumer Services

SERVICE QUALITY PANEL

("OCS"). These meetings were instituted at the request of NYSEG and RG&E to ensure adequate communication so that OCS staff members are aware of any issues at NYSEG and RG&E and how the companies are addressing such matters. These meetings were established as an opportunity to share service quality information, and Staff appeared satisfied with the results. In addition, NYSEG and RG&E have requested and held supplemental meetings with Staff on an as-needed basis to discuss particular initiatives (such as the customer information system replacement and *Voice Your Choice*). NYSEG and RG&E see no reason to replace these effective informal meetings with time-consuming formal reporting. Staff states itself that the only purpose behind these additional reporting requirements is merely to "alert Staff to any degradation of customer service, and allow Staff the opportunity to ensure that the company takes appropriate measures to improve performance" in the Consumer Services Panel's response to I/E (DPS-148). A copy of the response is included in Exhibit __ (SQP-1). As stated above, NYSEG's and RG&E's regular informal meetings with Staff already effectively accomplish this goal.

Q. Do you agree with the Consumer Services Panel's recommendation to set RG&E's complaint rate at the NYSEG complaint rate?

A. No. RG&E's complaint rate is only a couple of years old and does not need revisting in this proceeding. That rate was set by the Commission's *Order Adopting a PSC Complaint Rate for Rochester Gas and Electric Corporation's*

SERVICE QUALITY PANEL

Service Quality Performance Program, issued May 17, 2005 in Cases 03-E-0765 and 03-G-0766. There is no support for Staff's recommendation to set the complaint rate for RG&E at the same level as NYSEG. In the Consumer Services Panel's response to I/E (DPS-111), Staff states that its justification for its proposal is that "the merged companies could consolidate operations and should share the same best practices and, therefore, should have the same set of performance standards." A copy of the response is included in Exhibit __ (SQP-1). NYSEG and RG&E are not actually merging and there are no plans to consolidate operations. Additionally, the Commission has always established different complaint targets for NYSEG and RG&E – as they do for the other utilities. The composition of each company's service area, the type of complaints and the methodology of tracking complaints should be considered when a rate is established. RG&E's significant urban population should be treated differently than the more rural population at NYSEG. The NYSEG complaint rate was reset during a rate proceeding at the 5-year historical average. If the same methodology is utilized for RG&E (5 year historical average), the rate would be set at 1.4, as demonstrated in the following table:

2003	2004	2005	2006	2007	Average
2.0	1.6	1	1.1	1.3	1.4

SERVICE QUALITY PANEL

Q. Do you agree with the recommendation at page 14 of the Consumer Services Panel testimony that an "Escalated Complaint Response Time" should be adopted for NYSEG and RG&E?

A. No. The proposed metric will not lead to enhanced customer benefits. NYSEG and RG&E have consistently been below the required PSC complaint rate. In fact, NYSEG has had the lowest PSC complaint rate in the state for years. Moreover, with excellent performance on this measure and the small number of customers that would be impacted, we do not believe that the Escalated Complaint Rate Response Time measure – a measure of how quickly "paperwork" is sent to the Commission (independent of customer communications) - is of any benefit to consumers. There is no justification for the measure and associated revenue adjustment. Exhibit __ (SQP-2) shows NYSEG's and RG&E's PSC complaint rate performance.

Q. Have other utilities been required to implement Escalated Complaint Response Time measures?

A. No, as confirmed by the Consumer Services Panel's response to I/E (DPS-112). A copy of the response is included in Exhibit ___ (SQP-1). Staff's use of this proceeding to impose a CSPI on NYSEG and RG&E that no other utility has been required to implement and that will provide no additional benefits to customers is inappropriate and unnecessarily punitive.

SERVICE QUALITY PANEL

Q. What does the Consumer Services Panel recommend with regard to the amounts at risk?

A. The Consumer Services Panel recommends an increase in the revenue adjustments for the service quality metrics. Under Staff's proposal, the proposed total amount at risk for NYSEG electric more than doubles. The proposed total amount at risk for NYSEG gas is almost five times more than the current total amount at risk. The proposed total amounts for RG&E electric and RG&E gas are double the current total amount at risk, as shown in the following table:

	NYSEG		**RG&E**	
	Electric	**Gas**	**Electric**	**Gas**
Existing Amts at Risk	$3,500,000	$499,998	$2,500,000	$700,000
Staff Amts at Risk	$8,400,000	$2,400,000	$5,000,000	$1,400,000
Increased Amts at Risk	$4,900,000	$1,900,002	$2,500,000	$700,000

Q. Does the Consumer Services Panel provide any justification for the increased amounts at risk?

A. The Consumer Services Panel appears to base its recommendation primarily on the fact that the Commission imposed service quality conditions on the National Grid/KeySpan merger and the belief that the proposed transaction carries financial risks similar to those in the National Grid/KeySpan merger.

SERVICE QUALITY PANEL

Q. Does this position support the Consumer Services Panel's recommendations?

A. No, it does not. First, as addressed in the Mr. Meehan's testimony, the comparison between the transactions is inappropriate. Second, as noted above, NYSEG and RG&E have a history of excellent customer service. In direct contrast, Staff raised concerns regarding Niagara Mohawk's service quality during the National Grid/KeySpan merger based on the fact that Niagara Mohawk's quality of service had declined since it was purchased by National Grid. As a result, the Commission stated in its *Abbreviated Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island,* issued August 23, 2007 in Case 06-M-0878, that it was imposing service quality conditions because of National Grid's performance over the past few years. NYSEG's and RG&E's performance does not present any cause for concern, and certainly does not warrant comparison to National Grid a utility that Staff admits required improvements in its service quality performance.

Q. Is there any other justification for the Consumer Services Panel's proposal to increase the amounts at risk?

A. No. There are no changes in the customer base being serviced by either company or any changes in operations as a result of the proposed transaction to warrant the increase in the amounts at risk.

SERVICE QUALITY PANEL

Q. Do you believe implementing the recommended measures and increasing the associated amounts at risk would cause NYSEG and RG&E to take different actions within their customer service organization to ensure that service is not diminished?

A. No. As we mentioned earlier, NYSEG and RG&E already have a strong commitment in this area and adequate incentives to provide high quality customer service, because they are currently held to appropriate standards with associated revenue adjustments. If NYSEG and RG&E do not meet their current service quality targets, they are also financially harmed by customer dissatisfaction and increased workload. Meeting customer service expectations also allows NYSEG and RG&E to run their businesses more efficiently, thereby managing costs and resources.

Q. The Consumer Services Panel on page 6 asserts that the proposed acquisition has no consumer benefits. Do you agree?

A. No. There are clear consumer benefits to the acquisition of Energy East by Iberdrola as identified in the Joint Petition, Petitioners' initial testimony and the rebuttal testimony of the Petitioners' Policy Panel. The benefits outlined therein are far more valuable than Staff's proposal for enhancing CSPIs and dramatically increasing their corresponding revenue adjustments. NYSEG and RG&E already meet or exceed the CSPIs current in place with the exception of Service Level (calls answered in thirty seconds), which is not a customer satisfaction

SERVICE QUALITY PANEL

performance target for the companies, and Escalated Response Time, which has not been measured annually and does not directly benefit customers. Therefore increasing revenue adjustments for those metrics is unnecessary and provides no benefits to consumers. Additionally, Staff's new proposed CSPIs are largely redundant paperwork requirements that also provide no direct benefits to customers.

Q. In general, do you agree with Staff's statement that Iberdrola's acquisition of Energy East will require additional measures to ensure enhanced consumer benefits?

A. No. Staff has arbitrarily assumed that the acquisition would somehow cause RG&E and NYSEG to deliver a diminished level of service to their customers. There is no basis for the assumption that NYSEG's and RG&E's commitment to providing excellent customer service will change due to the acquisition by Iberdrola. Neither RG&E nor NYSEG expect any operational changes to customer services to take place as a result of the Iberdrola acquisition. Notably, neither NYSEG's nor RG&E's service quality diminished after the merger with Energy East, with the slight exception mentioned earlier that should only diminish over time.

Q. Has Staff raised concerns regarding RG&E's and NYSEG's service quality during other recent proceedings?

A. No. Staff did not raise major service quality concerns or seek to increase the revenue adjustments associated with CSPI in other recent proceedings. During the Energy East merger proceeding and during the most recent NYSEG electric rate case, only one aspect of NYSEG and/or RG&E's CSPI was changed and that was NYSEG's target for PSC complaints.

Q. Staff is recommending an expansion of CSPI and increases in the associated revenue adjustments for NYSEG and RG&E as a way to provide enhanced consumer benefits. Do you believe that CSPIs and the proposed increases in the associated revenue adjustments benefit customers?

A. No. NYSEG and RG&E customers already have the benefits of the companies' current CSPI targets and their associated revenue adjustments. Additional measures only create administrative work for the companies and Staff. NYSEG and RG&E have in the past and continue to strive to provide outstanding customer service independent of CSPI revenue adjustments. It is evident from Exhibit __ (SQP-2) that although NYSEG was not assessed a revenue adjustment on the measures reported, the Company seeks to exceed the Appointments Kept, Billing Accuracy, and Estimated Meter Reads measures.

Q. Is there any redundancy between NYSEG's current measures with a monetary revenue adjustment and the additional service quality metrics proposed by the Consumer Services Panel?

SERVICE QUALITY PANEL

A. Yes. NYSEG's current measures with a monetary revenue adjustment are directly related to the performance of many of the additional CSPI proposed at-risk measures, which will create an unnecessary redundancy. For example, if a company is not achieving its transactional-based performance targets, such as billing accuracy and meter reading, it will first become apparent in the company's contact satisfaction and soon thereafter in overall customer satisfaction surveys.

LOW INCOME PROGRAMS

Q. Do you agree with the Consumer Services Panel's recommendation on page 24 that NYSEG's Power Partner and Affordable Energy Programs should be continued at current funding levels?

A. Yes. These programs, which combine bill reduction with energy assistance and cover both electricity and natural gas customers, have been effective in assisting low-income customers.

Q. Do you agree with the Consumer Services Panel's recommendation on page 24 to continue RG&E's Non-Heating Gas Low Income Program?

A. Yes.

Q. The Consumer Services Panel, on page 24, is recommending that RG&E increase the number of Residential Energy Customer Assistance Program ("RECAP") participants and double program funding. Do you agree?

A. There is no justification for the Consumer Services Panel's proposal to double the number of RECAP participants and increase the annual budget to $1.1 million.

The needs of RG&E customers are adequately being met through the existing programs. If the Commission requires a new program, it should replace RECAP (in a different proceeding) to maximize efficiencies and increase customer satisfaction. In the Consumer Services Panel response to I/E (DPS-111), Staff states that "to the extent additional incremental costs are incurred, the companies are free to pursue rate relief *in an appropriate proceeding.*" (emphasis added). A copy of the response is included in Exhibit __ (SQP-1). By this response, Staff indirectly acknowledges that this proceeding is not the place to require increases to the low income programs.

Q. Do you agree with the Consumer Services Panel's recommendation on page 25 to create a new low income program for RG&E?

A. No. By retaining RECAP and establishing Power Partner at RG&E, the Commission would create unnecessary redundancies. There would be numerous issues associated with implementing the program, including having to decide which program to place customers in first (or to place customers in the programs simultaneously), how to reduce basic service charges (and whether such charges would be reduced twice), and how to handle arrears reduction segments in both programs. The duplicative nature of the programs would only lead to customer and company confusion.

Q. The Consumer Services Panel also recommends on page 25 that RG&E's proposed Power Partner program funding be "considered a positive benefit of the

SERVICE QUALITY PANEL

acquisition transaction and could be used to support a finding that approval of the transaction is justified." Is this similar to NYSEG's program?

A. No. NYSEG's Power Partner program, after which the Consumer Services Panel recommends RG&E model its program, is funded through rates. As asserted earlier in the Consumer Services Panel's testimony, utility ratepayers benefit from low-income customer assistance. Since ratepayers benefit from the low income programs, they should have to contribute to it.

OUTREACH AND EDUCATION PLANS

Q. Do you agree with the Consumer Services Panel's recommendation on page 26 that outreach and education plans with an "identified budget" be developed for NYSEG and RG&E annually and filed with the Director of the Office of Consumer Services?

A. We agree that, from an internal planning perspective and to facilitate communications with Staff, it is useful for the companies to continue the outreach and education plan filing process. NYSEG and RG&E file overall outreach plan goals, results, communication methods and messages with Staff annually and, in addition, submit filings – including budgets - for specific initiatives, such as *Voice Your Choice.* In addition, NYSEG and RG&E file plans and results upon request, such as winter heating outreach. The overall outreach plans include details on each area of outreach as determined by the company, Staff, and other utilities. NYSEG and RG&E provide overall budget figures and detailed budgets for

SERVICE QUALITY PANEL

specific programs as necessary. When the Consumer Services Panel was asked in an interrogatory to provide examples of detailed budgets and expectations to illustrate the level of detail required/proposed by the Consumer Services Panel for the outreach and education reports, the Consumer Services Panel responded "[f]or examples, see RG&E's and NYSEG's past filings." Clearly, the Consumer Services Panel believes that the content of NYSEG and RG&E's current overall outreach and education plan filings are sufficient. A copy of the response to I/E (DPS-116) is included in Exhibit __ (SQP-1).

Q. The Consumer Services Panel requests detailed budgets for individual outreach initiatives. Do you agree with Staff that such budgets are useful?

A. No. We disagree with Staff on the need to provide detailed budgets for the individual outreach initiatives. To do so would be administratively burdensome and inaccurate, because many of NYSEG's and RG&E's outreach activities cross over numerous outreach categories. For example, each company includes promotion of budget billing services in numerous communication vehicles. Budget billing promotions serve low-income customer outreach, winter heating customer outreach, elderly customer outreach, and summer cooling customer outreach. Budget billing is even mentioned for *Voice Your Choice*. It would be difficult to determine which portion of the company's costs for budget billing promotion would be allocated to the various outreach categories. Instead, we propose that we provide an overall budget as we do for NYSEG and have done

SERVICE QUALITY PANEL

for RG&E in the past. If Staff has questions regarding the companies' outreach and education, we suggest that Staff should continue to use informal means, such as the quarterly meetings, or to contact the company directly for budget details.

Q. Does this complete your rebuttal testimony at this time?

A. Yes, it does.

MS. KINSCH: I also have a copy of an executed and notarized affidavit from the witnesses attesting to the testimony. I ask that it be marked for identification as an exhibit, and we have extra copies for any party that would like one.

JUDGE EPSTEIN: That will be No. 7.

(Exhibit 7 marked for identification.)

MS. KINSCH: Attached to the testimony of the service quality panel were two exhibits, SQP-1 and SQP-2, and I would ask that they be marked for identification as the next exhibit.

JUDGE EPSTEIN: That will be 8 and 9.

(Exhibits 8 and 9 marked for identification.)

MS. KINSCH: There are no corrections to either the rebuttal testimony or the service quality panel or the exhibits they are sponsoring. Thank you.

I will now move on to the electric reliability panel.

Originally, Multiple Intervenors and the New York State Association For Public Power and the New York State Electric Cooperative Association were the only parties that reserved time for cross-examination. The New York State Association For Public Power and New York State Electric Cooperative Association notified the parties on Friday they would not cross-examine the panel, and Multiple Intervenors subsequently notified us that it had no cross-examination for this panel.

Therefore, I would like to move the testimony and the exhibits of the electric reliability panel into the record with an affidavit from the witnesses, Laura Conklin and Michael Conroy, attesting to the testimony and exhibits.

For the record, the panel prepared testimony entitled "The Rebuttal Testimony of the Electric Reliability Panel," which consists of a cover page followed by 20 pages of questions and answers.

I ask that the testimony of the electric reliability panel be incorporated into the record as if given orally today.

JUDGE EPSTEIN: Thank you.

(The following is the prefiled testimony of the electric reliability panel:)

ELECTRIC RELIABILITY PANEL

Q. Please state the names of the members on this Electric Reliability Panel (the "Panel").

A. Our names are Laura Conklin and Michael Conroy.

Q. Laura Conklin, please state your current position and business address.

A. My title is Vice President, Technical Services. My business address is 89 East Avenue, Rochester, New York 14649.

Q. Please summarize your educational background and work experience.

A. I have a B.S. degree in Electrical Engineering from Virginia Polytechnic Institute, and an M.B.A. from the Rochester Institute of Technology. I am licensed as a Professional Engineer in the State of New York. I began working at Rochester Gas and Electric Corporation ("RG&E") in 1990. Through 1997, I held a variety of engineering positions in the distribution engineering, substation engineering and marketing departments. From September 1997 through July 2000, I worked at Energetix as Manager, Marketing and Product Development. From July 2000 through 2001, I worked as an Engineering Manager at Sear Brown, a consulting engineering firm. In November 2001, I returned to RG&E as a project engineer, and was then promoted to Manager, System Planning and Operations Engineering. In 2003, I became Manager, Distribution Planning and Standards, for both RG&E and New York State Electric & Gas Corporation ("NYSEG"). I assumed my current position of Vice President, Technical Services, in 2004.

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

A. Yes. I testified in Cases 03-E-0765 and 05-E-1222.

Q. Michael Conroy, please state your current position and business address.

A. My title is Vice President, Operations. My business address is 89 East Avenue, Rochester, New York 14649.

Q. Please summarize your educational background and work experience.

A. I received a B.S. degree in Electrical Engineering from Cornell University,and an M.B.A. from the University of Southern Maine. I was employed by Central Maine Power Company ("CMP") from 1979 through 2002, serving in a variety of technical, supervisory and managerial positions. I left CMP as Vice President of Marketing and Economic Development to join RG&E and NYSEG in January 2003 as Vice President - Electric Technical Services. In September 2003, I was assigned the added responsibility of Gas Technical Services. I assumed my current position of Vice President, Operations, in 2004.

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

A. Yes. I testified in Cases 03-E-0765, 03-G-0766 and 05-E-1222.

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

A. The purpose of this testimony is to respond to the direct testimony of the Department of Public Service Staff ("Staff") Electric Reliability and Safety Panel,

ELECTRIC RELIABILITY PANEL

which is comprised of the testimony of Patrick Maher and Diane Barney. In particular, we address issues related to the Electric Reliability and Safety Panel's recommendations to: 1) dramatically increase the revenue adjustments associated with NYSEG and RG&E's System Average Interruption Frequency Index ("SAIFI") and Customer Average Interruption Duration Index ("CAIDI"); 2) require NYSEG and RG&E to provide "five-year forecasts of planned system upgrades, including the expected costs for each project or program," along with a reconciliation to the past year's forecast, thirty days from NYSEG's and RG&E's current planning cycle and annually thereafter; and 3) require NYSEG and RG&E to provide an assessment of the physical condition of all elements in their electric systems, along with repair plans, remedial actions and monitoring programs for any facilities found to be deficient, within ninety days from a decision in this proceeding. In addition, we address the testimony filed on behalf of the New York Association of Public Power and the New York State Rural Electric Cooperative Association (collectively," the Electric Cooperatives").

Q. Is this Panel sponsoring any exhibits?

A. Yes. Exhibit __ (ERP-1) contains a copy of an interrogatory response referenced in this Panel's testimony. E xhibit __ (ERP-2) includes Rural Electric Cooperative Association Interconnects.

Q. Does the Panel have any preliminary comments concerning the Electric Reliability and Safety Panel's proposals?

A. Yes. As more fully discussed later, NYSEG and RG&E have always been, and continue to be, committed to service reliability. As the Electric Reliability and Safety Panel concedes on page 6 of its testimony, the "historic performance of both NYSEG and RG&E have been acceptable relative to the established targets." The Electric Reliability and Safety Panel's proposal to dramatically increase the revenue adjustments for NYSEG and RG&E is unsupported and arbitrary, particularly in light of NYSEG's and RG&E's excellent history of reliable service. Staff appears to base its recommendations on the Commission's actions in the National Grid/KeySpan merger proceeding (Case 06-M-0878). However, Staff fails to recognize that the Commission's decision in that case was based on significant reliability concerns and a pattern of behavior that are absent at NYSEG and RG&E. Iberdrola, S.A. also possesses extensive transmission and distribution experience (approximately 100 years). Moreover, Staff's recommendations regarding annual five-year forecasts and an assessment of NYSEG's and RG&E's system are burdensome and unnecessary.

Q. Does the Panel have any preliminary comments concerning the testimony of the Electric Cooperatives?

A. Yes. NYSEG's transmission and sub-transmission lines are very reliable. They represent the backbone of the electric system and are therefore designed, built, inspected, maintained and replaced in a manner that ensures proper overall reliability, as evidenced by NYSEG's ability to meet reliability targets for ten years. Moreover, the Electric Cooperatives' assertions about specific instances of

ELECTRIC RELIABILITY PANEL

outages that occurred in the past, while not unimportant to them or NYSEG for that matter, are nonetheless unrelated to the instant merger proceeding.

CAIDI AND SAIFI REVENUE ADJUSTMENTS

Q. Do you agree with the Electric Reliability and Safety Panel's description of NYSEG's and RG&E's CAIDI and SAIFI targets and adjustments?

A. The description of NYSEG's and RG&E's SAIFI and CAIDI targets is accurate. However, we do not agree that NYSEG is subject to revenue adjustments. NYSEG's revenue adjustments expired with NYSEG's last multi-year rate plan, and the Commission did not include revenue adjustments in its *Order Adopting Recommended Decision with Modifications*, issued August 23, 2006 or its *Order on Rehearing*, issued December 15, 2006 in Case 05-E-1222.

Q. Do you believe NYSEG's and RG&E's existing reliability performance mechanisms are adequate?

A. Yes. NYSEG's and RG&E's existing reliability performance mechanisms are more than adequate as evidenced by the companies' excellent performance. As the Electric Reliability and Safety Panel acknowledged, NYSEG and RG&E have met their respective SAIFI and CAIDI targets for the past ten years. This is particularly meaningful data given that major and minor storms have challenged all New York electric utilities over the past severaly ears. In addition, NYSEG and RG&E continue to strive to exceed the targets by continually improving the companies' reliability and emergency response, including innovations in communications, outreach, and special services. NYSEG and RG&E have received accolades from customers and elected officials and an EEI Award for Emergency Response for their response to some of the most notable events in the State, including the 2006 flood and October snowstorm.

Q. Has Staff claimed inadequate performance by NYSEG or RG&E?

A. No. To the contrary, the Electric Reliability and Safety Panel acknowledges on page 6 of its testimony that NYSEG's and RG&E's performance has been "acceptable relative to the established targets."

Q. Does the acquisition of Energy East Corporation ("Energy East") by Iberdrola (the "Proposed Transaction") create any concerns relative to electric reliability?

A. No, it does not. The Proposed Transaction does not present any relevant electric reliability issues.

Q. What does the Electric Reliability and Safety Panel specifically recommend for NYSEG and RG&E relative to SAIFI and CAIDI?

A. The Electric Reliability and Safety Panel recommends a doubling of the revenue adjustments with an additional doubling of the adjustments in the following years if targets are not met; this methodology is identical to the methodology imposed by the Commission in the National Grid/KeySpan merger.

Q. Do you agree with this recommendation?

A. Absolutely not. There is no justification for the Electric Reliability and Safety Panel's recommendation. The Electric Reliability and Safety Panel overstates the risks of the Proposed Transaction, ignores Iberdrola's commitment to rely on local management, and inappropriately compares the Proposed Transaction to the

National Grid/KeySpan merger as further discussed in Mr. Meehan's testimony. Staff ignores the fact that we are not facing facts similar to those in the National Grid/KeySpan merger. Niagara Mohawk d/b/a National Grid ("National Grid") failed to meet its SAIFI targets in 2004, 2005 and 2006, and that the Commission, in June 2007, instituted a proceeding (Case 07-M-0773) to investigate Niagara Mohawk's failure to achieve its SAIFI standard. Two months later, the Commission in the National Grid/KeySpan merger proceeding increased the reliability revenue adjustments for those companies due to the companies' history of failing to meet reliability targets. The Commission's *Abbreviated Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island*, issued August 23, 2007 in Case 06-M-0878, specifically notes that it was concerned about National Grid's future performance based on the fact that National Grid had missed reliability targets in three of the previous five years. In fact, in its *Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island*, issued September 17, 2007 in Case 06-M-0878, the Commission describes National Grid's reliability as a "chronic deteriorating performance." In addition, the Commission imposed service quality conditions due to the fact that Niagara Mohawk's quality of service had declined since its merger with National Grid. The Electric Reliability and Safety Panel's response to I/E (DPS-142) admits that

National Grid "failed to meet its established SAIFI and CAIDI targets a total of four times prior to the doubling of the performance mechanism." A copy of the response is included in Exhibit __ (ERP-1). As we previously mentioned, in stark comparison to National Grid, NYSEG and RG&E have met their reliability targets for the past ten years. NYSEG's and RG&E's performance does not present any cause for concern and, certainly, does not warrant comparison to National Grid a utility that required substantial improvement in its reliability performance as recognized by Staff and the Commission in other proceedings.

Q. Has the Electric Reliability and Safety Panel cited the Commission's National Grid/KeySpan decision to support other elements of their proposal?

A. Yes. The Electric Reliability and Safety Panel also cites the Commission's National Grid/KeySpan decision as support for infrastructure plans and the "risk that resources might be diverted post merger." As discussed in Mr. Meehan's testimony, the Proposed Transaction, which only involves a change in ownership at the parent company level and is not a combination of operating companies, does not present the same risks as the National Grid/KeySpan merger. The comparison and increased requirements are unwarranted based on NYSEG's and RG&E's performance and the nature of the Proposed Transaction.

Q. Do you agree with the Electric Reliability and Safety Panel's recommendation on page 8 that NYSEG and RG&E should be required to file "annually a five-year forecast of planned system upgrades including the expected costs for each project or program"?

ELECTRIC RELIABILITY PANEL

A. No. First, Staff's concerns about the condition of the NYSEG and RG&E system are overstated given NYSEG's and RG&E's excellent performance with regard to reliability and their continuing efforts to further improve reliability,as mentioned earlier. Second, NYSEG currently provides quarterly reports on capital spending to the Directors of the Office of Electric, Gas and Water and the Office of Accounting, Finance and Economics. RG&E provides an annual report on electric and gas capital expenditures as part of the compliance filings required under its Joint Proposal. Staff therefore regularly receives information regarding the companies' capital expenditures. The preparation of an additional annual report would be burdensome and unnecessary.

Q. Do you agree with the Electric Reliability and Safety Panel's recommendation on page 8 that RG&E and NYSEG be required to provide an assessment of the physical condition of all elements in their electric systems within ninety days of a decision in this proceeding?

A. No. The Electric Reliability and Safety Panel's recommendation regarding an assessment of the physical condition of all elements in the NYSEG and RG&E electric system is based on a general concern regarding aging infrastructure and not any specific issues at NYSEG and RG&E. The companies' inspection, maintenance and capital replacement programs and practices represent systematic, ongoing assessment and follow-up actions that have resulted in reliable service. Thus, the additional assessment is unnecessary.

ELECTRIC RELIABILITY PANEL

Q. Could a detailed assessment of the NYSEG and RG&E electric system as proposed by the Electric Reliability and Safety Panel be completed in ninety days?

A. No. A detailed assessment of the physical condition of all elements in the electric system could not be completed in ninety days with existing resources and would detract from on-going inspection and maintenance activities. Completing a blanket assessment in such a rushed time-frame would not produce meaningful results and is not an adequate substitute for effective maintenance practices and policies and engineering-based investment strategies for capital replacements.

ELECTRIC COOPERATIVES

Q. What allegations do the Electric Cooperatives make in their testimony?

A. Generally, the Electric Cooperatives assert that outages have increased as a result of NYSEG's alleged failure to maintain its transmission and sub-transmission facilities. The Electric Cooperatives also make assertions about past outages.

Q. Are the Electric Cooperatives' assertions about past, specific instances related to the Proposed Transaction?

A. No, they are not. NYSEG and RG&E have a history of reliable service. Given Iberdrola's commitment to local management, there is no reason to believe that the Proposed Transaction will change NYSEG and RG&E's commitment to electric reliability. The Electric Cooperatives' allegations about specific instances in the past have no bearing on the Proposed Transaction.

ELECTRIC RELIABILITY PANEL

Q. Do you agree with the general assertions by the Electric Cooperatives that they are experiencing increasing numbers of outages due to NYSEG transmission and sub-transmission failures?

A. No. NYSEG's transmission and sub-transmission lines are very reliable. They represent the backbone of the electric system and are therefore designed, built, inspected, maintained, and replaced in a manner that ensures proper overall reliability. This is true of lines that serve electric cooperatives, as well as lines that serve NYSEG retail customers. Data provided by the Electric Cooperatives along with NYSEG outage history reflects that some lines experienced fewer outages in 2006 and 2007 while others experienced more. The difference is often driven by weather conditions.

Q. Do you agree with the Electric Cooperatives' testimony that NYSEG has failed to maintain adequate investment in infrastructure?

A. No. NYSEG continues to make substantial investments in infrastructure in the interest of reliability. The Transmission and Distribution Infrastructure Reliability Program (TDIRP) continues to be funded at $23 million per year. NYSEG's reliability performance is evidence that the company is making adequate investments in infrastructure for reliability purposes.

Q. Please respond to allegations by the Electric Cooperatives that NYSEG has not developed a consistent or sufficient program for transmission line patrol and right-of-way maintenance.

ELECTRIC RELIABILITY PANEL

A. Transmission line inspections are performed in accordance with NYSEG's established maintenance practices and policies. All transmission facilities are inspected twice annually by helicopter. Additionally, all transmission facilities are comprehensively patrolled on foot on a five-year cycle in accordance with the Commission's *Order Instituting Safety Standards*, issued January 5, 2005 and the Commission's *Order on Petitions for Rehearing and Waiver* issued July 21, 2005 in Case 04-M-0159. All 115 kV and above rights-of-way are now cleared on a six-year cycle pursuant to the Commission's *Order Requiring Enhanced Transmission Right-of-Way Management Practices by Electric Utilities*, issued June 20, 2005 in Case 04-E-0822. A danger tree program is conducted for all transmission lines 69 kV and above pursuant to the same Commission's Order. In summary, NYSEG patrols lines on a regular basis to identify any safety and reliability risks and any deficiencies identified during line inspections are reviewed and prioritized. NYSEG makes repairs within established timeframes based on the level of the deficiency. NYSEG's vegetation management practices for transmission and sub-transmission are on a consistent cycle with effective standards and proper execution. Our inspection and maintenance practices have contributed to solid overall reliability performance.

Q. Are there lines used to serve any of the Electric Cooperatives that have been improved or proposed to be improved by NYSEG under its reliability programs?

A. Yes. The Electric Cooperatives assertion that NYSEG has not improved its transmission facilities that connect to the Electric Cooperatives is unfounded.

ELECTRIC RELIABILITY PANEL

NYSEG upgraded its 532 Line in 2007, which will provide reliability benefits and accommodate load growth for Steuben Rural Electric Cooperative ("SREC"). NYSEG also completed an upgrade of an 803 Line segment in 2007, and is continuing a rebuild of an 802 Line segment. There are also proposed projects to upgrade additional segments of the 807 Line. The 802, 803 and 807 Lines provide service to Otsego Rural Electric Cooperative, including the New Berlin delivery point. All of these projects enhance reliability.

Q. How do you respond to the allegations that NYSEG is unresponsive and treats electric cooperatives as one customer?

A. NYSEG counts each service to an electric cooperative as one customer only for the purpose of calculating and reporting reliability indices. To our knowledge, this has been and remains standard practice for all New York utilities and is not at all misleading. A cooperative is in fact one customer of NYSEG. However, our response to events affecting the Electric Cooperatives reflects our understanding that the Electric Cooperatives serve many customers. NYSEG responds to an Electric Cooperative outage as if it involved multiple or critical NYSEG customers.

Q. Does this mean that the Electric Cooperatives can always expect an immediate response?

A. No electric customer, Electric Cooperative or otherwise, can reasonably expect an immediate response by NYSEG. The Electric Cooperatives by their very nature are rural. The transmission and sub-transmission lines that provide service to the

ELECTRIC RELIABILITY PANEL

Electric Cooperatives are long. In fact, one feed is fifty-nine miles long in its normal configuration and therefore requires more time to patrol and restore than some other NYSEG lines. However, this is not to say that NYSEG is unresponsive. NYSEG responds as quickly as allowed under the given circumstances. During storms, response times are naturally more extended than under normal conditions, and any delay is a function of conditions, not NYSEG's commitment.

Q. Is the Electric Cooperatives' allegation that NYSEG has too few workers true?

A. No. NYSEG maintains a sufficient complement of qualified crews as evidenced by our reliability,emer gency response, and customer service performance. Any exceptions to quick response or restoration are driven by the nature and location of the damage, weather, and the existence of other outage activity.

Q. Do you have any comments regarding the Dryden Brook incident mentioned on page 6 of Mr. Starheim's testimony?

A. Yes. Mr. Starheim has mischaracterized the planned outage at Dryden Brook. The incident resulted from Delaware County Electric Cooperative ("DCEC") employees giving NYSEG employees the wrong information regarding the outage request and work plan. The DCEC employee told both NYSEG's Manager of Regional Operations and Supervisor of Construction and Maintenance that he had arranged for the outage with other NYSEG employees and that they needed to take no further action. The day before the work was to be undertaken, the NYSEG Supervisor checked NYSEG's Outage Management System and determined that the outage request had not been properly made whereupon he placed an emergency outage request on behalf of DCEC. NYSEG arrived to perform the requested work only to find that NYSEG could not use the device it intended to operate. NYSEG experienced costs and inconvenience due to this incident.

Q. What about the failed lightning arrester incident at DCEC's South Kortright substation also mentioned on page 6 of Mr. Starheim's testimony?

A. The incident alleged by Mr. Starheim occurred in May 2006, not July 2006. It is true that NYSEG was performing preventative maintenance and testing on its transmission breaker. NYSEG completed switching to reconfigure the system for purposes of the test. While the system was in its temporary configuration, a fuse blew in the DCEC's substation. DCEC employees replaced the fuse. However, the DCEC also had a faulty lightning arrester. When the DCEC employees replaced the fuse restoring power to the faulty arrester, NYSEG's breaker operated to clear the fault. It is ironic that the Electric Cooperatives raise this issue, because NYSEG was not only performing preventative testing and maintenance on its own equipment at the time of the event, but it also had to restore service due to the outage the DCEC induced and had to identify the faulty insulator for the DCEC. As a result of DCEC's faulty lightning arrester, NYSEG lost service to approximately 16,166 customers of its own.

ELECTRIC RELIABILITY PANEL

Q. What were the circumstances surrounding the DCEC Jefferson Substation outages on December 24 and December 25, 2007 mentioned by Mr. Starheim on page 7 of his testimony?

A. The DCEC alleges that NYSEG caused excessive delays in outage restoration due to NYSEG "insufficient staffing." DCEC cites two examples – on December 24 and December 25, 2007. Given the specific circumstances, NYSEG's response was appropriate in both instances. On December 24, 2007, local line mechanics were aiding another NYSEG division with minor storm activity and responding to trouble calls in their own area. As we mentioned earlier, circumstances such as these can contribute to delays in restoration. On December 25, 2007, a damaged conductor was spotted. Crews were called and pre-positioned before taking the circuit out of service to make repairs. This prompt, proactive approach saved a longer unplanned outage.

Q. What were the circumstances surrounding the SREC outage on December 24, 2007 referenced on page 5 of Mr. Moyle's testimony?

A. This event occurred during a period when high winds caused widespread interruptions to 2,268 NYSEG customers served from the Hornell Division. The tree in question fell from *outside* the right-of-way,makin g contact with the NYSEG 539 sub-transmission line at approximately 11:00 am. NYSEG's Hornell crews restored service to SREC's Marshall Warner substation within approximately 74 minutes. NYSEG's last customer restored from this tree event was some 5.5 hours later. This event demonstrates several important points.

ELECTRIC RELIABILITY PANEL

First, a tree falling from outside a right-of-way on sub-transmission in no way indicates that tree maintenance was inadequate. In fact, clearing was last performed on the 539 Line in 2007. Second, NYSEG has no rights to cut trees that are outside the right-of-way. Third, NYSEG restored service to SREC much sooner than to many of its other customers – it did not treat SREC as a low priority for restoration. Further, NYSEG crews in the Western part of the service territory were close enough and plentiful enough that even during widespread restoration they responded and mobilized very quickly. This event serves to illustrate NYSEG's continuing commitment to reliable service and responsiveness to the Electric Cooperatives. This commitment will not change after completion of the Proposed Transaction.

Q. On page 7 of his testimony, Mr. Moyle claims that NYSEG's failure to assign an adequate number of switching crews extended an outage at Marshall Warriner substation. Do you have any comments regarding this allegation?

A. The outage in question was planned to be performed between 10 am and 3 pm. Plans were coordinated to minimize customer impact since both SREC and NYSEG had to perform work. NYSEG's work included installing a pole and set of inline switches, both of which are investments in infrastructure to improve system reliability. Five NYSEG representatives were assigned to switch for six locations (two were in close proximity). The work was properly planned, staffed and executed by NYSEG. The outage was completed at 2:45 pm, within the projected timeframe. This project again demonstrates NYSEG's commitment to reliable service and coordination with the Electric Cooperatives, including sufficient workforce to plan, coordinate and execute any necessary work.

Q. Can you respond to the issues raised on pages 7-8 of Mr. Moyle's testimony regarding capacity for a new substation in Erwin?

A. Yes. Mr. Moyle implies that NYSEG acted inappropriately relative to the SREC's request for a new substation line from Bath to Corning. His allegation is baseless. SREC requested a new interconnection to NYSEG's 532 Line between Bath and Science Park to serve a new customer load. The proposed load addition exceeded the available capacity on the line. Therefore, NYSEG could not provide a new interconnection point without upgrading the capacity of the line. NYSEG began engineering the upgrade to the 532 Line in January 2007. Construction began on the project in August 2007, and it was completed on January 5, 2008.

Q. Was SREC required to pay any of the costs to upgrade the sub-transmission line?

A. No. NYSEG invested $1,070,917 in the sub-transmission line upgrade. SREC was not required to make a contribution, because the upgrade provided additional capacity and reliability for the NYSEG system, as well as providing additional capacity to SREC's Curtis Delivery Point.

Q. On pages 6-7 of his testimony, Mr. Moyle makes a reference to cross-arms not replaced since the 1991 ice storm. Do you have any comments on this specific point in his testimony?

A. NYSEG's replacement of cross-arms is based upon condition. The line in question was patrolled in 2007, and the facilities were reported in good condition.

ELECTRIC RELIABILITY PANEL

By SREC's own records in Exhibit __ (RAM-1), page 5 of 5, the line in question experienced only two interruptions in the last four years, both in 2005, and neither interruption involved cross-arms. Based upon both regular inspection and outage history, SREC's suggestion that there are old cross-arms on this line that should have been replaced over the last sixteen years to ensure reliable service is without merit. Again, the performance of this line is further validation of NYSEG's inspection, maintenance, and infrastructure investment.

Q. Do you agree with Mr. Moyle's claim on pages 5-6 that outages are extended because NYSEG service personnel are located a substantial distance away?

A. No. Attached as Exhibit __ (ERP-2) is a map of Rural Electric Cooperative Association Interconnects. The map includes locations of electric cooperative substations and NYSEG offices. NYSEG's Gowanda and Hornell offices are proximate to the lines and substations serving SREC. Outage durations are driven by the nature of the damage, weather, and existence of other outage activity, not proximity. In fact, a review of the chart provided by Mr. Moyle on page 1 of 5 of Exhibit __ (RAM-1) reveals that the general pattern of outages attributed to NYSEG follows the pattern of what he claims to be Major Storm activity on SREC's system.

Q. Do you think this proceeding is the appropriate forum in which to have a discussion with the Electric Cooperatives regarding reliability?

A. No, it is not. NYSEG and the Electric Cooperatives should hold regular meetings to discuss reliability matters, including maintenance schedules, emergency response, and the prioritization of planned improvements. NYSEG would support regularly scheduled meetings at a location convenient to each of the Electric Cooperatives.

Q. Does this complete your rebuttal testimony at this time?

A. Yes, it does.

MS. KINSCH: I also have a copy of an executed and notarized affidavit from the witnesses attesting to the testimony. I ask that it be marked for identification as an exhibit.

JUDGE EPSTEIN: Number 10.

(Exhibit 10 marked for identification.)

MS. KINSCH: Attached to the testimony of the electric reliability panel are two exhibits, ERP-1 and ERP-2, and I ask that they be marked for identification as the next exhibits.

JUDGE EPSTEIN: 11 and 12.

(Exhibits 11 and 12 marked for identification.)

MS. KINSCH: There are no corrections to either the rebuttal testimony of the electric reliability panel or to the exhibits that they sponsored. Thank you.

JUDGE EPSTEIN: So would you like to call your first witness?

MS. KINSCH: Your Honor, the Joint Petitioners call the rate design and retail access panel: Mr. James Lahtinen, Mr. Mark Marini, and Mrs. Christine Stratakos.

JAMES LAHTINEN, MARK MARINI and CHRISTINE STRATAKOS, after first having been duly sworn, were examined and testified as follows:

DIRECT EXAMINATION

BY MS. KINSCH:

Q. Panel, would you please state your name and business address for the record.

A. (Stratakos) My name is Christine Stratakos, S-T-R-A-T-A-K-O-S, 18 Lent Drive, Binghamton, New York.

(Lahtinen) James Lahtinen, 89 East Avenue, Rochester, New York, 14649.

(Marini) Mark Marini, 89 East Avenue, Rochester, New York, 14649.

Q. Does the panel have in front of it the document dated January 31, 2008, entitled "The Rebuttal Testimony of the Rate Design and Retail Access Panel" consisting of a cover page and 22 pages of questions and answers?

A. (Panel) We do.

Q. Was that document prepared by you or under your supervision?

A. (Panel) Yes.

Q. Does the panel have any changes or corrections to the testimony?

A. (Panel) No.

Q. If I were to ask you the same questions today, would your responses be the same?

A. (Panel) Yes.

Q. Do you adopt this testimony as your sworn testimony in this proceeding?

A. (Panel) Yes.

MS. KINSCH: Your Honor, I ask the prefiled rebuttal testimony of the rate, design and retail access panel, consisting of a cover page and 22 pages of questions and answers, be copied into the record as if given orally today.

JUDGE EPSTEIN: Yes.

(The following is the prefiled testimony of the retail access panel:)

RATE DESIGN AND RETAIL ACCESS PANEL

Q. Please state the names of the members on this Rate Design and Retail Access Panel (the "Panel").

A. We are James Lahtinen, Mark Marini, and Christine Stratakos.

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

A. I am Vice President, Rates and Regulatory Economics of New York State Electric & Gas Corporation ("NYSEG") and Rochester Gas and Electric Corporation ("RG&E"). My business address is 89 East Avenue, Rochester, New York 14649.

Q. Please summarize your educational background and work experience.

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

RATE DESIGN AND RETAIL ACCESS PANEL

sector, I was employed by the New York State Department of Public Service from 1979-1984 and held the position of Principal Economist. From 1977-1979, I was an Economist at the New York State Consumer Protection Board.

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

A. I have testified on several occasions before the Commission, including Cases 02-E-0198, 02-G-0199, 05-E-1222 and 07-E-0479. In addition, I have testified before regulatory commissions in Pennsylvania, New Jersey, Vermont, Connecticut, Indiana, the District of Columbia, and the Federal Energy Regulatory Commission.

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

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

Q. Please summarize your educational background and work experience.

A. I graduated from Rochester Institute of Technology with a B.S. degree in Applied Mathematics. In my present position at RG&E, I am responsible for regulatory and tariff related issues for NYSEG and RG&E. I was hired by RG&E in June 1985. My responsibilities have involved rates and regulatory areas, including electric and gas pricing,dev elopment and preparation of cost of service studies,

RATE DESIGN AND RETAIL ACCESS PANEL

both embedded and marginal, load research, revenue allocation, rate design, tariff design, analysis and administration, and participation in regulatory proceedings. During my tenure, I have increasingly gained supervisory and management responsibilities.

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

A. I have testified on several occasions before the Commission. Most recently,I testified in Cases 03-E-0765 and 03-G-0766 on behalf of RG&E and Case 05-E-1222 on behalf of NYSEG.

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

A. I am Manager of Pricing & Analysis in the Rates and Regulatory Economics Department at NYSEG. My business address is Corporate Drive, Kirkwood Industrial Park, Binghamton, New York 13909.

Q. Please summarize your educational background and work experience.

A. I graduated from Cornell University, with a B.S. degree in Natural Resources. I also earned an M.B.A. from Syracuse University. I have been employed by NYSEG for 31 years, the last 27 of which have been in the rate and regulatory area, with increasing supervisory and management responsibilities. My responsibilities have involved rate and regulatory areas, including electric and gas pricing, development and preparation of cost of service studies, both embedded and marginal, revenue allocation, rate design, tariff design, analysis and administration, and participation in regulatory proceedings. In my current position, I am primarily responsible for cost of service and rate-related issues for both NYSEG and RG&E.

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

A. I have presented testimony before the Federal Energy Regulatory Commission and I have testified on several occasions before the Commission, including Cases 01-E-0359, 05-E-1222 and 07-E-0479.

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

A. The purpose of this testimony is to respond to the retail access portions of the direct testimony of the Department of Public Service Staff ("Staff") Policy Panel, which is comprised of the testimony of Thomas D'Ambrosia, Patrick Barry, Maynard Bowman, Michael Salony,and Stephen Berger. In particular, we address issues related to the Staff Policy Panel's recommendations regarding bill issuance and payment processing charges and an ESCO Referral Program for NYSEG and RG&E. In addition, we address matters related to NYSEG's lost revenues from Standby customers raised in Staff witness Dickens' testimony.

Q. Does this Panel testimony address Staff interrogatory responses that are related to the Staff's direct testimony?

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

RATE DESIGN AND RETAIL ACCESS PANEL

analysis will be required as there was insufficient time to complete our review of these responses in the time provided to submit this Panel testimony,and we reserve the right to modify this Panel testimony at hearing to address any changes to Staff's exhibits.

Q. Is this Panel sponsoring any exhibits?

A. Yes. Exhibit __ (RDRA-1) contains a copy of an interrogatory response and workpapers referenced in this Panel's testimony. Exhibit __ (RDRA-2) contains a standby lost revenue calculation.

Q. Does the Panel have any preliminary comments concerning either the issues related to the Staff Policy Panel's recommendations mentioned above or the issues related to NYSEG's lost revenues from Standby customers raised in Staff witness Dickens' testimony?

A. Yes. While the Panel wishes to acknowledge the importance of Staff's concerns, neither the issues Staff raises relating to bill issuance and payment processing ("BIPP") nor the establishment of a new ESCO Referral Program are related to the instant merger proceeding. The same goes for the issues Staff witness Dickens raises relating to NYSEG's lost revenues from Standby customers. It is inappropriate for Staff to attempt to use this proceeding to institute new programs and practices that have no relevance to the transaction between Energy East and Iberdrola. This Panel will nonetheless address each of these points in turn below.

RATE DESIGN AND RETAIL ACCESS PANEL

BILL ISSUANCE AND PAYMENT PROCESSING ("BIPP") AND OTHER UNBUNDLED CHARGES

Q. Do you agree with the Staff Policy Panel's statement on page 305 that "certain issues regarding the way that these utilities [NYSEG and RG&E] apply their billing charges do not conform to Commission Policy and Orders?"

A. No. Both NYSEG and RG&E have complied with all Commission Orders in the Unbundling Track proceeding (Case 00-M-0504), including those related to unbundled cost of service and rate design and those related to the unbundled bill format. While the companies are at different stages of unbundling of costs for competitive services for the electric and gas sides of the business, the Commission clearly recognized in its various orders that such would be the case. In its *Statement of Policy on Unbundling and Order Directing Tariff Filing*, issued August 25, 2004 in Case 00-M-0504 ("August 2004 Order") and its *Statement of Policy on Rate Design Issues*, issued February 14, 2005 in Case 00-M-0504 ("Rate Design Order"), the Commission required that unbundling and competitive service rate design be addressed in future utility rate cases. Additionally, in its *Order Directing Submission of Unbundled Bill Formats*, issued February 18, 2005 in Case 00-M-0504 ("Unbundled Bill Format Order"), the Commission required that utilities operating under rate plans that expire in the future to file unbundled bill formats with their next application for new rates or rate plan extensions, or to file unbundled bill formats when making billing system

RATE DESIGN AND RETAIL ACCESS PANEL

upgrades. Finally,while the Commission has established guidelines, it has also allowed for consideration of unbundling and rate design for competitive services in the context of individual utility cases.

Q. Please describe the status of unbundling for NYSEG.

A. In compliance with the August 2004 Order, NYSEG filed a fully unbundled electric cost of service study in Case 05-E-1222. In compliance with the Unbundled Bill Format Order, that filing also included sample bill formats. As a result of the Order Adopting Recommended Decision issued August 23, 2006 in Case 05-E-1222, NYSEG converted from backout rates to unbundled charges on its bills for electric customers. Additionally, NYSEG's electric BIPP charge was converted from a backout rate based on a per-bill methodology to an unbundled portion of the customer charge calculated on a per-meter, per-month basis.

Q. Did NYSEG also further unbundle gas delivery rates?

A. NYSEG proposed unbundling of the BIPP charge for gas customers. However, since the company continues to operate under its gas rate plan (Case 01-G-1668), the company did not propose a change in the rate; rather, NYSEG proposed to convert the $0.70 backout rate, in effect pursuant to the Commission's *Order Establishing Uniform Retail Access Billing and Payment Processing Practices*, issued May 18, 2001 in Cases 99-M-0631 and 98-M-1343, to the unbundled bill issuance portion of the monthly customer charge. Consistent with the above-referenced Orders, the company proposed to develop a new unbundled BIPP charge in the company's next rate proceeding.

Q. Did the Commission express concerns about the unbundling of the BIPP charges on the gas customer bills?

A. Yes. In its *Order Denying Tariff Amendments*, issued December 22, 2006 in Case 06-G-1386, the Commission raised two concerns – the amount of the bill issuance cost to be removed from the bills of customers who purchase electric and gas commodity service from ESCOs and whether listing a charge for the bill issuance cost on a gas customer bill violates a provision of the Public Service Law.

Q. Have the issues raised by the Commission been resolved?

A. Yes. In a compliance letter dated August 30, 2007 and filed with the Commission in Case 06-G-1386, NYSEG notified the Commission that NYSEG and Staff agreed that the company was not double-recovering costs and reached agreement concerning the manner in which the BIPP charge would be shown on the customer's bill consistent with the requirements of the Public Service Law. In accordance with that compliance filing, NYSEG plans to convert the bill issuance and payment processing backout rate to an unbundled component of the gas customer charge, consistent with the electric bill format, effective April 1, 2008.

Q. What about RG&E?

A. Similar to NYSEG, RG&E initially established its bill issuance and payment processing backout credit of $0.62 per bill in Cases 03-E-0765, 02-E-0198, and

03-G-0766. In compliance with the Unbundled Bill Format Order, RG&E converted its existing billing back out credits to separate electric and gas BIPP charges at the time it implemented its new billing system. The customer charge of each service class was reduced by the amount of the current backout credit to maintain revenue neutrality. RG&E made its tariff filing on June 15, 2006. The filing was approved per Commission Order dated September 25, 2006 in Case 00-M-0504. With the conversion to a bill issuance charge, RG&E changed the application from a per bill to a per service monthly charge.

Q. Do you have any concerns with the Staff Policy Panel's suggestion on page 308 of its testimony that the BIPP charge should be converted back to a per-bill charge that is the same whether the customer is a single commodity service customer or a dual electric and gas commodity service customer?

A. Yes. It is unclear whether Staff is suggesting that the change be made outside the context of a rate case for each company. The proper forum for modifying established BIPP costs and charges is when revenue requirement and rates are reset, not this proceeding. To calculate a single rate on a per-bill basis, it will be necessary to have both up to date unbundled electric and gas costs in the numerator and an updated value of electric and gas customer months in the denominator. While this is possible, electric and gas rate cases do not always happen simultaneously. Also, for both companies, the BIPP charges are currently (or in the case of NYSEG gas, will be) an unbundled component of the customer charge. As the Staff Policy Panel recognized in its testimony on page 309, the companies reduced other rate components to reflect the unbundling of bill issuance charges, such that the overall customer charge remained at the level set by the Commission in the companies' most recent rate-setting process. In light of these circumstances, the Staff Policy Panel's recommendations to convert back to a per bill charge in the context of this proceeding should be rejected.

Q. Do you have a recommendation regarding the re-establishment of per-bill BIPP charges?

A. Yes. Because of the issues associated with revenue requirement and rate design, we recommend that this issue be addressed in each company's next major rate proceeding, during which new revenue requirements and rates will be set.

Q. Do you have any comments on the Staff Policy Panel's testimony on page 312 that the companies should be required to file revised tariffs that convert all existing back-out credits to unbundled charges in a revenue neutral manner?

A. We assume that the Staff Policy Panel is referring to RG&E in this part of their testimony, since NYSEG will no longer have any backout credits once the BIPP charge is unbundled on gas customer bills effective April 1, 2008. Because customers are familiar with the current backouts and rate design at RG&E, the company recommends that the Staff Policy Panel's proposed changes be considered in the context of the company's next major rate proceeding. In that way, a comprehensive outreach plan to address any rate level, rate design, and bill

RATE DESIGN AND RETAIL ACCESS PANEL

format changes can be developed. There is no need to cause, unnecessarily, customer confusion in this proceeding when these issues can be properly addressed the next time the company established a new revenue requirement.

RATE DESIGN AND RETAIL ACCESS PANEL

ESCO REFERRAL PROGRAMS

Q. The Staff Policy Panel makes certain recommendations regarding an ESCO Referral Program for NYSEG and RG&E. Does RG&E currently have an ESCO Referral Program?

A. No, it does not. On September 1, 2006, RG&E submitted its proposed ESCO Referral Program Parameters, including incremental, ongoing and start-up cost estimates and requested waivers of certain provisions of the Commission's Uniform Business Practices ("UBPs"). RG&E also filed proposed tariffs to implement its program. This filing, subsequent to collaborative discussions, was made pursuant to the Commission's *Order Adopting ESCO Referral Program Guidelines and Approving an ESCO Referral Program Subject to Modifications,* issued December 22, 2005 in Case 05-M-0858. RG&E's program was scheduled to begin March 1, 2007, subject to Commission approval. The Commission has not acted on RG&E's ESCO Referral proposal. Upon Staff request, the tariffs have been postponed twice, each postponement covering six months. Staff recently requested a third postponement and RG&E agreed, submitting a filing with the Commission on January 28, 2008 to request a further postponement of the tariffs to September 1, 2008.

Q. Does NYSEG currently have an ESCO Referral Program?

A. No, it does not. On October 23, 2006, NYSEG submitted its proposed ESCO Referral Program Parameters, including incremental ongoing and start-up cost

RATE DESIGN AND RETAIL ACCESS PANEL

estimates and requested waivers of certain provisions of the UBPs. NYSEG also filed draft tariffs implementing its program. This filing, subsequent to collaborative discussions, was made pursuant to the Commission's *Order Adopting Recommended Decision With Modifications,* issued August 23, 2006 in Case 05-E-1222 and the *Order Adopting ESCO Referral Program Guidelines and Approving an ESCO Referral Program Subject to Modifications,* issued December 22, 2005 in Case 05-M-0858. The program was scheduled to begin March 1, 2007, subject to Commission approval. The Commission has not acted on NYSEG's ESCO Referral proposal.

Q. What is the Staff Policy Panel's recommendation regarding an ESCO Referral Program for NYSEG and RG&E?

A. The Staff Policy Panel recommends, as a condition of the Commission's approval of Iberdrola's acquisition of Energy East, that NYSEG and RG&E be required to hold a new collaborative and make a new filing describing the relevant costs, benefits, and best practices of an ESCO Referral Program in sufficient detail to allow the Commission to reach a decision on such a program, similar to what the Commission has ordered in recent proceedings for National Fuel Gas Distribution Corporation (NFG) in Case 07-G-0141 and Keyspan Corporation (Keyspan) in Cases 06-G-1185 and 06-G-1186.

RATE DESIGN AND RETAIL ACCESS PANEL

Q. Does the Panel agree with the Staff Policy Panel's recommendation?

A. No. The Staff Policy Panel's recommendation should be rejected. The Staff Policy Panel has not provided any evidence or analysis on NYSEG's and RG&E's existing retail access programs and practices to support their recommendation for an ESCO Referral Program, nor why the companies should engage in a new round of discussions and a filing for an ESCO Referral Program. The Staff Policy Panel's only support for its ESCO Referral Program recommendation is to point to recent determinations made by the Commission for NFG and Keyspan. The Staff Policy Panel has not provided any basis as to how the requirements imposed on NFG and Keyspan for ESCO Referral Programs, as determined in their individual rate proceedings, pertain to NYSEG and RG&E.

Q. Is there any other reason why the Staff Policy Panel's ESCO Referral Program recommendation should be rejected?

A. Yes. The Commission has an ongoing proceeding to review retail access programs and practices on a generic basis. The outcome of that proceeding should provide the basis for any determinations made regarding future retail access programs.

Q. Please discuss the Commission's proceeding to review retail access programs and practices.

A. On April 24, 2007, the Commission issued an *Order on Review of Retail Access Policies and Notice Soliciting Comments* in Case 07-M-0458 – Proceeding on

RATE DESIGN AND RETAIL ACCESS PANEL

Motion of the Commission to Review Policies and Practices Intended to Foster the Development of Retail Energy Markets (Retail Energy Markets). The Commission, on page 7 of the Order, invited parties to examine and submit comments on existing programs and practices of the utilities to promote retail market development. The Commission further stated, on page 7 of the Order, that "[t]he evaluation of such programs and practices should examine whether they are still necessary; if competitors are improperly subsidized; if risks and expenses are properly allocated among ratepayers, utilities and competitors; or if a program or practice should otherwise be reconfigured. On the other hand, parties may also point out that the continuation of a program or practice remains necessary,t o ensure that all market participants are treated fairly or to prevent the re-building of barriers to entry." The Commission cited several statistics of how the competitive retail energy market is established in New York and is continuing to expand and stated, on page 6 of the Order, "[i]f barriers to entry and other obstacles to the growth of competitive markets have been successfully removed, it may be preferable to allow competitive markets to develop on their merits without ratepayer subsidization." Given that background, on the same page, the Commission stated: "[i]t may be appropriate, at this time, to review these programs and practices to determine their effectiveness in removing barriers, examine the costs of these initiatives and the extent to which those costs are borne by ratepayers, and determine the need to continue programs and practices that are

RATE DESIGN AND RETAIL ACCESS PANEL

subsidized by ratepayers or, alternatively, the potential harm of discontinuing these programs." The Commission further stated, on page 7 of the Order, that "[c]omments on the issues raised in this Order and Notice will be considered on a generic basis. In the interim, while we are considering those comments, however, parties are encouraged to submit in rate proceedings, analysis of a particular utility's existing retail access programs and practices and, where appropriate, propose modifications, with the understanding that we might defer to the generic process in reaching a decision on any particular policy or program. Consideration in rate cases, however, will allow us to respond rapidly where a proposed modification to a retail access program or practice would clearly prevent subsidization of competitors or benefit ratepayers."

Q. Has the Commission made any determinations in Case 07-M-0458?

A. To date, it has not.

Q. Why is it the opinion of this Panel that Case 07-M-0458 should provide the basis for determining whether an ESCO Referral Program should be offered?

A. As mentioned above, the Staff Policy Panel has not provided any justification on why the NYSEG and RG&E should pursue a collaborative and filing of an ESCO Referral Program, nor has the Staff Policy Panel provided any evaluation or analysis of retail access in the companies' territories to suggest an ESCO Referral Program is necessary. The Commission has not taken any action on NYSEG's and RG&E's current filings for ESCO Referral Programs, made well over a year

RATE DESIGN AND RETAIL ACCESS PANEL

ago. The Commission is currently reviewing all retail access programs, practices and policies on a generic basis. With no support from the Staff Policy Panel to justify the need for ESCO Referral Programs for NYSEG and RG&E and an ongoing Commission proceeding on retail access, it is our position that we should await the outcome of the Commission's determinations in the Case 07-M-0458 rather than to engage in activities for ESCO Referral Programs in the manner recommended by the Staff Policy Panel.

Q. Does NYSEG currently have an ongoing collaborative regarding an ESCO Introduction Program?

A. Yes. As part of a Joint Proposal that was approved by the Commission in its *Order Establishing Commodity Program*, issued August 29, 2007 in Case 07-E-0479 (Supply Service), it was agreed that NYSEG would develop, through a collaborative, and implement an ESCO Introduction Program to replace the ESCO Referral Program pending in Case 05-M-0858. Pursuant to the Supply Service Joint Proposal, if a joint proposal regarding the ESCO Introduction Program results, NYSEG will request Commission approval to withdraw its pending ESCO Referral Program proposal and will file for approval of the ESCO Introduction Program in its place.

Q. What is the status of the collaborative?

A. As the Staff Policy Panel correctly notes, discussions are ongoing.

RATE DESIGN AND RETAIL ACCESS PANEL

Q. The Staff Policy Panel recommends that the results of NYSEG's ongoing ESCO Introduction Program be folded into an ESCO Referral filing. Does the Panel agree with that recommendation?

A. No, we do not. As discussed above, the ESCO Introduction Program is intended to replace an ESCO Referral Program as contemplated in Case 07-E-0479. This provision was agreed to by the parties to the NYSEG Supply Service proceeding and resulted in a Joint Proposal that was signed by various industry participants and was approved by the Commission just a few months ago. There was no provision contemplated in the NYSEG Supply Service Joint Proposal for an ESCO Referral Program to replace or supersede an ESCO Introduction Program, and no weight should be given to the Staff Policy Panel's recommendation.

Q. Should an ESCO Introduction Program be considered for RG&E?

A. No, it should not. The ESCO Introduction Program was a provision of an overall framework in a Supply Service Joint Proposal for NYSEG. The same circumstances do not exist at RG&E. Therefore, there is no justification for an ESCO Introduction Program. As stated above, it is our position that the Commission should take no action in this proceeding given the existence and generic nature of Case 07-M-0458.

STANDBY LOST REVENUES

RATE DESIGN AND RETAIL ACCESS PANEL

Q. Is Staff witness Dickens correct when he testifies on page 10 that NYSEG incurred standby lost revenues?

A. Yes. His statement on page 10 of his testimony that "NYSEG incurred lost revenue because existing standby service customers have been charged standby rates that are lower than the rate they would have been charged under the otherwise-applicable tariff rate" is accurate.

Q. Did NYSEG report in annual compliance filings, for the years 2004 through 2006, total lost revenues of $8,101,862 as stated on page 10 of Staff witness Dickens' testimony?

A. Yes, that is the number that NYSEG reported to the Commission.

Q. Does Staff take exception to NYSEG's calculation of the amount of lost revenues associated with a specific standby customer?

A. Yes. Staff witness Dickens takes issue with the "otherwise applicable rate" NYSEG used in calculating the amount of lost revenues related to Cornell University. Specifically, Mr. Dickens argues that NYSEG inappropriately used the S.C. 7 Transmission non – Industrial High Load Factor ("IIHLF") rate as the otherwise applicable rate in calculating lost revenues for Cornell for the period April 2004 through December 2006. He further states that NYSEG should have continued to use the S.C. 7 Transmission IHLF rate as the otherwise applicable rate despite the fact that Cornell's load factor fell below the threshold 68% load factor that the IHLF tariff requires for classification as an IHLF customer. Based

RATE DESIGN AND RETAIL ACCESS PANEL

on that assumption, Mr. Dickens' calculated an ASGA adjustment amount, which Staff witness Benedict has included in his proposed adjustment to NYSEG's ASGA balance.

Q. Do you agree with Staff witness Dickens' position?

A. No. Staff witness Dickens takes the position that the lost revenue calculations associated with Cornell University should be based on a rate at a single point in time, and should not reflect any changes in rates associated with the customers declining load factor. NYSEG contends that, pursuant to NYSEG's Standby Joint Proposal approved in the Commission's *Order Establishing Electric Standby Rates*, issued July 30, 2003 in Case 02-E-0779, the otherwise applicable rate should be the rate that Cornell would have been paying under the otherwise applicable service classification, given the actual load factor by the customer.

Q. How often does NYSEG review its IHLF customer list for continued eligibility?

A. NYSEG reviews its accounts annually to verify continued qualification based on usage during the previous year. It should be noted that customers meeting the tariff qualifications for the IHLF rate can shift to that rate at any time during the year.

Q. Does NYSEG calculate the lost revenues for its other standby customers based on the otherwise applicable rate as that rate may change based on a customer's consumption?

A. Yes.

RATE DESIGN AND RETAIL ACCESS PANEL

Q. Has Staff been aware of NYSEG's calculation methodology over the past several years?

A. Yes. NYSEG first provided the detailed workpapers supporting the lost revenue calculation for Cornell (and other customers) in an October 3, 2005 response to a data request from Mr. Dickens. In each of the following two years, NYSEG provided similar back-up data to Mr. Dickens for the 2005 and 2006 calendar years.

Q. Does NYSEG agree with the calculated level of adjustment supported by Staff witness Dickens' based on Staff's premise that the lost revenue calculation for Cornell should be based on the IHLF rate?

A. No. Based on Exhibit __ (RDRA-1), which is a Staff response to a Company data request, it appears that Mr. Dickens estimated the difference in the lost "Energy" revenues related to Cornell for each of the years based on the ratio of the IHLF to non-IHLF kWh rates for 2004. This results in an over-estimate of the amount of adjustment that would be made to the ASGA balance shown on Exhibit __ (JB-7) if one were to accept Staff's methodology.

Q. Has the Company prepared an exhibit that provides its calculation of the difference between the standby lost revenues for Cornell based on IIHLF and non-IIHLF rates?

A. Yes. Exhibit __ (RDRA-2) shows that had the lost revenue calculation for Cornell been based on the IHLF rates rather than the non-IHLF rates, the

RATE DESIGN AND RETAIL ACCESS PANEL

assessment of charges against the ASGA for the period from April 1, 2004 through December 31, 2006 would have been lower by $2,716,233.

Q. Does this complete your rebuttal testimony at this time?

A. Yes, it does.

BY MS. KINSCH:

Q. And panel, are you also sponsoring two exhibits to the testimony consisting of RDRA-1 and RDRA-2?

A. (Lahtinen) Yes.

Q. Are they public and highly sensitive trade secret versions of both exhibits?

A. (Lahtinen) Yes.

Q. For the record, does the RDRA-1 consist of a cover page and a public version of the Department of Public Service's response to interrogatory?

A. (Lahtinen) Yes.

Q. Does RDRA-2 consist of a cover page and the public version of an exhibit entitled "New York State Electric and Gas Corporation Standby Revenue Calculations"?

A. (Lahtinen) Yes.

Q. Were those documents prepared by you or under your supervision?

A. (Lahtinen) Yes.

Q. Are there any changes or corrections to those documents?

A. (Lahtinen) No.

MS. KINSCH: Your Honor, I ask that the public version of these exhibits be marked for identification as the next exhibits.

JUDGE EPSTEIN: Okay. That would be 13 and 14.

(Exhibits 13 and 14 marked for identification.)

(Brief off the record discussion.)

JUDGE EPSTEIN: We had a decision of exhibit numbering, and I take it we have here two confidential versions -- I mean, we have a confidential version of Exhibit 1 and Exhibit 2, is it?

MS. KINSCH: That is correct.

JUDGE EPSTEIN: So, Exhibit 15 will be the confidential version of No. 1 and Exhibit 16 will be the confidential version of No. 2.

(Exhibits 15 and 16 marked for identification.)

MR. VAN RYN: Your Honor, should we note at this point that those are the highly sensitive trade secret designation? There is a category in the proceeding of some information being more confidential than others, and this is the more confidential category.

MS. KINSCH: Your Honor, that information is available only to Energy East, Department of Public Service Staff and Consumer Protection Board pursuant to the protective order.

JUDGE EPSTEIN: That's fine in principal. There has been either some confusion or differences of opinion about whether the -- whether if the party claims highly sensitive trade secret status and that claim is unopposed, whether I am required to rule on it on my own initiative.

I have been assuming that I am. So, I suppose what we are doing here is we are treating it as highly sensitive trade secret information unless I call that into question on notice to the parties.

BY MS. KINSCH:

Q. Panel, were the documents marked as Exhibits 15 and 16 prepared by you or under your supervision?

A. (Lahtinen) Yes.

Q. Are there any changes or corrections to the documents?

A. (Lahtinen) No.

MS. KINSCH: The panel is available for cross-examination.

JUDGE EPSTEIN: Mr. Mager?

MR. BREW: Your Honor, as I indicated to Staff and the Company earlier, we no longer have cross-examination for the panel.

JUDGE EPSTEIN: Okay.

CROSS EXAMINATION

BY MR. MAGER:

Q. Good morning, panel.
A. (Panel) Good morning.
Q. Could you please turn to the bottom of page 18, top of page 19 of your testimony. Panel, that's where you testify--

(Brief interruption to resolve technical difficulties.)

JUDGE EPSTEIN: This system is not going to work. Let me just take a very short break to see whether there is another solution.

(Brief interruption to resolve technical difficulties.)

BY MR. MAGER:

Q. Panel, I would like to ask you some questions about the section of your testimony dealing with standby lost revenue; do you see that?
A. Yes.
Q. And on page 19, lines 7 through 10 of your testimony, you discuss a proposal by NYSEG to recover over $8.1 million in lost revenues related to standby service and to recover that from the ASGPA; do you see that reference?
A. (Stratakos) Yes.
Q. In this case, Staff has raised an issue about

that recovery, has it not?

(Brief interruption to resolve technical difficulties.)

JUDGE EPSTEIN: Back on the record. We are doing work with the telephone and now we'll proceed.

BY MR. MAGER:

Q. Now, panel, Staff has raised an issue about that recovery of standby lost revenues in this case; has it not?

A. (Stratakos) Yes. Just to clarify, that's between the years 2004 and 2006.

(Lahtinen) And I'd also like to clarify, they raised the issue regarding the amount, not as to whether or not we are entitled to recover. I think there is an issue with regard to the amount.

Q. Correct. In the Staff Witness Dickens testimony he testified that, on page 11, starting at line 3, that NYSEG has "substantially overstated its lost revenues"; is that Staff's position?

A. (Stratakos) With regard to a single customer.

Q. With respect to that customer, it's currently a standby customer, correct?

A. (Stratakos) That is correct.

Q. And the customer became a standby customer in late 2003?

A. (Stratakos) That is correct.

Q. And the period in dispute here is 2004 through 2006?

A. (Stratakos) April, I believe, 2004.

Q. And just so we are on the same page, I am going to purposely avoid asking any specific financial questions dealing with this customer because it is customer-specific, sensitive information.

A. (Stratakos) Okay.

Q. Now, prior to becoming a standby customer, this customer had on-site generation for quite some time; is that your understanding?

A. (Stratakos) Yes. I don't know how long but, yes.

Q. Now, can you explain now NYSEG calculated its lost revenues relating to this customer?

A. (Stratakos) NYSEG compares the revenues that it's receiving under the standby rates to the revenues that we'd have received had the standby JP not been implemented.

Q. So, the comparison deals with what the customer is paying under SC-11 versus what it would have paid if it was not a standby customer?

A. (Stratakos) Had the JP not been implemented.

They may have still been a customer under the old standby rates.

Q. Prior to that JP, this customer took service under service classification 7(4), correct?

A. (Stratakos) That is correct.

Q. And subsection 4 of that transmission level?

A. (Stratakos) Correct.

Q. Now, SC-7(4) has two different rate classes: Industrial high-load factor and nonindustrial high-load factor; is that your understanding?

A. (Stratakos) Yes, we refer to them as subclasses.

Q. And before moving to SC-11 standby service, this customer was a SC-7(4) high-load factor customer, was it not?

A. (Stratakos) Yes.

Q. And at the beginning of 2004, NYSEG started calculating its lost revenues based on the comparison of SC-11 rates versus SC-7(4) high-load factor rates?

A. (Lahtinen) Did you say before --

Q. At the beginning of 2004?

A. (Stratakos) Yes.

Q. Now, at some point, NYSEG switched -- changed the way it was calculating lost revenues with respect to this customer. I believe it was April 2004?

A. (Stratakos) We didn't change the way we were calculating. We changed the subclass against which we were comparing because the customer no longer met certain criteria.

Q. And at that point, the rate class that you started using for comparison purposes was SC-7(4) non-high-load factor?

A. (Stratakos) That is correct.

Q. Is it fair to say that Staff contended in this testimony that NYSEG should have continued comparing the standby rates to SC-7(4) high-load factor?

A. (Stratakos) In its testimony --

(Lahtinen) Which is what we are rebutting and don't agree with.

Q. Now, there is -- is there a high-load factor distinction for other rate classes other than SC-7?

A. (Stratakos) Yes.

Q. What classes are those?

A. (Stratakos) SC-2 can have a high-load factor customer and SC-3 could have high-load factor customers.

Q. Is this customer that we are talking about the only issue where this issue has arisen?

A. (Stratakos) I am not sure what "issue" you are referring to.

Q. How you calculate standby-related lost revenues?
A. (Stratakos) In terms --
(Lahtinen) I would say no. We have had other instances where, because of the prices of the tariff, customers might have started out as non-high-load factor customers and then went to high-load factor rate and calculated the lost revenues in the same fashion.
I think the point is we have applied this consistently. The provisions of the tariff provide for a change in a subclass depending upon the experienced load factor of the customer. We applied it consistently when we applied it here.
Q. Let's be clear, though. SC-11 does not have any high-load factor distinction, correct?
A. (Stratakos) SC-11 does not.
Q. So, at no point did the rates to the customer change in the 2004-to-2006 period?
A. (Stratakos) The rates for this particular customer did not change. SC-11 rates have changed over that period.
Q. At all times for the 2004 to 2006 period this customer was billed at standby rates?
A. (Stratakos) Yes.
Q. The revenues coming into NYSEG were, for this

entire period, based on the SC-11 rates as they may have been changing from time to time?

A. (Lahtinen) Yes. The loss revenue calculation has to look at something else as well.

Q. With respect to the SC-7(4) class, we talked about how there is a high-load factor rate and non-high-load factor rate. Would you agree with me the difference in rates is very significant?

A. (Stratakos) They are different.

(Lahtinen) One's higher; one's lower.

Q. Let's take an example: For SC-7(4) high-load factor customers, isn't it true that the demand charge for kw is zero; and for SC-7(4) non-high-load factor customers the demand charge is $1.73 per kw?

A. (Lahtinen) At the transmission level.

Subject to check, I think that is correct.

(Stratakos) The zero is correct. I recall that -- I will take the $1.73 subject to check.

Q. And for a large customer, that could amount to a significant amount of money; wouldn't you agree with that?

A. (Stratakos) Yes.

Q. Now, the customer in question, when it moved to SC-11, did it have any rate incentive to maintain its

high-load factor status?
A. (Stratakos) Any rate incentive?
Q. Let me rephrase the question.
Once that customer became an SC-11 customer, wasn't it charged the same rate whether it maintained a 68 percent load factor or not?
A. (Stratakos) Yes, they would.
Q. Now, would you agree that customers can modify their behavior to attain certain load factors?
A. (Stratakos) Sure. Some customers, yes.
Q. When this customer was on SC-7(4) rates it operated in a manner that qualified for high-load factor rate service?
A. (Stratakos) Correct.
Q. And then when it moved to an SC-11 standby rate, that incentive to remain a high-load factor customer was essentially eliminated?
A. (Stratakos) They no longer had to meet the criteria for the purpose of SC-11 rates, that is correct.
MR. MAGER: Thank you. I have no further questions.
JUDGE EPSTEIN: Okay, other cross? Redirect?
MS. KINSCH: Could I have a moment, Your Honor?

JUDGE EPSTEIN: Yes.

MS. KINSCH: Your Honor, we have no redirect for this panel. Thank you.

JUDGE EPSTEIN: Thank you, panel. You are excused.

MR. MUELLER: We'd ask that the gas safety and reliability panel be sworn.

MICHAEL EASTMAN and ALAN MATTHEWS, after first having been duly sworn, were examined and testified as follows:

DIRECT EXAMINATION

BY MR. MUELLER:

Q. Starting with you, Mr. Eastman, can you state your name and business address for the record.

A. (Eastman) Yes. My name is Michael Eastman, 1300 Scottsville Road, Rochester, New York.

Q. Mr. Matthews, can you state your name and business address for the record?

A. (Matthews) Alan Matthews, 1300 Scottsville Road, Rochester, New York.

Q. Gentlemen, do you have in front of you a piece of testimony entitled "Rebuttal Testimony of Gas Safety and Reliability Panel" containing your names in the lower right-hand corner and consisting of 27 pages of

questions and answers?
A. (Eastman) Yes.
(Matthews) Yes.
Q. Was that document prepared by you or under your direction?
A. (Eastman) Yes.
(Matthews) Yes.
Q. Do you have any changes or updates to your testimony at this time?
A. (Matthews) I have one change. Page 17, line 9, the year-end result is in the record as 64. The actual was 57 leaks, open leaks.
Q. And do you have any further changes or updates?
A. (Matthews) No.
Q. If I were to ask you the same questions today as are contained in these 27 pages would your answers be the same?
A. (Eastman) Yes.
(Matthews) Yes.
Q. Do you adopt this as your sworn testimony in this proceeding?
A. (Eastman) Yes.
(Matthews) Yes.
MR. MUELLER: Your Honor, I would ask that the

prefiled testimony of the gas safety and reliability panel, consisting of a cover page and 27 pages of questions and answers, be copied into the record as if given orally.

JUDGE EPSTEIN: Yes. Did the reporter get a copy that reflects that change on page 17?

MR. MUELLER: Yes. We are distributing copies right now that reflect that change.

(The following is the prefiled testimony of the gas safety and reliability panel:)

GAS SAFETY AND RELIABILITY PANEL

I. **INTRODUCTION**

Q. Please state the names of the members on this Gas Safety and Reliability Panel (the "Panel").

A. Michael D. Eastman and Alan L. Matthews.

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

A. My current position is Vice President - Gas Assets for New York State Electric & Gas Corporation ("NYSEG") and Rochester Gas and Electric Corporation ("RG&E"). My business address is 1300 Scottsville Road, Rochester, NY 14624.

Q. Please summarize your educational background and work experience.

A. I have an A.S. degree in Engineering Sciences from Broome Community College and a Bachelor of Mechanical Engineering Technology degree from the State University of New York at Binghamton. I have 27 years of utility gas experience in field operations, field and corporate engineering and gas business management functions. In addition, I was U.S. Business Development Manager for natural gas materials manufacturer UPONOR Aldyl of Oklahoma.

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

GAS SAFETY AND RELIABILITY PANEL

A. Yes, I have previously testified in other gas proceedings before the New York State Public Service Commission, the Maine Public Utilities Commission and the Vermont Public Service Board.

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

A. I am currently Director – Gas Engineering for NYSEG and RG&E. My business address is 1300 Scottsville Road, Rochester, NY 14624.

Q. Please summarize your educational background and work experience.

A. I graduated from Pennsylvania State University in 1977 with a Bachelor's of Science degree in Civil Engineering. I received a Masters in Business Administration from Alfred University in 2003. I am a licensed Professional Engineer in New York State. I have been employed in the utility operations and engineering field for over 29 years. I have worked in gas operations and engineering for 17 years, including management positions in field operations, field engineering and corporate engineering. In addition, I worked in the electric generation field for 12 years at NYSEG and Penelec.

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

A. No, I have not.

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

A. The purpose of our testimony is to respond to the direct testimony of the Department of Public Service Staff ("Staff") Gas Safety Panel, which consists of the testimony of Steven Blaney and Christopher R. Stolicky. In addition, Mr. Meehan, on behalf of the Joint Petitioners, addresses the Gas Safety Panel's comparison between the proposed transaction and the recent National Grid/KeySpan merger (Case 06-M-0878 – Joint Petition of National Grid PLC and KeySpan Corporation for Approval of Stock Acquisition and other Regulatory Authorizations, Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Adjustments for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island (issued Sept. 17, 2007) (the "GRID/KeySpan Merger")), and explains why the comparison is inappropriate. Our testimony rebuts Staff's recommendations to implement more stringent safety-related metrics and revenue adjustments for NYSEG and RG&E than are currently in place under each company's rate plan. We demonstrate that each of the revised gas safety performance measures proposed by Staff is arbitrary, unnecessary, excessive and punitive because NYSEG and RG&E consistently meet or exceed the current safety and reliability targets, and consistently out-perform most of the other local distribution companies ("LDCs") in the state in every category. We rebut Staff's erroneous assertion that the acquisition of Energy East by Iberdrola proposes "business as usual" and provides no benefits to customers, and we demonstrate the inappropriateness of Staff's comparison of the proposed transaction with the recent KeySpan/National Grid Merger As Mr. Meehan explains in his rebuttal testimony, the financial risks that the Commission

GAS SAFETY AND RELIABILITY PANEL

identified in the GRID/KeySpan Merger are not present in this transaction. Accordingly, there is no justification for increasing the gas safety and reliability standards applicable to NYSEG and RG&E.

Q. Does the Proposed Transaction create gas safety and reliability issues?

A. No, it does not. No changes to NYSEG's and RG&E's operations are anticipated as a result of the transaction, and therefore, the issue of gas safety and reliability is irrelevant in the context of this proceeding. Staff admits that at least some of its proposed enhancements are irrelevant to the transaction on page 18 of the Gas Safety Panel testimony where it states,"[T]he need to replace leak-prone pipe on a more expedited basis is not dependent on a merger or related to what business entity owns the LDC." We believe Staff's admission on this point is true of all of the Gas Safety Panel's proposed enhancements. It is inappropriate for Staff to attempt to use this proceeding as an opportunity to impose more stringent gas safety and performance standards on NYSEG and RG&E than are currently required.

Q. Do you agree that Staff's proposed measures are necessary in order to provide incentives to the Companies not to deteriorate in the area of safety and reliability following the acquisition of Energy East by Iberdrola?

A. No. In light of the Companies' excellent safety record there is no need to change their performance metrics or associated revenue adjustments because of the pending transaction with Iberdrola. Staff's assumption that the acquisition will

GAS SAFETY AND RELIABILITY PANEL

cause NYSEG and RG&E's safety and reliability standards to deteriorate is arbitrary and without foundation. In fact, because no change in operations is anticipated as a result of the transaction and because NYSEG's and RG&E's customer bases will not change, the evidence indicates that the Companies' performance will continue to be excellent and to improve.

Q. Is this Panel sponsoring any exhibits?

A. Yes, Staff's response to Information Request DPS-120 is attached as Exhibit __(GSRP-1). The 2006 Gas Safety Performance Measures Report (the "2006 Safety Report"), prepared by Staff, is provided as Exhibit ___(GSRP-2).

Q. Are NYSEG and RG&E subject to safety-related targets pursuant to their current gas rate plans?

A. Yes. NYSEG is subject to targets and associated revenue adjustments related to infrastructure enhancements, leak management, damage prevention and emergency response times, established in Case 01-G-1668, as modified in 2005 (Case 01-G-1668 -- Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State & Electric Corporation for Gas Service,Order Esta blishing Steel Mains Replacement Program (issued November 7, 2005) ("2005 NYSEG Order and JP"). RG&E is subject to similar targets and revenue adjustments adopted by the Commission in Case 03-G-0766, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Gas Service (issued

GAS SAFETY AND RELIABILITY PANEL

May 20, 2004) ("2004 RG&E Order and JP"). The targets for both companies continue in effect through 2008, and from year to year unless modified by the Commission. It is inappropriate for Staff to attempt in the context of this transaction to reopen the gas safety and reliability targets it agreed to in prior proceedings.

Q. Explain the purpose of the Gas Safety Performance Measures Report, Exhibit __(GSRP-2).

A. The Gas Safety Performance Measures Report, attached as Exhibit __(GSRP-2), which is prepared and issued annually by Staff, examines the performance of all LDCs in the state of New York in the areas pertaining to safety, damage prevention, emergency response and leak management. The 2006 Safety Report displays performance data for every LDC for every year from 2003 through 2006 for each category and reports the results for 2006. The purpose of the gas safety performance measures is to improve gas delivery system safety by measuring the performance of LDCs in the areas identified as presenting the greatest risks. See Exh. __(GSRP-2) at 2. The 2006 report demonstrates that NYSEG and RG&E have consistently met or exceeded their current safety-related targets, and consistently matched or out-performed the top performing LDCs in the state in every area pertaining to safety and reliability.

GAS SAFETY AND RELIABILITY PANEL

Q. Does the Panel have any preliminary comments regarding the Staff's proposed "enhancements" to the current safety and performance measures applicable to NYSEG and RG&E?

A. Yes. The proposed measures are unnecessary,e xcessive and, in many instances, redundant because NYSEG and RG&E have demonstrated a commitment to gas safety and reliability and do not need additional "incentives" in the form of harsher standards and higher revenue adjustments to continue this commitment. As more fully discussed below, the evidence is uncontroverted that RG&E's and NYSEG's performance has improved significantly over the last five years, and in 2006, the Companies ranked among the top performers in the state in virtually every area. Neither NYSEG nor RG&E is cited in the 2006 Safety Report for poor performance in any category,and neither company is singled out as requiring improvement for any safety measure. In fact, there are several instances in the report where Staff acknowledges the superior performance of NYSEG or RG&E. (e.g., NYSEG is among the better performers in the state in the area of leak repairs; NYSEG improved 42% in the total damages per ticket measure; and NYSEG and RG&E are "among the best in the State" in the damage mismarks category). It is noteworthy that in the Recommendations section, NYSEG and RG&E are the only LDCs in the State in 2006 that were not required to "self-assess their performance" and "respond with action plans on how to improve performance in the future." See Exhibit. __(GSRP-2) at 27.

GAS SAFETY AND RELIABILITY PANEL

Q. Please comment on Staff's assertion that the transaction promises "business as usual" with no demonstration of benefits for customers in the area of safety and reliability.

A. As an initial matter, "business as usual" seems to mean continued strong performance using the metrics referred to above. Moreover, Messrs. Azagra, Rude, and Laurito have testified and, as identified in the Joint Petition and in the Petitioners' initial testimony, the acquisition of Energy East by Iberdrola will provide benefits to NYSEG's and RG&E's customers. In addition, notwithstanding the pending acquisition, NYSEG and RG&E continually strive to find ways to improve the quality and safety of their service by instituting safety related-improvements that are necessary for system safety and reliability.

II. **TESTIMONY**

A. **Leak-Prone Mains and Services**

Q. What are NYSEG and RG&E's current requirements for Infrastructure Enhancements?

A. Pursuant to the 2005 NYSEG Order and JP relating to NYSEG's cast iron mains replacement program, NYGEG is currently required to replace 15 miles of bare steel mains (defined as "uncoated steel mains, wrought iron mains and ineffectively coated mains") each year, and is subject to a $100,000 revenue adjustment for failure to meet this target (JP, Section III.B.1.a). Under the 2002

Joint Proposal in Case 01-G-1668, NYSEG is required to replace a minimum of 1,900 leak prone services annually,and to replace an average of 2,000 services per year over the period of 2003-2008. Failure to meet this requirement is subject to a revenue adjustment of $150,000. Pursuant to the 2004 RG&E Order and JP, RG&E is required to replace 15 miles of cast iron and bare steel leak-prone pipe and 1,000 miles of services. Failure to achieve these metrics will subject RG&E to a revenue adjustment of $50,000.

Q. Does Staff base the need for NYSEG and RG&E to expedite the replacement of leak-prone mains and services on the pending transaction with Iberdrola?

A. No. In fact, Staff admits on page 18 of the Gas Safety Panel testimony that the new measures have no relevance to the transaction between Energy East and Iberdrola. Specifically,Staf f states, "the need to replace leak-prone mains and services on a more expedited basis is not dependent on a merger or related to what business entity owns the LDCs." Therefore, Staff appears to be inappropriately using this docket as an opportunity to reopen NYSEG's and RG&E's existing targets although it expresses no concerns related to the transfer of control.

Q. Have NYSEG and RG&E met or exceeded its mains and services targets during the last five years?

A. Yes. NYSEG has exceeded the leak-prone main replacement and bare steel service replacement targets currently in effect. From 2003 to 2005, in accordance with the requirements then in effect for Cast Iron Main Replacements under the

GAS SAFETY AND RELIABILITY PANEL

December 2002 Order in Case 01-G-1668, NYSEG replaced 8.51, 8.44 and 8.28 miles of cast iron pipe each year. For the years 2006 through 2007, under the increased levels established in the 2005 NYSEG Order and JP, NYSEG exceeded the 15-mile minimum requirement and replaced 15.67 miles of leak prone main in 2006 and 15.37 miles in 2007. With respect to bare steel services, NYSEG exceeded its minimum requirement of 1,900 and met the required average for the period of 2,000 by replacing 2,173 services in 2003, 2,148 in 2004, 2,167 in 2005, 2,093 in 2006 and 1,954 in 2007. RG&E has also exceeded its leak-prone main replacement target for the years 2004 through 2007. RG&E's bare steel and cast iron main replaced as part of the priority pipe replacement program from 2004 through 2007 are as follows: 16.60, 16.24, 15.69 and 16.21 miles for each year from 2004 through 2007. The yearly bare steel services that RG&E replaced over the same period total 1,388, 1,225, 1,278 and 1,222 for each year.

Q. Summarize Staff's proposal with respect to Infrastructure Enhancement – Replacement of leak-prone pipe and services.

A. Staff recommends that effective in 2008, at a minimum, NYSEG replace 20 miles of leak-prone main and 2,500 leak-prone services. RG&E should be required to replace 20 miles of leak-prone main and 2,000 leak-prone services. Failure to meet either of these targets will result in a pre-tax revenue adjustment of $344,000 and $240,000 to NYSEG and RG&E, respectively.

GAS SAFETY AND RELIABILITY PANEL

Q. Did the Commission revise NYSEG's incentives for cast iron main replacements two years ago?

A. Yes. The 2005 NYSEG Order and JP adopted revised gas safety metrics for NYSEG, including the requirement that NYSEG increase the minimum mileage of bare steel mains replaced annually from 8 miles to 15 miles. The Commission noted that the purpose of the 2005 Joint Proposal was to "refocus the rate plans incentives onto other gas safety activities." Id. at 2. Staff's attempt to reopen the terms of NYSEG's 2005 Joint Proposal in this proceeding is inappropriate.

Q. Are Staff's proposed "enhancements" to the infrastructure measures (leak-prone mains and services) reasonable?

A. No, it is unreasonable to expect an increase in mains replacements of approximately 30 percent at both companies and an increase in services replacements of 25 percent and 100 percent for NYSEG and RG&E, respectively. It is also unreasonable to expect the Companies to absorb the additional cost for potential backsliding in their performance for which no evidence exists. In addition, selecting a mileage and number of services to be replaced without considering the currently very low number of outstanding and newly discovered leaks by each company is arbitrary and unsupported by the performance data.

GAS SAFETY AND RELIABILITY PANEL

Q. What additional steps do NYSEG and RG&E take to improve their mains and services?

A. NYSEG and RG&E were the first LDCs in the state to proactively implement a bare steel isolation program, the purpose of which is to take proactive steps to prolong the useful service life of bare steel gas mains. The bare steel main isolation program eliminates electrical contacts between bare steel gas main facilities and foreign underground structures, increasing the cathodic protection on the existing gas main, prolonging the useful life of the gas facilities and preventing future leaks from occurring. In many cases, this also prolongs the useful life of the gas services that are attached to the isolated mains.

Q. Please comment on Staff's statement that the infrastructure proposals would increase capital spending by $1.6 million for each company.

A. Staff attempts to justify no rate base treatment of its estimated $1.6 million for the increase in capital spending levels for each company for mains based upon its arbitrary assumption that *"the relative dollar amount of our recommendation is very small compared to the approximately $1 billion that shareholders and company management are slated to receive if the merger is approved."* Gas Safety Panel Test., p. 18. In fact, the capital spending increase of $1.6 million calculated by Staff for each company does not reflect the continuing escalation of construction costs in the periods between rate cases. Staff's calculation of $1.6 million for each company also relates to mains only, and does not include the

GAS SAFETY AND RELIABILITY PANEL

capital cost for the significant increase in services replacements that Staff proposes. Staff's calculation in the work papers provided with its response to IR DPS-120 (Exhibit ___(GSRP-1)) of the incremental costs for NYSEG to replace an additional five miles of pipe is not correct because the average cost per mile Staff uses does not take into account costs that NYSEG incurs to replace the bare steel pipe as required for highway projects.

Q. Is Staff correct that its proposed infrastructure enhancements would escalate NYSEG's performance levels by only 18 percent and RG&E's by 50 percent?

A. No. Staff is attempting to minimize the harshness of its proposal by mischaracterizing the percentage increase in the required performance levels for the infrastructure measure. The percentage increases of 18 percent for NYSEG and 50 percent for RG&E on page 12, lines 21-22 of Staff's testimony are based on the Companies' historical performance levels, which exceed their current targets. Staff is attempting to make its proposal appear more reasonable by using the Companies' actual performance levels instead of the metrics. Using the metrics established in the Companies' rate plans, the increase over the current metrics would be 25 percent for NYSEG, not 18 percent, and 100 percent for RG&E, not 50 percent.

GAS SAFETY AND RELIABILITY PANEL

B. **Leak Management**

Q. Describe the current leak management requirements.

A. Under the Commission's regulations, 16 NYCRR Part 255, only Types 1, 2A and 2 leaks are measured and reported, i.e., leaks that are categorized as requiring immediate effort to protect life and property, or to eliminate a hazard, and which require repair at least within one year. Type 3 leaks are minor leaks that do not require repair, but should be monitored annually in case they develop into Type 1, 2A or 2 leaks.

Q. Describe the requirements under NYSEG's and RG&E's current rate plans for leak management.

A. The requirements for each company are different. Under its current rate plan adopted in Case 03-G-066, RG&E's requirements are to maintain a level at or below 4 percent for Types 1, 2 and 2A leaks pending repair as a percentage of leaks repaired at the end of each calendar year. Under NYSEG's rate plan, as updated by the 2005 NYSEG Order and JP, NYSEG's year-end total leak backlog for Types 1, 2A, 2 and 3 leaks, must not exceed 165 in 2007 and 150 in 2008. Failure by either company to meet these targets will result in a pre-tax revenue adjustment of $100,000 for that year.

GAS SAFETY AND RELIABILITY PANEL

Q. Have NYSEG's and RG&E met or exceeded its leak management performance requirements over the past 5 years?

A. Yes. NYSEG and RG&E are leading the state in the backlog of leaks requiring repair for Types 1, 2 and 2A leaks. Moreover, unlike other LDCs in the state that only repair Types 1, 2 and 2A leaks, NYSEG is required, and it is RG&E's practice, to go beyond the minimum requirements under the Commission's regulations, and to repair all leaks, including Type 3 leaks.

Q. Summarize Staff's proposal with respect to Leak Management.

A. Staff recommends that, at a minimum, NYSEG achieve a year-end backlog of total leaks no greater than 125, and for RG&E, the year-end backlog of total leaks must not exceed 175. Taking into account that RG&E 's current requirement includes only Types 1, 2 and 2A leaks, extending its requirement to no more than 175 total leaks at year end (i.e., including Type 3 non-priority leaks) is a significant increase. With respect to NYSEG, the backlog maximum under the 2005 Joint Proposal is set to decrease gradually each year (i.e., no more than 175 in 2006, no more than 165 in 2007 and no more than 150 for 2008), but Staff's proposed maximum of 125 leaks starting in 2008 would implement a reduction of 40 leaks for NYSEG in a single step. This is an unreasonable target that appears to be designed to set NYSEG up for failure in its leak management program. It is also an inappropriate attempt to reopen NYSEG's 2005 Joint Proposal agreed to by Staff and approved by the Commission only two years ago.

GAS SAFETY AND RELIABILITY PANEL

Q. Is Staff's proposal to increase the requirements relating to leak backlogs reasonable?

A. No, it is unnecessary, unreasonable and punitive to reduce dramatically the level of leak backlogs for NYSEG and RG&E. The Companies have demonstrated that they have implemented a rigorous program for repairing leaks. In 2006, when NYSEG's required target was a backlog not to exceed 175 leaks requiring repair, NYSEG's year-end backlog total was only 142. Based on preliminary data, under its 2007 target of no more than 165 leaks requiring repair, NYSEG's year-end result was ~~54~~ 57. In the 2006 Gas Safety Report, Staff noted that "NYSEG remains among the better performers in this area. The company's level of repair activity remained relatively constant in 2006 compared to 2005 as it discovered approximately 10 percent fewer potentially hazardous leaks and repaired about 11 percent fewer." RG&E's performed equally well in 2006 and 2007. In 2006, RG&E's level of leaks pending repair was 2.7 percent, i.e., significantly below its required 4 percent threshold, and its 2007 level is at 1.5 percent, based upon the preliminary year-end figures. Figure 9 on page 24 of the 2006 Safety Report illustrates that the Companies are out-performing most of their peers. In light of the Companies' aggressive efforts to manage their leaks and to complete repairs early, it is unreasonable to impose a backlog of no more than 125 total leaks on NYSEG and 175 total leaks on RG&E.

GAS SAFETY AND RELIABILITY PANEL

C. **Damage Prevention**

Q. Describe the damage prevention requirements that NYSEG and RG&E is subject to under their current rate plans.

A. For RG&E, failure to maintain a level at or below 4.0 for excavation damages per 1000 gas One-Call Tickets will result in a pre-tax revenue adjustment of $100,000 for that year. NYSEG is required to maintain an overall excavation damages per 1000 One Call Tickets of 5.0, and failure to maintain the required level for any calendar year will result in a pre-tax revenue adjustment of $50,000. NYSEG is also subject to $50,000 for failure to maintain 1.0 for mismark damages.

Q. How have RG&E and NYSEG performed under the current damage prevention measures?

A. The 2006 Safety Report demonstrates that NYSEG and RG&E are among the best performers in the state under the Damage Prevention measure, which include damages per 1000 tickets, damages due to Mismarks, damages due to Company and Company Contractors, Damages to Excavation Error, and Damages due to No-Calls. NYSEG's and RG&E's performance in each of these sub-categories of damage prevention was above the statewide average. In the area of total damages, for example, although every LDC improved in this measure, NYSEG improved by approximately 42 percent, significantly exceeding the improvement achieved by the other top performers in this category. 2006 Safety Report, p. 8. Similarly, in the area of mismarks, NYSEG improved its performance by greater

GAS SAFETY AND RELIABILITY PANEL

than 50 percent over prior years, and was acknowledged by Staff as being "among the best in the state," with Orange and Rockland. Id. at 11. The report also cites RG&E's 46 percent improvement in its performance in Company and Contractors Damages, and NYSEG's improvement of 43 percent for damages due to Excavator Error. Id at 12 and 14.

Q. Please comment on Staff's allegation at pages 27-29 of its testimony that in 2007 NYSEG's and RG&E's performance appears to have slipped compared to 2006.

A. The data do not reflect the fact that major construction projects that would have occurred in 2006 were deferred to 2007 because of the widespread flooding that occurred in June, 2006. With additional construction in 2007, therefore, the opportunity for damage was increased, which affected the Companies' 2007 results under their performance metrics when compared to 2006 when there was less construction. Even with the backlog of construction projects from 2006, however, the performance of both companies in 2007 exceeded their current targets, and exceeded the levels in 2003, 2004 and 2005.

Q. Please comment on whether the implementation of the new federally-mandated 811 nationwide telephone number may have had an impact on NYSEG's and RG&E's performance in 2007

A. It is also possible that the implementation in April, 2007 of the new nationwide 811 telephone number (mandated by the Federal Communications Commission) has impacted the Companies' performance under the damage prevention metrics

GAS SAFETY AND RELIABILITY PANEL

because of the increase in the number of calls from excavators. Although the new, three-digit telephone number is expected to relieve excavators from having to remember multiple telephone numbers if they work in areas covered by different one-call centers, as the rate of excavator calls to request a mark out of underground facilities increases, LDCs may be required to dedicate more resources in order to continue to meet their required targets. It is too early, however, to quantify the impact, if any, the implementation of the 811 call-in number may have had on NYSEG's and RG&E's performance.

Q. Summarize Staff's recommendations relating to the damage prevention measures.

A. Staff recommends that NYSEG should be required to maintain a level of overall excavation damages of 2.0 or below per 1000 One-Call Tickets, and RG&E should be required to maintain a level of 2.5 or below excavation damages per 1000 One-Call Tickets. Failure to achieve this target will result in revenue adjustments of $172,000 and $120,000 for NYSEG and RG&E, respectively. For damages due to mismarks, Staff recommends that both NYSEG and RG&E be required to maintain a level equal to or below .50 excavation damages due to mismarks per 1000 One Call Tickets. The mismarks revenue adjustment is $430,000 for NYSEG and $300,000 for RG&E. And for damages caused by Company Crews and Contractors, both companies should be required to maintain a level equal to or below .20 excavation damages per 1000 One Call Tickets.

GAS SAFETY AND RELIABILITY PANEL

Failure to achieve this target will result in a revenue adjustment of $172,000 and $120,00 for NYSEG and RG&E, respectively.

Q. Please comment on Staff's revised damage prevention measures.

A. The proposed changes to the damage prevention metrics cause the most concern to the Companies. At page 26 of its testimony, Staff states, "If a company is performing worse than the statewide performance level, we typically recommend they improve to at least that level. *If a company is performing better than the statewide performance level, we recommend a performance target that generally discourages the company from backsliding while also providing a reasonable cushion*" (emphasis added). Contrary to the Staff's statement, the proposed increases do not provide a "reasonable cushion." Gas Safety Panel Test. p. 26. There is no evidence that any other LDC could achieve the levels Staff is proposing for NYSEG and RG&E, i.e., 2.0 and 2.5 for excavation damages per One-Call Tickets for NYSEG and RG&E, respectively,and 0 .50 for mismarks for each company.

Q. How does NYSEG's and RG&E's performance in the area of damage prevention compare to the other LDCs in the state?

A. In the 2006 Safety Report referenced in Staff's response to DPS-120 (Exhibit ___(GSRP-1)), Central Hudson, KeySpan, NGRID, National Fuel Gas, Corning and Orange & Rockland were each required to submit action plans to the Commission with proposals for improving their performance related to either

GAS SAFETY AND RELIABILITY PANEL

Mismarks, Excavator, Company, or Company/Contractor Damages. Because the evidence demonstrates that RG&E's and NYSEG's performance in this area presents no current cause for concern, there is no basis for imposing more stringent damage prevention requirements on NYSEG and RG&E. In neither its testimony nor its responses to discovery, Staff cited no examples of other LDCs either in New York, or elsewhere in the country that are subject to and meets such stringent damage prevention levels. Staff's proposal seeks to penalize NYSEG and RG&E for its superior performance by raising the bar to an unreasonable height and needlessly increases the likelihood of the companies failing.

D. **Emergency Response**

Q. Does Staff propose any changes to the existing Emergency Response measures.

A. No. Staff acknowledges that both companies are currently exceeding the targets. Therefore, its recommendation is to maintain the current level to "encourage" NYSEG and RG&E "to avoid significant deterioration in performance."

Q. Does Staff propose changes to the existing revenue adjustments associated with the Emergency Response metrics for NYSEG and RG&E?

A. Yes. Staff proposes substantial increases in the revenue adjustments for NYSEG and RG&E over current levels. Failure to respond to 75 percent of all gas leak and odor calls within 30 minutes will result in a revenue adjustment of $344,000 for NYSEG and $240,000 for RG&E. Failure to 90% of calls within 45 minutes, will result in revenue adjustments of $172,000 and $120,000 for NYSEG and

GAS SAFETY AND RELIABILITY PANEL

RG&E, respectively, and failure to respond to 95% of calls within 60 minutes will result in revenue adjustments of $86,000 for NYSEG and $60,000 for RG&E. Currently, RG&E's failure to respond to on-site gas emergency calls will result in a maximum annual pre-tax revenue adjustment of $50,000 for that year, regardless whether RG&E fails to meet one of the three measures or all three. NYSEG is subject to a $50,000 revenue adjustment for each measure, and therefore faces a maximum potential annual revenue adjustment of $150,000.

E. **Revenue Adjustments**

Q. What does Staff's Gas Safety Panel recommend with regard to revenue adjustments?

A. The chart below provides a comparison of the current targets and revenue adjustments that NYSEG and RG&E are subject to and Staff's recommended changes to the targets and revenue adjustments:

GAS SAFETY AND RELIABILITY PANEL

	NYSEG		RGE	
Measure/Revenue Adjustment	**Present**	**Proposed**	**Present**	**Proposed**
Replacement of Leak-Prone Main	15 miles	20 miles	15 miles	20 miles
Revenue Adjustment	$100,000	$344,000	$75,000	$240,000
Replacement of Leak-Prone Services	1900 Min/2000 AVG	2500	1000	2000
Revenue Adjustment	$150,000	$344,000	$50,000	$240,000
Leak Management	150 Total	125 Total	4%	175 Total
Revenue Adjustment	$100,000	$516,000	$100,000	$360,000
Overall Damages	5.0	2.0	4.0	2.5
Revenue Adjustment	$50,000	$172,000	$100,000	$120,000
Damage due to Mismarks	1.0	0.5	NA	0.5
Revenue Adjustment	$50,000	$430,000	0	$300,000
Damages Caused by Co and Co Contractors	NA	0.2	NA	0.2
Revenue Adjustment	0	$172,000	0	$120,000
Emergency Response				
Within 30 minutes	75%	75%	75%	75%
Revenue Adjustment	$50,000	$344,000	$50,000	$240,000
Within 45 minutes	90%	90%	90%	90%
Revenue Adjustment	$50,000	$172,000	$50,000	$120,000
Within 60 minutes	95%	95%	95%	95%
Revenue Adjustment	$50,000	$86,000	$50,000	$60,000
Emergency Response Maximum Annual Penalty	$150,000	$602,000	$50,000	$420,000
Total Potential Revenue Adjustments	$600,000	$2,408,000	$375,000	$1,680,000

Note that the proposal for NYSEG does not address BS pipe isolation and QA Program

Note: RGE Leak Measure is pending Type 1, 2A, 2 leaks as % of total leaks repaired (type 1, 2A, 2 and 3)

As the chart demonstrates, the amount at risk under the infrastructure enhancements measure (mains and services) would more than triple for NYSEG and would more than double for RG&E under Staff's proposal. Under the leak

GAS SAFETY AND RELIABILITY PANEL

management measure, the proposed total amount at risk for NYSEG is five times more than the current total amount at risk ($100,000 compared to $516,000), and more than three times the amount of RG&E's current risk ($100,000 compared to $360,000). For mismarks, NYSEG's revenue adjustment would increase from $50,000 to $430,000 under Staff's proposal and a new mismark revenue adjustment would be implemented for RG&E in the amount of $300,000. Because there is no change in the customer base of either company due to the acquisition and no changes in operations, there is no need to increase the revenue adjustments to these extraordinary levels.

Q. Does Staff provide any justification for the increased revenue adjustments?

A. No, other than vague and arbitrary statements that increasing the costs to the Companies "would not adversely affect Iberdrola." See Gas Safety Panel Testimony, p. 17. The Gas Safety Panel also assumes that the proposed transaction carries the same risks as the National Grid/KeySpan merger. As addressed in Mr. Meehan's testimony, the comparison between the transactions is inappropriate. In particular, there is no justification for imposing on NYSEG and RG&E the doubling, tripling, quadrupling mechanism adopted in the KeySpan/National Grid merger for failure to meet gas safety and reliability targets. As previously demonstrated, there is no comparison between the performances of NYSEG and RG&E and that of GRID or KeySpan in the area of safety and reliability. In the 2006 Safety Report, Staff acknowledged that

GAS SAFETY AND RELIABILITY PANEL

NYSEG and RG&E out-perform KeySpan and NGRID in virtually every safety–related measure. For example, in the area of mismarks, Staff states, "NGRID remains an outlier . . . with the lowest measure of performance among the LDCs." In excavation errors, the Staff also notes, "KeySpan continues to experience more than double this type of damage than most of the other LDCs." Finally, in the area of backlogs, the Staff noted that KeySpan "continues to have high repairable leak backlogs." A review of the various tables throughout the report, for every category measured, demonstrates that NYSEG's and RG&E's performance does not present any cause for concern, and certainly does not warrant the same level of revenue adjustments adopted in the GRID/KeySpan merger -- LDCs that Staff admits require significant improvements in their safety-related performance.

Q. Does NYSEG or RG&E earn rewards or incentives for superior performance under the current safety-related measures?

A. No. Not only are there no incentives/rewards under current Commission policy for utilities that exceed their performance targets, but Staff's proposal would also effectively penalize NYSEG and RG&E for consistently exceeding their targets and out-performing their peer LDCs. Staff's proposal punishes NYSEG and RG&E by holding them to higher standards than the other companies, while requiring them to absorb the incremental capital and O&M expense costs to implement the standards. Even if the Companies needed an incentive, which they do not, the existing gas safety and performance measures and revenue adjustment levels already provide it.

F. **Reporting**

Q. Please comment on Staff's recommendation that the Commission direct NYSEG and RG&E to submit a report to the Director of the Office of Electric, Gas and Water on their gas safety and reliability performance under the proposed targets within 30 days following the end of each calendar year.

A. Staff's proposal should be rejected. A formal report would be duplicative of the Gas Safety Performance Measures Report prepared and published annually by Staff, which is based upon data provided to Staff by the LDCs. Therefore, layering additional reporting requirements on NYSEG and RG&E would be unnecessary, costly, ineffective and counter-productive. Moreover, 30-days from the end of the calendar year is an unreasonable and unworkable timeframe within which to prepare and produce such a report.

III. CONCLUSION

A. Does this complete your rebuttal testimony at this time?

A. Yes, it does.

BY MR. MUELLER:

Q. Panel, did you also include with your -- attached to your testimony two exhibits, Exhibit GSRP-1, containing seven pages of responses to interrogatories, and GSRP-2, containing a 40-page 2006 Gas Safety Performance Measures Report?

A. (Eastman) Yes.

(Matthews) Yes.

Q. And do you have any changes to those documents at this time?

A. (Eastman) No.

(Matthews) No.

MR. MUELLER: Your Honor, I would like to ask that those two exhibits be marked as the next sequential exhibits for identification.

JUDGE EPSTEIN: That would be 17 and 18.

(Exhibits 17 and 18 marked for identification.)

MR. MUELLER: The panel is available for cross-examination.

MR. VAN RYN: Your Honor, at this point, Staff would like to introduce its omnibus IR exhibit, which consists of various request responses from the Company.

JUDGE LYNCH: I am sorry, Mr. Van Ryn, were you about to identify it?

MR. VAN RYN: Yes, Your Honor. What I've handed out was a list of the IRs Staff wants to use in this proceeding. It consists of IRs that are public, IRs that are confidential, and IRs that are highly sensitive trade secret confidential.

What I have handed out just now is the packet of public IR responses that we will be relying on.

I would like to have that marked for identification. And I'd like to reserve two numbers, one for the confidential IRs we'll be relying on, and one for the highly sensitive trade secret IRs.

JUDGE EPSTEIN: So the public document is Exhibit 19; the confidential version is Exhibit 20, and the highly sensitive trade secret version is Exhibit 21.

(Exhibits 19 through 21 marked for identification.)

CROSS EXAMINATION

BY MR. VAN RYN:

Q. Good morning, panel?

A. (Panel) Good morning.

Q. Could you please turn to page 8 of your testimony.

At the bottom of the page, you state that "NYSEG and RG&E were the only gas LDCs in the state that were not required to perform self-assessments based on performance"; is that correct?

A. (Eastman) Yes.

(Matthews) Yes.

Q. Could you please turn to Exhibit GSRP-2. If you look at your page 34 of that exhibit, it's page 27 of a document; is that correct?

A. (Matthews) Yes.

Q. And that document is a 2006 gas safety performance measures report?

A. (Matthews) Yes.

Q. And page 27 lists the LDCs that are required to perform self assessments; is that correct?

A. (Eastman) Yes.

Q. Do you see Con Edison's LDCs operations listed there?

A. (Eastman) Yes.

Q. Could you show me where?

A. (Eastman) I am sorry. The answer is no.

Q. And do you see St. Lawrence's LDC operations listed there?

A. (Eastman) No.

(Matthews) No.

Q. So those two LDCs are not required to perform

self-assessments; is that correct?
A. (Eastman) Yes.
Q. Could you turn to your Exhibit GSRP-1.
That exhibit is the work papers of Staff witness Stolicky; is that correct?
A. (Matthews) Is that page 2 of 7 that you're looking at?
Q. Yes.
A. (Matthews) Yes.
Q. And the process here was that Staff Witness Stolicky took your responses to IRs IBER-194 and -195 and then made handwritten edits to those two responses and submitted those as his work papers; is that correct?
A. (Eastman) It appears, yes. I am not certain what it is, these handwritten notes he has on his --
Q. Could you please turn to page 11, line 11, of your testimony. And there you list the miles of gas main replacements that RG&E performed on an annual basis; is that correct?
A. (Eastman) Yes.
Q. Could you please turn to page 7 of GSRP-1.
A. (Matthews) Is that page 7 of 7?
Q. Yes.
A. (Matthews) Okay.

Q. For each annual figure shown there for RG&E, the miles of pipe replacement are significantly higher than the annual figures you show in your testimony; is that correct?

A. (Matthews) Yes.

Q. May I ask which number is the accurate number, the one in your testimony or the one in your exhibit?

A. (Matthews) For RG&E, the rate case measure is 15 miles, and that's called priority pipe as determined through a computer program that ranks the sections of main to be replaced. And so what we are actually reporting is related to that 15-mile measure.

On this page, one thing that is not included in that measure for RG&E is any replacements that are associated with highway projects. So, this page 7 includes highway-related replacement projects in addition to the required replacement projects from the prioritization program.

In this case, then, both are accurate but they are related to different measures.

Q. Could you please turn to page 3 of Exhibit GSRP-1. And that page lists the gas service replacements; is that correct?

A. (Matthews) Yes.

Q. If you look at line 13 of page 11 of your testimony you have annual figures there for RG&E gas service replacements; is that correct?

A. (Matthews) Could you tell me that page again?

Q. Page 11, line 13.

A. (Matthews) Thank you. Yes.

Q. Again, the annual numbers in the testimony are significantly less than the annual numbers shown in the exhibit; is that correct?

A. (Matthews) Yes. The numbers that are included in our testimony relate to the official submittal that RG&E made related to the service replacement program. So that is the document that was filed as part of the reply to those service replacements.

Q. Could you describe that document more fully. The official document is...

A. (Matthews) It's a document that has been generated by our -- through -- in conjunction with the rates department and is filed with the Commission, and it's submitted within 60 days of the end of year.

Q. Please turn to page 13, line 20, of your testimony.

There you state that "Staff's calculation of $1.6 million relates to mains only. It does not include

service replacements"; is that correct?
A. (Eastman) Yes.
Q. Please turn to Exhibit GSRP-1, page 1 -- excuse me, page 2.

If you look at the lower right-hand corner, do you see the Staff calculated figure of approximately 1.6 million?
A. (Eastman) Yes.
Q. And do you see above there where it describes services?
A. (Eastman) Yes.
Q. Did you review this calculation to see if the services were or were not included?
A. (Eastman) Yes, we did.
Q. Why did you conclude that the services were not included?
A. (No response.)
Q. We can have the answer provided at a later time if you prefer.

MR. VAN RYN: Make that a transcript request for the Company.

BY MR. VAN RYN:
Q. Could you turn to page 14, line 4, of your testimony.

And there you state that Staff's estimate of the cost to replace miles of pipe is not accurate because Staff did not take into account the cost required for highway projects; is that correct?

A. (Matthews) Yes.

Q. Did you include the cost for highway projects when you responded to IRs 195 and 194?

MR. MUELLER: Do you have a copy for the witnesses?

MR. VAN RYN: The witnesses can see it from the work paper, Exhibit GSRP-2. It's what they gave Staff and the handwritten is what Staff edited.

Q. Basically what I am asking: Is the hard copy data in GSRP-2, does that include the highway project costs?

A. (Matthews) GSRP-2 is gas safety performance measures.

MR. MUELLER: 2 is the 2006 report.

MR. VAN RYN: Excuse me. I have been confused.

Q. Could you turn to GSRP-1. And do those figures there include the highway project costs at page 1?

A. (Matthews) The 1.653, is that the number that you are referring to?

Q. No. I am asking about the costs at the top of the page there where you have various figures for replacement.

MR. MUELLER: Can I just get a clarification? I'm looking at GSRP-1, page 1 of 1.

MR. VAN RYN: Page 2 is where the data is.

Q. Again, at page 5, you list various construction costs for pipe replacement.

MR. MUELLER: Objection. Compound question. Can we take these one at a time, please?

MR. VAN RYN: I don't think it's a compound question. I'm asking if either of the locations in the two points is including a single item --

MR. MUELLER: Objection, Your Honor --

MR. VAN RYN: I am not finished.

Seems to me that if he can find anywhere else in there where they are or not in that exhibit, he can refer to that in his answer.

Q. So I guess I am saying: Anywhere in that exhibit, did you or did you not include the highway project costs?

MR. MUELLER: I'm just asking, Your Honor, that counsel extend courtesy to these witnesses by allowing them to answer the first part of the question before moving on to the second part of the compound question.

JUDGE EPSTEIN: I think Mr. Van Ryn has adequately simplified it. He wants to know if the highway costs are included anywhere in the exhibit page.

A. (Matthews) Which pages are you referring to as far as the calculations? That's where I am having trouble looking at.

If you go to page 6 of 7, that number is, for example, distribution mains, replacement-reliability. That number does not include highway costs, if that's the page you are referring to.

MR. VAN RYN: Thank you.

BY MR. VAN RYN:

Q. Now, let's refer back to page 1 -- or excuse me, page 2.

At the top of the page, do the printed figures there include highway costs?

A. (Matthews) At the top of the page, that's gas services.

Q. Okay, thank you. So turning back to page 5 again, you are saying that does not include the highway replacement costs?

A. (Matthews) It does not.

Q. So we've established that on page 7 you did include the highway miles; is that correct?

A. (Matthews) That is correct.
Q. Can you explain why you include the highway miles but not the highway costs?
MR. MUELLER: This isn't the witness' document. It was prepared by Staff.
A. (Eastman) That wasn't our exact question.
BY MR. VAN RYN:
Q. Getting back to the original question we asked here, the hard copy data, the printed data came from company responses to information requests 194 and 195; is that correct?
A. (Matthews) I guess I can't answer.
MR. MUELLER: Objection. No foundation for that statement.
MR. VAN RYN: I note, Your Honor, that previously the witnesses answered the question yes.
BY MR. VAN RYN:
Q. I will show the witness the responses to IR-194. Is the data in response to 194 the same as the data that's listed at GSRP, page 6?
A. (Matthews) Yes.
Q. Is the printed data on the next page of the IR response the same as the printed data on GSRP-1, page 7?
A. (Matthews) The one difference is that the second

page you are referring to is only RG&E. The previous page includes RG&E and NYSEG. And the reference was made in particular to the NYSEG numbers on page 6 of 7. So this is RG&E only. Both companies.

The NYSEG numbers do not include costs for highway replacement.

MR. VAN RYN: One moment, Your Honor.

BY MR. VAN RYN:

Q. Turning to GSRP page 5 again.

You pointed out that there are RG&E gas main replacement costs there; is that correct?

A. (Eastman) GSRP-1 page 5?

Q. Yes, page 5.

A. (Matthews) Page 1?

Q. Page 5 of GSRP-1.

A. (Matthews) That's NYSEG only.

JUDGE EPSTEIN: Mr. Van Ryn, you have to indicate whether you are referring to the page number from the work paper Stolicky or page number of panel's exhibit.

BY MR. VAN RYN:

Q. If you could look at page 6 of the exhibit.

A. (Matthews) Of the exhibit?

Q. There you list the RG&E gas main replacement

number; is that correct?
A. (Matthews) RG&E is there.
Q. And NYSEG is below it; is that correct?
A. (Matthews) Correct.
Q. Did you include road project costs in the RG&E numbers?
A. (Matthews) Again, no, it's not included in that number.
Q. You did include road project miles on the next page of the exhibit; is that correct?
A. (Matthews) Yes.
MR. VAN RYN: Your Honor, I have here a document, a March 1st, 2006 letter from NYSEG regarding its annual compliance filing for a prior rate plan for gas safety and other measures. I ask that this be marked for identification.
JUDGE EPSTEIN: 22.
(Exhibit 22 marked for identification.)
BY MR. VAN RYN:
Q. If you look at the third page of this document it sets forth gas operation and safety measures; is that correct?
A. (Eastman) We don't have a document.
Q. Sorry. That wasn't helpful.

Could you please turn to page 3. If you can hang on for a second, I think I further confused matters.

MR. MUELLER: Can we give the witnesses a minute to look at the document, please.

MR. VAN RYN: Sure.

BY MR. VAN RYN:

Q. Do the witnesses have the document in front of them?

A. (Matthews) Yes.

Q. At the third page, it refers to gas operation and safety measures for NYSEG; is that correct?

A. (Eastman) Yes.

Q. And this is the annual compliance filing submitted in 2006 for the 2005 annual period; is that correct?

A. (Matthews) 2007.

Q. I think I have caused more confusion here. I apologize. Let me see what I gave you.

Could you take a look at that document, please?

JUDGE EPSTEIN: Explain that for the record, Mr. Van Ryn.

MR. VAN RYN: What I handed them was the correct copy of the exhibit we have been referring to, which is the March 1st, 2006 letter that's been marked

for identification.
A. (Matthews) Yes.
Q. If you look at the third page of that document it shows annual data for the year 2005; is that correct?
A. (Eastman) Yes.
Q. And if you look at the bare steel services replacement for that year it shows 2,169; is that correct?
A. (Eastman) Yes.
Q. Could you refer to your testimony, page 11, line 11. It states there for 2005 that the number is 2,167; is that correct?
MR. MUELLER: Objection. Can we give a different reference? I don't see that number on that line.
BY MR. VAN RYN:
Q. Line 7.
A. (Matthews) Yeah, I see that.
Q. If you could turn to page 4 of GSRP-1. What is the figure there for 2005?
A. (Matthews) Page 4 of 7.
Q. Yes.
A. (Eastman) 2,196.
Q. Do you have any comment on the discrepancies in

the three numbers?

A. (Eastman) I think the discrepancy may be in the reporting time. One of the numbers is two more and one of the numbers is two less, but in total, they are the same.

Q. I believe one is 2196 and one is 2169.

MR. VAN RYN: Can you get back to us at a later time? We will make this a transcript request.

MR. FITZGERALD: For clarity, the transcript request --

MR. VAN RYN: The three numbers for 2005 are different for the three sources. We'd just like to know which one is correct.

Your Honor, I have another document I would like to have marked for identification. This is a March 11, 2008 letter from NYSEG updating the gas operation and safety measures.

JUDGE EPSTEIN: 23.

(Exhibit 23 marked for identification.)

The witnesses have been handed the document.

MR. VAN RYN: Then I have one other document I would like marked for identification. It's a quarterly report submitted by NYSEG and RG&E for the calendar year 2007.

BY MR. VAN RYN:

Q. You are familiar with the quarterly reports?

A. (Eastman) Yes.

JUDGE EPSTEIN: I don't think I mentioned the 2007 document is No. 24.

(Exhibit 24 marked for identification.)

MR. VAN RYN: I have no further questions, Your Honor.

MR. MUELLER: I object to moving these documents into evidence. If there is no cross-examination, we don't know what the relevance is to this proceeding.

MR. VAN RYN: Your Honor, they are utility documents. They are normally submitted -- it's like any other document in which cross is not asked. It's information the utility has provided. In particular, we have a March 11th letter.

MR. MUELLER: Particularly, what's been marked as Exhibit 24. Granted it indicates NYSEG at the top of the page. I don't know if this is a complete copy of a document. There is no context for this document and no foundation for bringing it into the record.

JUDGE EPSTEIN: This is the type of argument I was planning on reserving for the end of the hearings.

And possibly, between now and then, Staff can satisfy NYSEG of the providence of the document to the point where Energy East would not object. But be that as it may, we understand, Mr. Mueller, that you reserve your objection.

Okay. So, is there --

MR. MAGER: Your Honor, I have a very, very short cross of this panel.

JUDGE EPSTEIN: Fine.

BY MR. MAGER:

Q. Good morning, panel.

Is it true that both NYSEG and RG&E are subject to certain gas safety and reliability performance standards right now?

A. (Matthews) Yes.

Q. Along with the performance standards are also potential revenue adjustments, correct?

A. (Eastman) Correct.

Q. When were those standards and revenue adjustments established for each of the two utilities?

A. (Eastman) In 2004 for RG&E, and 2003 for NYSEG, with an adjustment made in 2005 when all of the cast iron was completely replaced and additional programs were put in place to allow the replacement of other

pipes to the end of the rate -- the 2008 case.
Q. And if the merger is approved and goes forward, will NYSEG and RG&E's performance under the existing standards improve or decline?
A. (Eastman) It should have no -- there is performance metrics that are currently in place right now which we perform to have penalties assigned to them. We follow those guidelines and are currently achieving pretty much the top performance in the state for both companies and all operational performance measures.
Q. Would you agree with me the merger is not likely to result in any improvements in gas safety or reliability?
A. (Eastman) I wouldn't use the word "improvements." I would say, if you are -- we are top performers. Both utilities are top performers. And continued top performance should be of value to customers no matter who owns the --
Q. Are you saying your performance can't be improved?
A. (Eastman) No, I'm not saying that.
Q. Is it fair to say that this merger, if it's approved, will have no impact on -- will not result in any improvement to the performance in terms of gas

safety and reliability?

A. (Eastman) I didn't say that either. We always continue to strive to improve. That's why we are the leaders in the state in many of the programs. We excel and exceed in almost every performance area because we have a strategy to be the top performer, and incentives or penalties are currently in place which allow us to do that.

Q. And how do the incentives do that?

A. (Eastman) They are penalties such that you make sure you don't miss your performance targets.

Q. And if the incentives were increased wouldn't -- I am sorry.

If the revenue adjustments were increased, wouldn't that provide additional incentive not to miss the targets?

A. (Eastman) Yes.

Q. Now, with respect to the performance itself, I understood you testified that you already consider NYSEG and RG&E to be top performers, but that wasn't the specific question I asked.

What I asked was: Is it true that this merger, if it's approved, would not improve the company's performance in terms of gas safety or reliability?

A. (Eastman) I don't think that's true. We continue to try to improve our performance year after year after year.

Q. How will the merger help it improve?

A. (Eastman) It will allow us to continue with the programs that we currently have penalties in place already throughout the rest of the time or period of those cases.

Q. Isn't that true if Iberdrola was not here and there was no merger?

A. (Eastman) Yes.

Q. So how does the merger help you improve your performance for gas safety and reliability?

A. (Eastman) We were not proposing to change the performance targets with the merger. We were proposing to continue with the current targets that were in place which already allow us to offer high performance for the customers and safety performance in the state.

Q. I understand you are not proposing any changes. What I am asking is: Do you agree with me that the merger will not provide any improvements or benefits to customers in terms of gas safety and reliability?

A. (Eastman) I do not agree. Continued high performance is a benefit to the customers. Being able to continue at the superior level we currently perform is a benefit.

Q. Let me rephrase my question. How will merging with Iberdrola -- withdrawn.

What will change in terms of the Company's performance or commitment with respect to gas safety and reliability if Iberdrola purchases Energy East?

A. (Eastman) The proposed metrics are proposed to remain the same.

Q. And so the Company would do nothing differently than what it's doing now?

A. (Eastman) No. We always -- even though those metrics are in place, we are always continuing to try to improve the performance.

Q. I'm asking with respect to the merger. If the merger goes through, does that have any impact on what you are doing?

A. (Eastman) I am not certain that I am the correct one to answer that question.

Q. Is it your understanding that anything will change with respect to gas safety and reliability if the merger is approved?

MR. MUELLER: Objection. Asked and answered.

MR. MAGER: No, I didn't ask that question.

JUDGE EPSTEIN: I think you pretty much covered that, Mr. Mager.

MR. MAGER: Let me rephrase.

BY MR. MAGER:

Q. Sitting here today, you are not aware of anything that would change in terms of gas safety or reliability if the merger were to be approved, are you?

MR. MUELLER: Objection. Asked and answered. Argumentative. This witness has already said he's not the appropriate witness to respond to that question.

MR. MAGER: These are the Company's witnesses on gas safety and reliability. I am entitled to explore whether they are aware of anything that would change in their areas of expertise.

JUDGE EPSTEIN: Panel, look at it this way: If the merger were not approved, would the incentive structure remain the same and would the Company continue its practice of always -- as you put it -- seeking improvements going forward?

A. (Eastman) Yes.

BY MR. MAGER:

Q. Would any of that change if the merger were approved?

A. (Matthews) I am not sure we are the right -- that

we can answer that question.
Q. Is that your answer?
A. (Eastman) The performance metrics that are in place currently, it is our plan to continue operating to those current metrics. Our proposal was to continue to operate at those current performance measure criteria.
Q. Do you believe having performance metrics with revenue adjustments provides a benefit to customers?
A. (Eastman) Yes.
Q. Okay. And if, as a result of the merger, the Commission were to make those performance standards more stringent and/or increase the revenue adjustments, wouldn't that be seen as a benefit of the merger?
A. (Eastman) We personally don't see what benefit there is to increasing those performance measures to levels that, in many cases, no one has ever achieved in the state, and we don't understand how -- the reward for top performance seems to be punishment in what's being proposed.
Q. I understand you disagree about whether the performance standard should be increased or the revenue adjustments increased, but if those standards and revenue adjustments are a benefit to customers and were increased or made more stringent, wouldn't that be a

potential benefit of the merger?

MR. MUELLER: Objection. Asked and answered.

MR. MAGER: It was asked.

JUDGE EPSTEIN: Mr. Mager, they said that making the criteria more stringent would not be a benefit because they are -- the Company is functioning at an optimal level already. So that's what they're saying. You can't ask them to agree with your last proposition.

A. (Eastman) There are multiple performance measures being proposed. There are pipe replacement miles being proposed. There are numbers of services to increase. There is mismarked damages. There is leaks. There are many areas.

Some of the performance metrics, such as increasing the miles of main to be replaced, could be a benefit. Other areas, like reducing leaks from 150 to 125, that may be a benefit. But in order to accomplish that, may be questionable for the ability of the Company to achieve such stringent goals, which no one else currently has in place.

So, your question as to -- to group all four of those categories, the answer may be yes to one or so of those categories, but it may be no to others of those categories. That's why I'm having difficulty answering your question in one encompassing answer.

Q. Okay, I think I understand your difficulty now.

If I am understanding you correctly, you would agree that at least some of the more stringent performance standards recommended by Staff, if adopted, could be interpreted as a benefit of the merger?

A. (Eastman) Yes.

MR. MAGER: Thank you. I have no further questions.

JUDGE EPSTEIN: Further cross? Redirect?

MR. MUELLER: Could I have a minute with the witnesses, please?

JUDGE EPSTEIN: We will be in recess for 20 minutes.

MR. MUELLER: Thank you.

(Recess.)

JUDGE EPSTEIN: Mr. Mueller, do you have any redirect for the witnesses?

MR. MUELLER: Yes, I do, Your Honor.

REDIRECT EXAMINATION

BY MR. MUELLER:

Q. Panel, do you recall a line of questions regarding benefits associated with the merger?

A. (Eastman) Yes.
Q. In addition to your statement that continuing the Company's goals to perform at the highest level would result from the merger, are there other benefits you would expect as a result of the merger in the area of gas safety and reliability?
A. (Eastman) Yes.
Q. Can you expand?
A. (Eastman) We believe that Iberdrola sharing their global experience and expertise and best practices, knowledge will present opportunities for continued improvements in the future.

MR. MUELLER: Thank you. We have nothing further, Your Honor.

JUDGE EPSTEIN: Recross?

RECROSS EXAMINATION

BY MR. MAGER:

Q. Panel, can I ask how you came to recall that benefit?
A. (Eastman) In discussions that we have had before and those discussions will be followed up with the policy panel who will further describe those benefits.
Q. Can you tell me what best practices Iberdrola has with respect to gas safety and reliability that you are

looking to integrate into your practices?

A. (Eastman) I think they are operators of a large distribution facility, and they also are one of the largest gas storage operators in the United States. We operate a storage field on Seneca Lake salt cavern. So, I think the ability to review and share ideas and practices amongst those facilities present an opportunity for us to continue our improvement.

Q. Do you know anything now that you would do differently as a result of the merger?

A. (Eastman) Not currently, I do not, specifically.

Q. And if the merger is likely to result in improvement in areas of gas safety and reliability, then it's possible the Company also would be able to achieve or satisfy even higher performance standards; wouldn't that be correct?

A. (Eastman) Yes, I believe that's correct.

Q. Were higher performance standards adopted and achieved, wouldn't that be a benefit to customers?

A. (Eastman) Yes, certainly.

MR. MAGER: Thank you, I have no further questions.

JUDGE EPSTEIN: Mr. Mueller?

MR. MUELLER: No redirect.

JUDGE EPSTEIN: Thank you, panel. You are excused.

MR. MUELLER: Company would like to call the revenue decoupling mechanism panel.

DAVID SEGAL, NEIL FISHER and JAMES LAHTINEN, after first having been duly sworn, were examined and testified as follows:

DIRECT EXAMINATION

BY MR. MUELLER:

Q. Good morning, gentlemen?

Beginning with Mr. Segal, can you please state your name and business address for the record.

A. (Segal) My name is David Segal from the Northbridge Group. Business address is 30 Monument Square, Concord, Massachusetts, 01742.

(Lahtinen) James Lahtinen, RG&E and NYSEG, 89 East Avenue, Rochester, New York.

Q. Mr. Fisher, would you provide the same information.

A. (Fisher) Neil Fisher, Northbridge Group, 30 Monument Square, Concord, Massachusetts, 01742.

Q. And panel, do you have in front of you a document with a cover page "Rebuttal Testimony of the Revenue Decoupling Mechanism Panel," which contains your names in the lower right-hand corner and which is dated January 31, 2008?

A. (Panel) Yes.

Q. Was this document prepared by you or under your direction?

A. (Panel) Yes.

Q. And do you have any changes or updates to that testimony?

A. (Panel) No.

Q. If you were asked the same questions today that are contained therein, would your responses be the same?

A. (Panel) No.

Q. Do you adopt this testimony as your sworn testimony in this proceeding?

A. (Panel) Yes.

MR. MUELLER: Your Honor, I would like to ask that the prefiled -- or rebuttal testimony of the revenue decoupling mechanism panel consisting of 24 pages of questions and answers be copied into the record as if given orally.

JUDGE EPSTEIN: Yes.

(The following is the prefiled testimony of the revenue decoupling mechanism panel:)

RDM PANEL

I. INTRODUCTION

Q. Please state the names of the Panel members.

A. The Panel members are James A. Lahtinen, David W. Segal and Neil S. Fisher.

Q. Please state your current positions and summarize your educational background and work experience.

A. The current positions and summaries of the educational background and business experience for each member of the Panel are included as Exhibit ___ (RDM_1).

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

A. The Panel will address the recommendations of Staff witness Dickens and the Staff Gas Rates Panel that, as a condition of the merger, NYSEG and RG&E (the "Companies") should be directed to file a Revenue Decoupling Mechanism ("RDM") for implementation on January 1, 2009. The Panel also will respond to the RDM-related issues raised by Natural Resources Defense Council ("NRDC") witness Gupta.

Q. What is the Panel's view as to the appropriateness of Staff's proposal for implementing an RDM for NYSEG and RG&E in this proceeding?

A. As discussed later in our testimony, the Commission has consolidated this case with Case 07-E-0996, regarding consideration of an RDM for NYSEG, and NYSEG and RG&E have both committed to filing RDM proposals in the second quarter of 2008. The commitment of NYSEG and RG&E to file RDM proposals

RDM PANEL

in the second quarter of 2008 is consistent with the prior orders of the Commission and the previous commitments made by the companies, and will provide sufficient time for a timely review by the Staff and Commission. The recommendation by the Staff Gas Rates Panel that approval of the proposed transaction should be conditioned on implementation of gas RDMs for NYSEG and RG&E is inappropriate and unnecessary. We do not believe that approval of an RDM, or specific decoupling methodology, is relevant to the Commission's determination as to whether the proposed acquisition is in the public interest. Because Staff has proposed that the acquisition be conditioned on implementation of RDMs, NYSEG and RG&E are compelled to respond to Staff's proposals. Our response, however, is without prejudice to the petitioners' positions that these issues are unrelated to the proposed acquisition and should be considered in a subsequent proceeding following the filing of RDM proposals by NYSEG and RG&E in the second quarter of 2008.

Q. What are the Panel's conclusions concerning the recommendations sponsored by Staff and NRDC with respect to implementation of an RDM for NYSEG and RG&E?

A. As explained in this testimony, the Panel reached the four following conclusions. First, the Companies agree with Staff witness Dickens that the Companies should file RDM plans. Second, the Companies propose that the same reconciliation mechanism be used for both electric and gas services unless a compelling rationale can be established for separate procedures, unlike Staff who argue for different mechanisms for electric and gas.[1] Accordingly, the Companies recommend that the RDM targets chosen should be consistently applied as to both electric and gas. Third, NYSEG and RG&E endorse an RDM that includes an annual indexing of targets. That design feature will help avoid the need for frequent rate filings to recover general increases in delivery costs (e.g., due to inflation). Fourth, the Companies recommend that their respective fixed price commodity programs should not be subject to an RDM.

II. DELIVERY REVENUE DECOUPLING MECHANISM

Q. Would the Panel briefly summarize the RDM-related recommendations offered by Staff and NRDC?

A. Yes. Staff witness Dickens recommends that the Companies should be directed to file an RDM proposal for review by the parties so that it can be approved by the New York Public Service Commission ("Commission") for implementation effective January 1, 2009.[2] The Staff Gas Rates Panel[3] further adds that NYSEG and RG&E should each be required to implement a gas RDM as a precondition of

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1 Staff witness Dickens argues for a total revenue reconciliation mechanism for electric service while the Gas Rates Panel argues for a revenue-per-customer reconciliation procedure.

2 Staff Testimony, Dickens at 14.

3 Consisting of the testimony of Michael Salony and Michael Wayand.

RDM PANEL

approval of any merger.[4] Staff witness Dickens outlines general guidelines for a future RDM filing for electricity, while the Staff Gas Rates Panel provides guidelines for a gas RDM. The NRDC also provides general principles for an RDM.[5]

Q. Do NYSEG and RG&E plan to file an RDM proposal that could be in effect for calendar year 2009?

A. Yes. While none of the parties specified a date for an RDM filing,[6] the Companies plan to submit an RDM proposal in the second quarter of 2008. That timeframe comports with the prior orders issued by the Commission and the previous commitments made by the Companies. Specifically, submission of an RDM will be in compliance with the Commission's April 20, 2007 Order Requiring Proposals for Revenue Decoupling Mechanisms ("RDM Order"),[7] and in response to the Commission's August 29, 2007 Order Establishing Commodity

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4 Staff Gas Rates Panel at 9.

5 NRDC, Gupta Testimony at 4-7.

6 NRDC proposes a three month stakeholder process and compliance filing process after the Commission's decision in this case. (Gupta Testimony at 6).

7 Case 03-E-0640, Proceeding on Motion of the Commission to Investigate Potential Electric Delivery Rate Disincentives Against the Promotion of Energy Efficiency, Renewable Technologies and Distributed Generation and Case 06-G-0746, In the Matter of the Investigation of Potential Gas Delivery Rate Disincentives Against the Promotion of Energy Efficiency Renewable Technologies and Distributed Generation,, Order Requiring Proposals for Revenue Decoupling Mechanisms (issued April 20, 2007).

Program for NYSEG ("NYSEG Commodity Program Order").[8] The NYSEG Commodity Program Order approved a Joint Proposal that, among other things addressed RDMs. Section II.F of the Joint Proposal in Case 07-E-0479,[9] dated July 10, 2007, states that NYSEG will address a revenue decoupling mechanism as part of any major electric rate case filed by NYSEG, a Commission-initiated review of NYSEG's electric rates or as otherwise ordered by the Commission. In its order approving that Joint Proposal, issued August 29, 2007, the Commission decided to begin immediately a new proceeding to develop an RDM for NYSEG.[10] By its Order Instituting Proceeding, issued the same day as the Commodity Program Order, the Commission commenced Case 07-E-0996 (later changed to Case 07-M-0996)[11] to examine the development and implementation of an RDM for NYSEG's sales of both electricity and gas.[12]

Subsequently, the Commission determined that the matters intended to be

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[8] Case 07-E-0479, Tariff Filing of New York State Electric & Gas Corporation to Offer Customers a Single Fixed Supply Service, Order Establishing Commodity Program (issued August 29, 2007).

[9] Case 07-E-0479, Tariff Filing of New York State Electric & Gas Corporation to Offer Customers a Single Fixed Supply Service.

[10] Case 07-E-0479, supra, Order Establishing Commodity Program (issued August 29, 2007) ("Commodity Program Order").

[11] By Notice of Case Number Change, issued September 10, 2007, the Commission noted that it was modifying the case designation in Case 07-E-0996 to "M" from "E" because the proceeding pertained to both electric and gas decoupling.

[12] Case 07-E-0996, Proceeding on Motion of the Commission to Consider a Revenue Decoupling Mechanism for New York State Electric & Gas Corporation, Order Instituting Proceeding (issued August 29, 2007).

RDM PANEL

resolved in Case 07-M-0996 could more effectively be considered in Case 07-M-0906.[13] Case 07-M-0906 has been addressing, among other things, the effects upon NYSEG's operations should the Commission approve a proposed corporate acquisition. Accordingly, on October 22, 2007, the Commission issued a Notice Consolidating Proceedings in Cases 07-M-0996 and 07-M-0906, by which it determined that consideration of an RDM for NYSEG's sales of electricity and gas will be heard in Case 07-M-0906 and discontinued and administratively closed Case 07-M-0996.[14]

The Company commits to make a filing in the second quarter of 2008 so that the parties have adequate time to review the proposed mechanism. This timeframe also will afford the Commission sufficient time to consider and approve the implementation of the Companies' proposed RDM.

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

A. In its RDM Order, the Commission stated that the purpose of an RDM is to "significantly reduce or eliminate any disincentives caused by the recovery of utility fixed costs via volumetric rates or marginal consumption blocks."[15]

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13 Case 07-M-0906, Joint Petition of IBERDROLA, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation for Approval of the Acquisition of Energy East Corporation by IBERDROLA, S.A.

14 Cases 07-M-0906 and 07-M-0996, supra, Notice Consolidating Proceedings (issued October 22, 2007).

15 RDM Order at 3.

RDM PANEL

According to the Commission, such disincentives "may discourage utilities from actively promoting energy efficiency, renewable technologies and distributed generation"[16] because utilities' revenues are directly tied to the throughput of electricity and gas sold on their system. Because an RDM will protect a utility from lost revenues due to decreased sales from efficiency, conservation and other similar programs, it is believed that utilities will more likely support (or at least not oppose) efforts to improve energy efficiency and conservation if an RDM is in place.

Q. Do the Companies support economic energy efficiency programs?

A. Yes. The Companies have been, and continue to be, strongly supportive of economic energy efficiency efforts in the State. To that end, the Companies will continue to actively participate in the Commission's ongoing proceeding addressing energy efficiency matters.[17]

Q. Please summarize the structure articulated by Staff with respect to how an RDM program should be designed.

A. Staff's proposed RDM structure differs for electricity and gas. For the electricity businesses, Staff witness Dickens recommends use of a total delivery revenue target:

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16 RDM Order at 2.

17 Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard.

RDM PANEL

> Staff recommends a total delivery revenue reconciliation mechanism be designed and implemented for each customer service class, with the exception of the lighting, buyback, individually negotiated contract, and standby service classifications at this time. Forecasted delivery revenue targets, for each service class or sub-class will need to be established for each month of calendar year 2009.[18]

For the natural gas businesses, the Staff Gas Rates Panel proposes a different RDM methodology based on revenue-per-customer targets as opposed to total revenue targets.

> We recommend the development of a RDM structured on an average pure base delivery revenue per customer (RPC) basis premised on rate case quality sales forecasts. We contemplate the establishment of annual RPC factors for residential and commercial customer classes excluding cooking and large industrial customer groups...[19]

Q. Do the Companies agree with the structure identified by Staff?

A. At this time, the Companies oppose Staff's recommendation to apply inconsistent RDM target methodologies to gas and electric services absent a showing of a compelling rationale. In order to simplify administration, the Companies recommend that the same RDM methodology should be used for gas and electric. Therefore, the Companies plan to file a joint RDM proposal using a consistent methodology for both gas and electric businesses at NYSEG and RG&E.

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[18] Staff Testimony, Dickens at 14-15.

[19] Gas Rates Panel at 9-10.

RDM PANEL

Q. Do the Companies propose to use fixed revenue or a revenue-per-customer RDM targets?

A. Currently, the Companies are compiling information that will be used to assess the merits and drawbacks of each approach. A fixed revenue target is simpler to implement and does not require tracking of customer accounts,[20] but ignores the impact of customer growth and economic development on delivery costs. An RDM plan that adjusts against a simple total revenue target implies that the Companies would absorb the incremental costs associated with any unanticipated increase in new customers or would retain the revenues associated with any unanticipated decline in customers, potentially causing a disincentive to attract new customers to the service territories.

A revenue-per-customer target would allow the Commission to achieve its stated goals to remove disincentives to promote energy efficiency,re newable technologies and distributed generation, yet would continue to accommodate economic development and allow delivery revenues to change with changes in customer counts in the service territories.[21] Given the Commission's and

[20] The Gas Rates Panel at 10 states that an accurate accounting of customers within each service class or group is a critical element of the RDM and will require a reliable and transparent data source. Further, the Panel suggests that the number of open active gas meters may be a reliable proxy.

[21] The RDM Order at 8 notes that revenues calculated on a per customer basis can encourage economic development by allowing utilities to collect revenues for new customers.

RDM PANEL

Governor's other goals of encouraging economic development in New York, including those related to the development of renewable resources, the revenue-per-customer target might better address energy efficiency and economic development goals. This method, of course, requires that a transparent and objective standard be agreed upon to monitor the number of customers on an ongoing basis. The Companies are currently evaluating the extent to which it is necessary in the Companies' service areas to reflect increases and/or decreases in the number of customers in the RDM methodology over time. If customer growth over time is relatively modest and stable, the importance of a revenue-per-customer target is somewhat diminished.

Q. Are there other policy objectives that should be considered in the design of an RDM?

A. Yes, there are several additional objectives that merit consideration at this time. First, an RDM must be implemented in a manner that maintains reliable service. An RDM should not be designed in a way that all but guarantees that utilities will suffer revenue insufficiency unless they file a rate case on an annual basis to recover inflationary cost increases. An RDM should seek to avoid expensive and time consuming rate cases due to cost increases.

An RDM provides for an automatic "true-up" mechanism (i.e., either a credit or surcharge) that adjusts rates between rate cases based on the over- or under-recovery of the revenue-based targets. To the extent that the RDM revenue

RDM PANEL

adjustments more closely track all changes in delivery service costs, there would be less need for time-consuming and costly rate cases in the future.

In the long run, the primary drivers of the utilities' delivery costs stem from increased demand for electricity/gas service and the impact of inflation on the utilities' cost structure. Increases in demand ultimately stress the infrastructure and necessitate significant investment in pipes, wires, substations and so forth. These long-run changes in delivery costs can and should be addressed either in the context of a rate or other appropriate proceeding such as the extension of an existing rate plan.

In the short run, or between rate cases, the primary drivers of the utilities' delivery costs are created by inflationary cost pressures and potential increases in customers. Therefore, to ensure that an RDM functions in the intended way, it must address the impacts associated with these cost drivers. The Companies are currently evaluating the need to adjust revenue targets for changes in the number of customers. However, the Companies strongly believe that in order to appropriately cover inflationary costs, RDM targets should be subject to an annual adjustment such as inflation less a productivity offset.[22] NRDC, in its testimony,

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[22] The RDM Order at 8 suggests that an inflation and productivity adjustment mechanism may be incorporated in the RDM mechanism. O&R similarly suggests that the Commission should consider a formula based ratemaking approach that would provide utilities with a means to offset the impact of inflationary increases in operating costs and new infrastructure investments. Such an approach would afford

RDM PANEL

also supports the concept of allowing utility revenues to adjust over time to capture expected growth in costs with a productivity offset, and recommends that the simplest approach possible should be used at the outset subject to later evaluation.[23] An annual adjustment for inflationary costs will enable the Companies and other parties to avoid the regulatory costs associated with more frequent rate cases.

Currently, the Companies are able to capture any revenue growth as system load and the number of customers increase between rate cases. Both this load and/or customer growth currently increase revenues directly based on average rates in effect at the time. Such revenue growth can help to offset general cost increases over time in operations, maintenance, capital costs and certain taxes. An RDM mechanism eliminates or significantly restricts the opportunity for the Companies to increase revenues, but provides for no relief from increased costs. Similarly, while it is important that an RDM remove disincentives for utilities to promote efficiency, it should not be designed in a manner that discourages economic development through new customer growth. Care in RDM design is required to align the Companies' interests with the economic interests of their respective service territories.

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utilities with the opportunity to seek ways to delay the filing of annual base rate cases. (O&R RDM filing at 9).

[23] NRDC, Gupta Testimony at 6-7.

RDM PANEL

Second, the Commission recognizes that the recovery of any net lost revenues component of the mechanism should not, in and of itself, produce inter-class revenue re-allocations.[24] This suggests that RDM reconciliations should be performed on a service class basis to the extent possible. However, an RDM should also remain sufficiently flexible to accommodate significant, unforeseen events that may have large unintended rate impacts in a particular service class with a relatively small number of customers. In some cases, customers in the Companies' service territories can elect to switch between service classes and the RDM methodology should consider the potential impact of such switching so as to avoid unintended rate consequences.

In sum, a properly designed RDM should recover fixed delivery costs as they increase over time, should be consistent with economic development objectives, and should not inadvertently harm customers and/or shareholders.

Q. Do you agree with NRDC's assertion that allowed revenues "should be adjusted for desirable or unexpected and unavoidable factors that increase or decrease costs"?[25]

A. In theory, NRDC's recommendation has merit as long as such mechanisms are transparent and simple to implement. NRDC aptly notes that growth in customers, jobs, and businesses are all desirable factors that might drive up

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[24] RDM Order at 16.

[25] NRDC, Gupta Testimony at 4.

delivery costs, while extreme storms or terrorist attacks represent unavoidable and unexpected factors that could increase costs. NRDC also correctly suggests that allowed revenues may need to be adjusted on a customer class basis if there are significant factors unique to a particular class.

Q. Please respond to Staff's recommendation that the Companies need to file an up-to-date forecast of delivery revenues, sales and number of customers for each service class or sub-class for each month of calendar year 2009 to establish an RDM.

A. The Companies agree with Staff's statement. A properly-designed RDM should include approved RDM targets based on reasonably achieved revenue targets. To that end, the Companies plan to base their targets on a forecast of the likely revenues that would be realized in 2009, absent the implementation of an RDM and absent the impact of any new energy efficiency programs that may be implemented.

The Companies will propose RDM targets that are calculated on a monthly basis for each applicable RDM service class or grouping of service classes (as described later). The Companies plan to file RDM targets using their approved delivery rates, a weather-normalized 2009 sales forecast by service class,[26] the resulting forecast 2009 delivery revenues by service class, and a 2009

[26] Weather-normalized sales will be used to establish targets at appropriate levels, that is, so as not to include the impact of "abnormal" weather on actual revenues.

RDM PANEL

forecast of customers by service class. Based on this information, the Companies will establish the "Allowed Delivery Revenue" or "Allowed Delivery Revenue-per-Customer" for each service class. The "Actual Delivery Revenue" will be measured as the sum of the billed revenue from all energy, customer and/or demand charges related to delivery service for each service class.[27]

Q. Please describe the reconciliation process that the Companies endorse.

A. The Companies envision an approach similar to the recommendations of Staff witness Dickens and the Staff Gas Rates Panel to use a reconciliation process based on 2009 monthly RDM targets. Under the approach endorsed by the Companies, each month, the difference (if any) between the Allowed Delivery Revenue and Actual Delivery Revenue for each service class will be tracked. At the end of the calendar year (or appropriate RDM period), the deferral balance will be refunded or surcharged to the appropriate service class via an "RDM Rate Adjustment" mechanism. The RDM Rate Adjustment will be calculated on a dollars per kWh or dollars per therm basis. This true-up would include, among other things, any net lost revenues attributable to the implementation of energy efficiency programs. For example, if at any time during the year the value of the deferral account exceeds a certain amount (e.g., $10 million) (positive or negative), the utility would employ an interim RDM Rate Adjustment in the

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[27] The Weather Normalization Adjustment currently in place for NYSEG's gas service will continue and be implemented prior to any RDM adjustments.

following month.[28] The Companies will implement interim RDM Rate Adjustments by service class on no less than ten days' notice. These interim adjustments would be subject to reconciliation at the end of the annual RDM period.[29] The deferral account will be subject to a carrying charge at the rate most recently adopted by the Commission for other deferral accounts.

Q. Do you agree with NRDC that any adjustments to revenue targets, actual revenues, or true-ups should be calculated in a transparent manner?[30]

A. Yes, the input information and formulas should be straightforward, subject to review, and readily replicable.

Q. Please address Staff's recommendation concerning those customers that should be covered by an RDM.

A. Staff proposes that the RDM should be implemented for each electric customer service class or subclass, with the exception of: (i) the lighting, buyback,

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[28] The RDM Order at 8 specifies that the true-up should occur no less frequently than once per year, but the intent should be to avoid the accumulation of large liabilities and the ensuing bill impacts and general price instability for ratepayers. The definition of significant accumulated balances is not specified in the RDM Order.

[29] If for any reason, a service class, as defined for the purposes of the RDM, no longer has any customers, the revenue target for that discontinued service class, plus any delivery revenue excess or shortfall, would be reallocated to other remaining service classes to provide for equitable treatment of revenue deficiencies or surpluses from the discontinued service class. The Company will consult with Commission Staff regarding such reallocation.

[30] NRDC, Gupta Testimony at 4-5.

RDM PANEL

individually negotiated contract, and standby service classifications at this time[31]; and (ii) certain gas customers (residential and commercial customer classes excluding cooking and large industrial customer groups).[32]

Q. What customers do the Companies currently plan to include in their RDM proposal?

A. The Companies currently plan to apply RDM to the vast majority (over 99%) of electric and gas customers. These customers represent a significant portion (approximately 96%) of sales volume. Exhibit ___ (RDM_2) summarizes the applicable RDM service class categories and lists those service classes that will be excluded from the Companies' RDM proposal. In general, it is important that revenue decoupling be applied across a broad customer base in order to stabilize rate impacts. Otherwise, energy efficiency improvements (or any sudden change in load) could have dramatic rate impacts for customers within the service class. For example, the addition of a new customer among large users or a large change in the consumption of a key customer could have a disproportionate effect on rates for other customers in that service class.

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31 Staff Testimony, Dickens at 14.

32 Gas Rates Panel at 9-10.

RDM PANEL

Q. Do the Companies plan to aggregate any customer classes for the purpose of the RDM?

A. Yes. Rate volatility associated with RDM adjustments is more of a concern in service classes where there are relatively few customers and/or there is more diversity of customer load. Therefore, the Companies currently plan, in some instances, to aggregate particular service classes for purposes of establishing RDM targets and reconciliation. Specifically, the Companies will combine customer service classes that have relatively similar consumption characteristics or classes that have too few customers to warrant stand-alone treatment.

The aggregation of certain service classes achieves several objectives. First, and most importantly, combining certain classes for RDM purposes provides a more stable rate adjustment mechanism, especially in service classes where there are a relatively small number of customers and an RDM could have a disproportionate impact on the rates for those customers in that service class. Second, combining certain service classes will avoid the potential for customer gaming or inadvertent revenue changes in those instances where a customer can move easily between service classes.[33] Third, aggregation of certain service classes reduces administrative complexity by limiting the number of rate adjustments that need to be calculated and communicated to customers.

[33] For example, if a customer moves from a low average revenue-per-customer class to a high average revenue-per-customer class, this could impact total revenues.

RDM PANEL

Q. Do NYSEG and RG&E recommend the exclusion of any customers from the RDM?

A. As noted above, the Companies propose the exclusion of a small number of customers from their RDM proposal. The Companies will exclude service classes in which (1) customers have individual service agreements (e.g., flex rate contracts, bypass rates), or interruptible transportation service; (2) there are few or no customers; and/or (3) the rate designs for such class(es) already recover fixed delivery costs on a non-volumetric basis (e.g., standby service).

III. COMMODITY REVENUE DECOUPLING MECHANISM

Q. Does Staff recommend an RDM for electric commodity revenues on the sale of the fixed price option ("FPO")?

A. Staff does not recommend an RDM applicable to electric commodity revenues at this time. However, Staff does propose that NYSEG should address the FPO commodity issues the Commission raised in its earlier Orders.[34]

Q. What is the Companies' position concerning whether an RDM should apply to commodity revenues?

A. The Companies oppose extension of an RDM to commodity revenues. In support of the Companies' position, the Panel will briefly summarize the NYSEG and

34 Staff Testimony, Dickens at 16.

RDM PANEL

RG&E commodity programs and then provide the rationale for the exclusion of associated revenues from an RDM.

Q. Would the Panel provide an overview of the NYSEG and RG&E commodity programs?

A. The NYSEG Commodity Program Order requires NYSEG to address the applicability of an RDM to NYSEG's electric FPO. NYSEG's FPO is a one-year fixed price commodity product that most customers of the utility can choose during a two-month enrollment period beginning each November. The FPO rate is determined based on forward wholesale prices for energy and capacity,and is converted to a retail price using a conversion factor consisting of a percentage of 16.9% and an adder for risk and a profit opportunity of 6 mills per kWh. Any profits realized by NYSEG are shared as follows – the first $10 million of pre-tax profits goes to NYSEG, and any additional profits are shared 85% to customers and 15% to NYSEG. Any losses are absorbed completely by NYSEG. The FPO is charged to customers entirely on a volumetric cents/kWh basis.

RG&E's FPO is a one-year fixed price commodity product that most customers of the utility can choose during a three-month enrollment period beginning each October. The FPO rate is determined based on forward wholesale prices for energy and capacity,and is converted to a retail price using a conversion factor of 35% that covers certain costs, risks and a profit opportunity. Any profits realized by RG&E flow through the Company's overall earnings

RDM PANEL

sharing provision in which customers receive 50% of earnings above a 12.25% overall ROE for commodity and delivery combined. Any losses are absorbed completely by RG&E. The FPO is charged to customers entirely on a volumetric cents/kWh basis.

Q. Why do the Companies believe that an RDM should not be applied to these commodity programs?

A. There are three main reasons. First, an RDM is not appropriate for the Companies' FPO because the economics of the commodity and delivery businesses are fundamentally different. Second, an RDM is not appropriate for FPO because the Companies have little incentive to increase sales. Third, an RDM is not appropriate for FPO because of other program design features. Each of these reasons is described in more detail below.

Q. What is the basis for the first reason?

A. An RDM is being contemplated in New York State in order to align utility incentives for revenue recovery with the desire to promote energy efficiency and conservation of usage. A typical utility delivery business has two key attributes which lead policy makers to perceive that utility incentives are not currently aligned to achieve these goals. First, delivery costs are substantially fixed and do not vary with changes in load. Second, rates are currently designed to collect a substantial portion of fixed delivery costs through volumetric charges (e.g., per kWh). Therefore, incremental usage results in relatively large contributions to fixed cost recovery.

The Companies' FPO programs do not share these same attributes. First, supply costs are almost entirely variable. Changes in usage by FPO customers can cause the Companies to incur substantial expense through purchases of power at market prices. If a customer uses an additional kWh, the Companies must purchase incremental energy and incremental line losses. If a customer uses one less kWh, the Companies' costs decline similarly.

Second, unlike the delivery business, an incremental change in usage from what is expected creates real costs and substantial risks. Incremental usage is often associated with high-priced periods during on-peak or during super-peak periods because periods of high demand due to weather are strongly correlated with increases in supply costs. In these periods, the Companies are likely procuring power in the wholesale spot market at costs that exceed the retail fixed price charged to the customer. Thus, not only are the Companies not realizing a margin of 6 or more mills per kWh during these periods, they are probably incurring a loss to acquire the incremental energy. Therefore, the economics are fundamentally different for the commodity and delivery businesses.

With respect to commodity, the Companies do not have any incentive to encourage additional usage, especially during on-peak and super-peak periods. Similarly,a decrease in usage creates costs and causes risks in a different way.

RDM PANEL

Lower than expected usage is often correlated with lower than expected prices. Unexpectedly mild weather causes low demand and low prices as low-cost generation sets the market price. In these periods, the Companies must sell power previously purchased at higher prices and will receive a lower spot price. In these times, the Company loses the opportunity to earn any of the above-referenced margins because the customer is not using electricity. Finally, it makes no economic sense to blindly fix the FPO commodity program revenues – either with a total revenue target or with a revenue per customer target – when the costs of service vary substantially with changes in load and time of use, and customers are able to freely switch to an energy services company ("ESCO") from FPO service.

Q. What is the rationale supporting the second reason identified above?

A. An RDM is not appropriate for the FPO because the Companies have little incentive to increase sales. For a residential electric customer paying the SC1 rate, consumption of an additional kWh costs the customer 3.47 cents at NYSEG and 2.27 cents at RGE in incremental delivery charges. As discussed above, this incremental revenue largely increases profit margin since the delivery costs associated with this additional usage are largely fixed. Presuming for the moment that consumption of an additional kWh creates an additional 0.6 cents per kWh in net commodity margin (although this is far from an expected outcome), the Companies have roughly one-sixth to one-fourth as much perceived incentive to encourage additional usage. At NYSEG, this incentive is reduced substantially

RDM PANEL

once the earnings sharing mechanism of the commodity program is triggered. NYSEG's share of this margin is 15%, or 0.09 cents per kWh – roughly 2.5% of the magnitude of incremental margin created by delivery rates. Therefore, the underlying motivation for RDM does not apply to the Companies' commodity programs. The Companies have little incentive to increase commodity sales above expected levels.

Q. Would the Panel explain the third reason?

A. An RDM is not appropriate for FPO because of other program design features. In addition to the lack of incentive caused by the rate and earning sharing features of the FPO programs, there are design features to the programs that further warrant leaving the structure unaffected by an RDM. First, customers must affirmatively elect a fixed price rate from the Companies during a two or three-month enrollment period. For 2008, only 11.7% at NYSEG and 17.8% at RGE of the load will fall under this rate option. This further narrows any perceived incentive. At NYSEG, beginning in 2008, customers have the freedom to switch to an ESCO at any time during the one-year period the FPO is in effect. This new ability creates substantial additional risk for NYSEG with no additional upside opportunity – customers can not return to the FPO program if leaving an ESCO during the year. Third, the percentage of load choosing the FPO program has been falling over time. As fewer customers choose the FPO, the total potential margins from the program fall.

RDM PANEL

Q. Does this complete your rebuttal testimony at this time?

A. Yes, it does.

BY MR. MUELLER:

Q. And panel, looking at that same rebuttal testimony, is it true that there were two exhibits attached, RDM-1 and RDM-2, the first RDM-1 containing three pages reciting your qualifications and RDM-2 containing two pages of proposed applicable service classes?

A. (Panel) Yes.

Q. Do you have any changes or corrections to those documents?

A. No.

MR. MUELLER: Your Honor, I would like to ask the two exhibits be marked as the next sequential exhibits.

JUDGE EPSTEIN: RDM-1 is 25 and RDM-2 is 26.

(Exhibits 25 and 26 marked for identification.)

MR. MUELLER: Panel is available for cross-examination.

CROSS EXAMINATION

BY MR. MAGER:

Q. Good afternoon, panel. For purposes of clarity in the record, can we agree that RDM stands for revenue decoupling mechanism?

A. (Panel) Yes.

Q. We will use RDM for the remainder of the cross if possible.

In your testimony starting at page 1, the petitioners are proposing to advance RDM proposals for both NYSEG and RG&E in the second quarter of 2008; do you see that?

A. (Lahtinen) Yes.

Q. And your testimony, I believe, on page 2 is that you don't believe that specific RDM is related to whether the merger should be approved or not?

A. (Lahtinen) That is correct.

(Segal) Correct.

Q. In support of your position in this case, you are relying on -- I will refer you to page 4, the April 20, 2007, order regarding RDMs, correct?

A. (Lahtinen) In part.

(Segal) In part.

Q. And with respect to that order, isn't it true that the Commission directed utilities to file RDMs in rate cases?

A. (Lahtinen) If you give me a minute to check the order. I think it's a little more generic than that.

Q. How about if I point you to some examples in the order, if you have it, and you can verify them? Do you

have the order?
A. (Lahtinen) Yes.
Q. Page 3, right before the procedural background section, the Commission states, "These revenue decoupling proposals should be followed in ongoing and new rate case whereby the Utilities and Department of Public Service Staff and interested parties can address specific design details."
Do you see that?
A. (Lahtinen) Yes, I do.
Q. And then turn to page 13 of the order.
First full paragraph, the Commission states, "We believe that the proper forum for designing an appropriate delivery service revenue decoupling mechanism is in utility rate cases."
Do you see that?
A. (Lahtinen) Yes, I see that.
Q. Turning to page 14, right above the heading "Allowed Rate of Return Changes." Do you see where the Commission states -- and this is the middle of the sentence, "...we support the proposal of the parties recommending that both the design and implementation takes place in the context of individual utility rate cases"?

A. (Lahtinen) That was on page 14?

Q. Yes. The two lines right above the heading at the bottom of the page.

Do you see that?

A. (Lahtinen) I got it, yes.

Q. Finally, above page 15, right above the heading "Conclusion," the Commission states that they agree that the effect of a delivery service revenue decoupling mechanism on a utility rate of return should be considered to the extent appropriate along with other factors in the context of individual utility rate proceedings"?

A. (Lahtinen) Yes, I do see that.

Q. Do the Companies consider this case to be a rate proceeding?

A. (Lahtinen) No, we don't.

Q. Nonetheless, you are proposing to file RDMs in April of this year outside of a rate case; is that your proposal?

A. (Lahtinen) No. We are proposing to file a more detailed revenue decoupling mechanism proposal in the second quarter of this year.

Q. In a rate case or outside a rate case?

A. (Lahtinen) If the Commission order comes out, it will be directed by a Commission order. We are proposing a separate filing in the second quarter of this year that will provide more detail with regard to revenue decoupling mechanism proposal we sketched out in this testimony.

Q. So, we just talked about the order where the Commission said it was appropriate to examine RDMs in rate cases, and your proposal in this proceeding is to, essentially, file a detailed RDM proposal in April outside of a rate proceeding; is my understanding correct?

A. (Lahtinen) Could you repeat the question, please.

Q. Not withstanding the Commission's directives in the RDM order that RDMs be considered in the context of rate proceedings, you nevertheless are proposing to file detailed RDM proposals for both NYSEG and RG&E in the second quarter of 2008 outside of a rate proceeding?

A. (Lahtinen) That is correct, and also in compliance with the order issued in this case, which is rolled into the merger proceeding. I mean, we have been told -- there is a generic order on revenue decoupling mechanisms that we believe we need to respond to, and there also was a revenue decoupling mechanism provision case that arose out of the approval of a NYSEG supply-side service agreement which eventually got incorporated into this case.

Q. Does that order mention RG&E at all?

A. (Lahtinen) That order does not mention RG&E at all. However, on February 1st, we did file a proposal to continue the RG&E rate plan, and our reading of the RDM order would require us to consider revenue decoupling mechanism, which we did by reference to the testimony in this case.

Q. So, right now, you are saying that the RDM order, which directs the consideration of RDMs in rate cases, requires the consideration of a proposal for RG&E now?

A. (Lahtinen) The way we read the order -- and I will look and find the particular reference to the order that I think would trigger my memory -- I think there was at least some question among people in the Company that we had to at least address a revenue decoupling mechanism in the RG&E rate plan continuation filing.

Q. Let me ask you this: If the Companies had their choice, would you agree it would be more efficient to examine RDMs within the context of a full rate case?

A. (Lahtinen) Well, if we had a rate case that was ongoing or started, probably it would be more efficient to handle that in the context of one case.

However, the revenue decoupling mechanism doesn't appear to me to be beyond the realm of possibility to set revenue decoupling mechanism targets with our existing rates based on forecasts for 2009 as we have suggested and still have a rate case.

One of the problems or one of the issues that may arise -- is likely to arise is, the Commission has a generic proceeding on energy efficiency programs. Those energy efficiency programs, if we're ordered to implement those the middle or end of next year, I think the Company would probably want to have a revenue decoupling mechanism in place to protect itself against revenue losses associated with energy efficiency programs.

Q. Let's just follow up on your proposal then. Your proposal is to establish RDMs effective for NYSEG electric and gas and RG&E electric and gas effective January 1, 2009?

A. (Lahtinen) That is correct.

Q. To set up those RDMs, you would need rate and revenue forecasts?

A. (Lahtinen) Yes. We'd need forecasts of the number of units -- either kilowatt hours or customers -- and we'd need to price out those kilowatt hours and customers times the current -- whatever the current rates are.

Q. And if the merger is approved, are the Companies agreeing to forego any rate cases for 2009?

A. (Lahtinen) That really is a question that's probably better addressed to the policy panel.

Q. It's your proposal to do an RDM for calendar year 2009, right?

A. (Lahtinen) That is correct. We proposed to make a proposed filing in the second quarter of this year which would give the Commission sufficient time to implement revenue decoupling mechanism proposals effective 1/1/09; that is correct.

Q. And then what happens if the Company files a rate case later this year?

A. (Lahtinen) Well, I mean, purely speculation, but depending upon when the filing was made, when the Commission issued an order, I don't see any reason why a revenue decoupling mechanism couldn't take effect 1/1/09 and have the revenue target subject to change or readjustment at the beginning of January 1, 2010, because there are revenue reconciliation procedures that would be embodied within the revenue decoupling mechanism. So, I think it could be done.

Q. Would you be agreeing not to have any new rates take effect until 1/1/10?

A. (Lahtinen) No. I don't think that's what I agreed to.

Q. Under your proposal, the situation could arise where the parties would spend a good part of 2008 examining a revenue decoupling mechanism to take effect 1/1/09. Then, at some point during '09, rates could change again. Should the Company file rate cases?

A. (Lahtinen) Base rates could change, that is correct, which would trigger an adjustment at some point in time to the revenue targets included in the revenue decoupling mechanism proposal. That is correct.

(Segal) It could certainly be done in a way that the structure of the RDM is all contested, agreed upon, in the initial filing triggered by the second quarter filing. And then all that would happen would be that targets would be adjusted based on the new rates and revenue requirements.

Q. I would like to turn to page 10 of your testimony.

You state, starting on line 15, "RDMs should not be designed in a way that all but guarantees the utilities would suffer insufficiency unless they file a rate case on an annual basis to recover inflationary cost increases."

Do you see that?

A. (Lahtinen) Yes.

Q. Is the purpose of an RDM to grant automatic rate relief to the utility?

A. (Lahtinen) No. I think the principal purpose of a revenue decoupling mechanism is to guard against fixed revenue losses for the Company. But as we say --

Q. Do you do energy efficiency or distributed generation? Isn't that why the Commission adopted RDMs?

A. (Lahtinen) That is correct, but as we set forth further on in the testimony, we also raise the question -- because it's in response to the question raised in the Commission RDM order -- that Companies may want to consider cost adjustments in order to protect the Company against having to file -- unnecessarily file rates for base rate changes on a more frequent basis.

I believe that's page 8 of the RDM order.

Q. I am just finding it now.

A. (Lahtinen) Last paragraph.

Q. You're interpreting that to mean the RDM could provide rate relief to the utility outside of a multi-year rate plan?

A. (Fisher) We were reading that clause to refer to specific characteristics of a revenue decoupling mechanism proposal, one of which is whether allowed revenues per customer basis or revenue where you have indices to the targets based on inflation less some offset for productivity.

(Segal) The economic concept that underlies that is that you have a delivery cost structure, which is largely fixed with respect to usage, and most of those expenses and costs that you incur will -- all other things being equal -- inflate with general inflation or some other measure of inflation.

If you restrict revenue collection to a fixed, nominal number, and you allow that to happen over a number of years, you don't any longer have the benefit of additional revenue collected from increased usage to absorb those costs. Hence you, over time, would likely have an increase in cost expense that has no revenue associated with it.

Q. Costs don't always go up though, correct?

A. (Segal) Inflation doesn't always go up, and the concept here that's been laid out is both an inflation index with a productivity offset.

Q. In NYSEG's last rate case, didn't the Commission find that its cost of providing delivery service should be reduced by almost $40 million?

A. (Segal) I think there is a distinction between the initial appropriate revenue requirement that might have specific line items that have changed for any number of factors or are litigated in a proceeding such as that, and approved and known expenses that, once they are in the revenue requirement, will tend to increase with inflationary pressures.

Q. Let's suppose that there is a merger and then manpower is reduced following the merger. That could lead to a reduction in the Company's cost, could it not?

A. (Segal) That's correct.

Q. If the RDM was increasing the utility's revenue requirement, the utility would just make that much more profit. Isn't that how it would work under those facts?

A. (Segal) I think it's subject to an earnings sharing, and it's also subject to the right of parties and the Commission to request that the Company come back in.

Q. The Company would always have the right to file a rate increase, would it not, even under your proposal?

A. (Segal) Yes. The concept here is designed to not have to go through annual cases to reset all the revenues and RDM factors due to inflation cost increases.

Q. Isn't that what multi-year rate plans are for?

A. (Segal) Yes, but you could have an agreement on a multi-year rate plan with indexes. That's all that we are saying here. In the context of an RDM, it could all be connected in.

Q. Are you also saying that an RDM could increase outside of a multi-year rate plan? That without a multi-year rate plan the utility would automatically get revenue increases?

A. (Lahtinen) Or depending upon whether the inflation factor went up or down or the productivity offset could go up or down.

Q. So your proposal is not limited to multi-year rate plans?

A. (Lahtinen) That is correct.

Q. That's what I thought. Now, describe the RDM rate adjustment mechanism that you propose.

A. (Lahtinen) Do you have a specific page reference?

Q. 15.

A. (Segal) The Company would track, over time, on a monthly basis, the difference between the allowed parameters of revenue, whether it's a revenue-per-customer design or a revenue design, for each service class or grouping subject to the RDM, and compare the actual revenue with the targeted or allowed revenue for each one of those groups. And to the extent each one of those in each group or service class is different, there would be an amount of dollars calculated as a difference. That would then subsequently be collected or returned to that group over the subsequent period. We are recommending or suggesting an annual process.

Q. Would you agree that delivery service is primarily demand-based or fixed-cost?

A. (Fisher) I would say primarily fixed-costs and, I guess, demand to some extent.

Q. Yet your proposal for your RDM rate adjustment is a volumetric adjustment; do you see that?

A. (Lahtinen) Yes.

Q. Why?

A. (Lahtinen) I think the biggest reason for that was just administrative simplicity.

Q. For larger customers that do have demand-based charges, would you agree that that would make more sense?

A. (Lahtinen) Again, provided that the

administrative complexity wasn't too great. In concept, we certainly could consider that for the second quarter filing. I mean I think conceptually it's a legitimate question to ask, but for purposes -- when we thought through this and started looking at it in terms of what the likely impacts would be and what the administrative complexity would be, we proposed a cents-per-kilowatt hour adjustment.

But, clearly, there is some merit into considering that in terms of coming up with a final RDM proposal.

Q. Wouldn't doing it on a volumetric basis also increase the risk of intra-class subsidies?

A. (Lahtinen) Again, it's possible. I think the question is: What's the probability? What's the potential magnitude?

That's clearly something we would have to consider and will consider before we make our second quarter filing. But again, the point is: It's a legitimate question and we certainly will have to reconsider it. But for purposes of putting this testimony together, we propose a cents-per-kilowatt hour adjustment. We certainly could re-examine that before we file the proposal in the second quarter.

Q. Let me give you a hypothetical and you tell me if this is a beneficial outcome.

Let's say you have a large high-load factor customer that is -- basically pays delivery service primarily through a customer charge or demand charge. And the customer invests heavily in energy efficiency to reduce its peak demand. And now, because of its commitment to energy efficiency, there is now a revenue shortage in that service class.

As I understand your proposal, that class is going to have to make up the revenue shortfall through a volumetric charge that essentially penalizes or recovers that shortage most heavily through large high-load factor customers.

Does that sound like a beneficial outcome?

A. (Lahtinen) The example you give, yes, you would have an adjustment through kilowatt hour.

Again, the RDM is designed to protect the Company against fixed -- losses through fixed revenues. Again, it could have some change in revenue allocations if you went from converted demand charges and spread it over remaining customers on a class-per-kilowatt-hour basis. Certainly we'll consider that for the second quarter filing.

Q. Let's just quickly change to the last topic I wanted to cover.

If you could turn to page 17, you discuss what customers you would include in the RDM proposal.

Do you see that?

A. (Lahtinen) Yes, I do.

Q. And there is specifically listed in Exhibit 26 -- what's been marked Exhibit 26, RDM-2?

A. (Lahtinen) Yes.

Q. Now, your proposal is for both NYSEG and RG&E to include in the RDM its largest customer classes, SC-8 for RG&E and SC-7 for NYSEG; is that true?

A. (Lahtinen) That is correct.

Q. Now, isn't it true that there are no volumetric delivery charges for RG&E's SC-8 customers?

A. (Lahtinen) No, I wouldn't agree with that. There's a demand charge. I wouldn't consider that volumetric. I think I came to the opposite conclusion.

Q. Isn't it true there are no volumetric delivery charges for an SC-8 customer? There's a demand charge.

A. (Lahtinen) I think I came to the opposite conclusion. I think if you have a demand charge, I would consider that a volumetric charge because it varies with the load used by the customer.

Q. Let me be more specific then: Isn't it true there are no per-kwh charges for delivery service for RG&E?

A. (Lahtinen) For SC-8?

Q. Yes.

A. (Lahtinen) I would have to check the tariff, but I think that's generally correct.

Q. And will you also accept, subject to check, that the per-kwh charges for NYSEG's SC-7 class are relatively small and predominantly revenue recovery is through demand charges or customer charges for that class?

A. (Segal) Not all of them.

Q. SC-7.

A. (Segal) For example, the 7(4) high-load factors have no demand charge. They only have a volumetric charge.

Q. Will you accept, subject to check, that for SC-7 customers the per-kwh charges are very low?

A. (Lahtinen) Relative to a residential customer, yes.

Q. Now, when you were talking about the Commission's order, didn't the Commission's RDM order also raise the prospect that RDMs would only apply to certain customer classes?

A. (Lahtinen) I think that's one of the questions that they asked companies to consider.

Q. On page 8 of that order the Commission said "One of the questions to consider was whether the mechanism is applied to all or only some customer classes"?

A. (Lahtinen) Correct.

Q. Are you aware of other utilities that have proposed RDM that have excluded their largest customers?

A. (Lahtinen) I think I am aware of some that have proposed to have included them. I thought Con Ed had included them. I am not really clear. I am not sure if any of these have been issued -- if the Commission has issued an order.

I've seen some things earlier on like that that were all over the place. Frankly, I don't know the status of efficiency incentives.

(Fisher) I believe Central Hudson proposed to include them and O&R proposed to include them as well. We did look at some other RDM programs outside of the state as well that included in them California.

(Segal) I think as part of our filing, one of the things we will do is look at the groupings, look at the amount of usage-related revenue that derives from the various groups, including the largest customers, and see if it's a material amount or not, and that will help us come to a final decision on what classes to include.

Q. So, would you agree, then, if the per-kwh revenues are either nonexistent for a class or very small, it may not make sense to include them in the RDM?

A. (Segal) I think we would include both per-kwh and the per-kw charges. All of those are usage-related. Efficiency is going to hit both total usage and peak usage as well.

Q. And you believe that's consistent with the focus of the Commission's RDM order?

A. (Lahtinen) Yes. Again, it's designed to protect utilities against fixed cost recovery losses.

Q. Where costs are not cost-based.

A. (Lahtinen) I am not quite sure what that comment means.

Q. Don't they say that with respect to certain customer classes the rate design impacts are more prominent when there is fully cost-based rates in effect, and they mention large commercial and industrial classes?

A. (Lahtinen) Could I have the reference?

Q. Pages 10 and 11.

A. (Fisher) Yes, it did. But also in the order, I know there was some discussion about exempting specific classes. I know MI raised it in the RDM order and they talk about page 12, given -- one alternative to RDM is going to a fully cost rate and going to RDM as opposed to RDM.

And that -- you can still have rate impacts when you do that. And so that -- while rate design is a good long-term objective, that RDM still may be necessary in the near-term to deal with these rate impacts.

A large class, you could still have big rate impacts if you went to fully fixed-cost charges, fixed customer charges, even in SC-7(4), whether you have a 5-megawatt customer or a 60-megawatt customer. And putting everything into a fixed customer charge, you could still have pretty significant rate impacts in that situation.

Q. It's your belief that the Company's existing charges are not currently cost-based?

A. (Lahtinen) Yeah. I mean, obviously, we try to set our rates as close as we can to the cost of service. Clearly, there is customer impacts and we can't get there in one fell swoop.

I mean if in a perfect world we could set all our fixed charges and fixed customer charges or fixed monthly charges we might not need a revenue decoupling mechanism, but we are not there yet. And my own personal view is that revenue decoupling mechanisms are an interim measure until the rates get designed more appropriate over time. How long that takes, who knows? There are customer impacts you have to deal with.

I think in concept, as a conceptual matter, yes, a perfect rate design would probably eliminate if not completely minimize the need for a revenue decoupling mechanism.

Q. And so your idea of a perfect rate design is recovering everything through the monthly customer charge?

A. (Lahtinen) No. It would be to recover the fixed costs, the fixed monthly charges.

(Fisher) I think we would want to look at the fully allocated cost of service study to make that determination as to how much should be in the demand charge versus the customer charge.

Q. Like the ones that were filed in the last RG&E and NYSEG rate cases?

A. (Lahtinen) We did file fully allocated cost of service study, no question about it, but we also didn't

move the rates all the way to reflect costs. Perfect example is the residential customer charge because of their rate impacts. We moved it a couple of bucks.
Q. My question is not based on residential customer classes.
A. (Lahtinen) I understand.
MR. MAGER: No further questions.
BY MR. BREW:
Q. Good afternoon.
A. (Panel) Good afternoon.
Q. I will try to pick up where Mr. Mager left off hopefully without running over his areas or being too repetitive.
Do I take it from your rebuttal you would not want an RDM that would result in annual rate filings?
A. (Fisher) That is correct.
Q. And that you wouldn't want an RDM that would tend to produce cross-class subsidies or misallocations of cost recovery?
A. (Lahtinen) That would not be our intent.
Q. And you wouldn't want an RDM that would misalign the utilities' interest with the service territory's, specifically with respect to interest in economic growth?

A. (Segal) Yes.
(Lahtinen) Yes.
Q. So, in designing an RDM at a minimum you would want to try to avoid each of those pitfalls?
A. (Lahtinen) I mean I would agree that we want to consider them. To the extent that you couldn't avoid them all, there might be some trade-offs involved. So, clearly, we'd try to pick the best bundle that you could. Separately, we would agree with your items.
Q. Now, you talked about the purpose of an RDM in terms of your fixed-cost recovery of costs that are currently recovered from usage charges; is that right?
A. (Lahtinen) Yes.
Q. What do loads get out of an RDM? What do customers get out of an RDM?
A. (Lahtinen) To the extent the revenues increase, they get an adjustment through the RDM to lower their rates. The revenue decoupling mechanism is designed -- as I read the order -- to remove any barriers of disincentives from utilities to promote energy conservation.
Q. So it doesn't focus on the customers' incentives to invest in energy efficiency or conservation?
A. (Segal) The flip side of Jim's point is that,

to the extent a customer does invest in energy efficiency he is going to see lower dollars -- not necessarily a lower per-unit charge, but lower dollars on his electric bill.

Q. So if I understand -- and I am a little fuzzy because you haven't actually made a proposal yet, right?

A. (Lahtinen) That is correct.

Q. And you've described what you think are features that an RDM should include or shouldn't include?

A. (Lahtinen) That is correct.

Q. But we won't know what you are actually proposing until --

A. (Lahtinen) Second quarter; that is correct.

Q. Or the next rate case or whenever you have sufficient information.

A. (Lahtinen) I think we proposed to make a filing in the second quarter which would have the revenue decoupling mechanism targets by class.

Q. What you are talking about is -- if I understand at least the implementation aspects of it is you would have monthly forecast of sales and revenues by the groupings that are listed in RDM-2?

A. (Lahtinen) Yes.

Q. For 2009?

A. (Lahtinen) Yes.
Q. In May 2009, if we had an unseasonably warm May and sales were up, what happens?
A. (Segal) That would be tracked, and at the end of '09, if that resulted and there were no other unusual events, that would be tracked in an account and returned, the extra dollars collected through usage charges -- reduced to those customer classes or groups that incurred electric charges.
Q. So, the excess consumption, if you will, in May of '09 comes back to customers in a credit when? Sometime in 2010?
A. (Segal) Most likely in 2010. If it triggered a large number, if it triggered a liability back to customers or the reverse of a predetermined large amount, it could get through rates sooner than that.
Q. Sooner than that but still some time well after the normal billing cycle?
A. (Segal) Yes.
(Lahtinen) Oh, yes.
Q. So from a price signal perspective, would an RDM be improving or be more adverse to providing adequate price signals to customers?
A. (Segal) I think it's probably kind of neutral.

You have four price signals in the delivery rate structure today, to the extent we have been talking about usage-related rates with fixed costs. That's not a great price signal.

The RDM doesn't really completely improve that for any given customer, but it probably doesn't make it worse either.

Q. So during the hot weather in the May month, consumption is up, but you actually get a credit for it later on. Are you saying that's neutral as to price signals?

A. (Segal) If you had perfect cost-based ratemaking, that customer would pay presumably a lot more on the supply portion of the bill because prices would be up in that month. It would be unexpectedly warm.

Really, for the most part, extra consumption would not necessarily stress the delivery system and cause extra costs to be incurred.

Q. I haven't gotten there yet. I'm just talking about the revenue side.

A. (Segal) That's what I am saying is that he would be paying in his May bill extra revenues for the delivery part of the bill that didn't necessarily go along with extra incurred costs. That's how the RDM functions to return that money back.

Q. Because it's guaranteed you that revenue target, not the actual revenues?

A. (Fisher) The purpose of the RDM is to more closely align the fixed delivery costs with the revenue stream. That's the purpose.

Q. Right. So what I am trying to get to is: The RDM is indifferent to the reasons for those variations, right?

A. (Lahtinen) That is correct.

Q. So, if instead of it being unusually warm in May, you have -- or cold -- you have an economic slow down, and you have a very large industrial load that shuts down for two months because of excess inventory.

The result of the RDM is that my per unit cost goes up because the RDM allows you to recover your targets. So in the midst of an economic slow down, it actually would push rates up higher for that class of customers.

A. (Fisher) Again, it's trying to stabilize the revenue stream and more closely align the revenues with the fixed cost.

Q. Was the answer to my question yes?

A. (Fisher) Yes.

Q. Again, a matter of clarification. Since we haven't seen your proposal yet: Are you agreeing or disagreeing with the RDM proposal that Staff has offered?

A. (Segal) Which one?

Q. Let's take the electric first.

A. (Lahtinen) It's not clear. I think the primary specifics that Staff gave in their testimony was, one, you ought to look to see what classes should be eliminated from the RDM.

I think the electric -- Mr. Dickens, I think, suggested that the revenue targets be based on a total revenue target, and the gas panel recommended that the target be based on a dollars-per-customer basis.

We haven't reached a conclusion on that yet. We are still looking at the data. Our testimony merely goes to, absent a compelling rationale, you probably ought to have the same mechanisms for electric and for gas unless there's a good reason to have a different mechanism.

That's essentially, I think, about the only specifics that Staff gave in their testimony. They clearly recommended that the Company file a revenue decoupling mechanism, and they clearly had a preference that the revenue decoupling mechanism be in effect 1/1/09.

(Fisher) We agree with that.

Q. But is it also your testimony that simply doing a total revenue approach may be too simplistic and create unintended consequences?

A. (Lahtinen) I think our opinion was, depending upon customer growth, and depending upon the other policies that the revenue decoupling mechanism wanted to support, like attracting new customers to the territory for economic development, that it might dissuade the Company from spending a lot of time going out and attracting new customers to the territory if those additional revenues get returned to everybody.

Q. Would you agree that the point you just raised is an important public policy goal?

A. (Lahtinen) Certainly.

(Fisher) I think we've described the advantages and disadvantages of both approaches.

(Lahtinen) We are not sure.

Q. Explain for me if you can -- I am sure you can -- the types of adjustments that you think are needed beyond just regular updating the sales forecasts in order to avoid what you described as the potential for annual rate cases.

Let me rephrase that. In your testimony at page 10 you described the prospects of if you simply do an RDM and nothing more you're building in earnings erosion because you haven't kept up with the costs that increase with expected growth, and that's sort of going to stimulate a regular filing of base rate cases.

My question there is: What are you looking at beyond simply revenue adjustments for a complete RDM?

A. (Segal) There would be revenue targets that would be a part of a filing, and there would be a proposed formula along the lines of inflation, minus a productivity offset that, if the Company were not involved in a subsequent rate case the following year, or some other year, the rates would be allowed to continue in place with an adjustment to those targets equal to an index using that RPI minus X factor.

Q. Index of what? Are you talking expenses now or sales?

A. (Segal) Revenues.

Q. You are only adjusting the revenue side?

A. (Segal) Yes. You don't get any increased revenues related to increased sales growth.

Q. So the purpose of the productivity adjustment is to what?

A. (Segal) Recognize that the Company can do a little bit better than simply absorbing inflationary costs.

(Lahtinen) Again, to follow up, it's similar to what Staff has proposed and the Commission has accepted in most recent cases where they just apply general 1 percent productivity offset to inflation. That's what we're talking about.

Q. By applying a productivity offset you're doing what to the sales forecast and the RDM? Increasing?

A. (Segal) Nothing to the sales forecast. You would be -- all other things equal -- lowering the allowed revenue collection. If you had a million dollars in revenue collection initially, and inflation was 3, the next year you would have a million 30 in allowed revenue collection. If you had an offset of one, you'd only have a million 20 in revenue collection.

Q. You would update your monthly forecasts every year?

A. (Segal) Absent a rate case, you would start with the targets.

Q. You don't update your targets every year?

A. (Segal) No, you don't. The only thing you would update is the allowed revenue target, the total revenue-per-customer class or revenue-per-customer in each class, depending on which technique is chosen.

You don't update the number of customers in each rate class as a target, and you don't update the kilowatt hour sales as a target.

Q. You only update the dollars?

A. (Segal) You only would update the allowable dollars as targets.

(Lahtinen) Again, if we had a dollar-per-customer target starting off 1/01/09 at 10 bucks, and inflation was 3 percent, January 1, 2010 the target would go to $10.30, assuming there was no inflation -- any productivity offset.

MR. BREW: Thank you. That's all I have.

JUDGE EPSTEIN: Okay. Is there other cross for this panel?

(No response.)

Okay, we are going to be in recess for one hour.

I am sorry.

MR. MUELLER: Can I just confer with the panel for 30 seconds on redirect and see if we can't get this panel off?

JUDGE EPSTEIN: Fine, okay.

MR. MUELLER: Company has no redirect. We would like to ask that the panel be excused.

JUDGE EPSTEIN: Thank you. You are excused.

(Lunch recess taken.)

(Resume at 2:30 after lunch break.)

JUDGE EPSTEIN: We are back on the record. And I just want to explain for the benefit of the people on the telephone lines, if any, that what happened earlier today was that we cut off the connection because we couldn't put a stop to the extraneous conversations and other noise that was coming in. And now the arrangement that we have at the moment, if anyone is still on the line, the arrangement we have is that you can presumably hear us, but we can't hear you. And I think we will need to continue to operate that way.

I also have e-mail right in front of me in case you need to communicate with me about something or, of course, you can call my office at (518)474-4514.

With that, I believe the next order of business is for the Petitioners to call the Rate Panel.

MR. MUELLER: Yes, Your Honor, Petitioners would like to ask that the Rate Adjustment Panel be sworn.

STEVEN R. ADAMS, JOSEPH J. SYTA and ERNEST W. WALKER, after first having been duly sworn, were examined and testified as follows:

JUDGE EPSTEIN: Thank you.

DIRECT EXAMINATION

BY MR. MUELLER:

Q. Good afternoon, gentlemen. Mr. Walker, starting with you, could you please state your name and business address for the record.

A. Yes, my name is Ernest S. Walker, III and my address --

JUDGE EPSTEIN: Let me make you start over again. You have got to turn that microphone on on the base there.

A. My name is Ernest S. Walker, III. My business address is Corporate Drive, Kirkwood Industrial Park, Binghamton, New York.

Q. And can you provide the same information, Mr. Syta?

A. Yes, my name is Joseph Syta. My corporate address, 89 East Avenue, Rochester, New York.

Q. And, Mr. Adams?

A. My name is Steven Adams, 52 Farm View Drive, New Gloucester, Maine.

Q. And, Panel, do you have in front of you a document with a cover page entitled, Rebuttal Testimony of Rate Adjustment Panel that has your names in the bottom right-hand corner and the date, January 31, 2008 in the bottom left-hand corner?

A. (Adams) Yes.

Q. And was that document prepared by you or under your direction?

A. (Adams) Yes.

Q. Any does the panel have any updates or changes to that testimony?

A. (Adams) We have three corrections. Page 36, line 1.

Q. Allow the parties a minute to get there, please.

A. (Adams) The fourth word should be inappropriate instead of appropriate.

Page 66, line 17, at the very end of that sentence you should strike the word cite, the parenthetical. We did the reference earlier.

And page 74, line 11, you should strike the first the, t-h-e.

Q. Thank you. And if I were to ask you the same -- with those corrections, if I were to ask you the same questions today, would your responses be the same as contained in this document?

A. (Adams, Syta, Walker) Yes.

Q. And do you adopt this testimony as your sworn testimony in this proceeding?

A. (Adams, Syta, Walker) Yes.

MR. MUELLER: Your Honor, I would like to ask that the Rebuttal Testimony of the Rate Adjustment Panel, which consists of 93 pages of questions and answers be copied into the record as if given orally?

JUDGE EPSTEIN: Yes, sir.

MR. MUELLER: And we are providing copies of that testimony to Your Honor and to the court reporter which contain the changes that the Panel just reviewed.

(The following is the prefiled testimony of The Rate Adjustments Panel.)

RATE ADJUSTMENTS PANEL

I. <u>INTRODUCTION</u>

Q. Please state the names, current position and business address of the members of the Rate Plan Panel.

A. (Mr. Adams) My name is Steven R. Adams and I am Vice President – Regulatory Policy of Energy East Management Corporation. My business address is 52 Farm View Drive, New Gloucester, Maine 04260.

(Mr. Syta) My name is Joseph J. Syta and I am Vice President, Controller and Treasurer of New York State Electric & Gas Corporation ("NYSEG" or the "Company") and Rochester Gas and Electric Corporation ("RG&E"). My business address is 89 East Avenue, Rochester, NY 14649.

(Mr. Walker) My name is Ernest S. Walker III and I am Manager, Revenue Requirements of NYSEG and RG&E. My business address is Corporate Drive, Kirkwood Industrial Park, Binghamton, New York 13902.

Q. Please summarize your educational background, work experience and prior testimonies.

A. A summary of our educational backgrounds, work experience and prior testimonies are provided in Exhibit __ (RAP-1).

Q. Has this Panel reviewed Staff interrogatory responses that are related to the Staff's direct testimony?

A. Yes. We have reviewed several such responses by Staff. However, additional analysis will be required as there was insufficient time to complete our review of these responses in the time provided to submit this Panel testimony. We further note that in certain responses, Staff has indicated that it intends to revise certain exhibits and we reserve the right to modify this Panel testimony at hearing to address any changes to Staff's exhibits.

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

A. The primary purpose of our testimony is to rebut the positive benefit adjustments ("PBA") proposed by Staff witnesses John W. Benedict and Robert H. Haslinger, to explain why their proposed rate plan modifications are inappropriate for this proceeding and, in the event they are nonetheless deemed relevant to the proceeding, to address serious flaws in the proposed rate plan modifications. More specifically, Staff witness Benedict reviews NYSEG's historical performance from a financial perspective, identifies regulatory adjustments that are described as potential positive benefits to ratepayers under the proposed acquisition, identifies further regulatory adjustments based on the NYSEG annual compliance filings made for the years 2002 through 2006, and suggests modifications to NYSEG's current gas rate plan and electric order. Staff witness Haslinger covers virtually the same topics for RG&E. We also will address issues raised by other Staff panels, including the elimination of the Gas Cost Incentive Mechanism ("GCIM") raised by the Staff Gas Rates Panel, and the Gas and

Electric Capital Expenditure proposals raised by the Staff Gas Rates Panel, respectively. We also address certain issues discussed in the testimony of the Staff Policy Panel.

II. SUMMARY

Q. Please summarize your testimony.

A. The testimony of Mr. Benedict and Mr. Haslinger attempts to inject a new and irrelevant rate proceeding into the Commission's consideration of the proposed acquisition. As discussed herein, and in the rebuttal testimony of the Petitioners' Joint Policy Panel ("JPP"), Staff's rate adjustment proposals are inappropriate, overstated, and beyond the scope of this proceeding.

As described in the rebuttal testimonies of the JPP and Mr. Meehan, the customers of NYSEG and RG&E will realize positive net benefits as a result of the proposed transaction. Several of the issues identified by Mr. Benedict and Mr. Haslinger are ones that might be appropriately raised in response to the companies' Annual Compliance Filings ("ACFs"), except that Staff has, for five years, repeatedly failed to provide a response to those filings. If Staff believes the companies are somehow obscuring over-earnings in their annual filings, the appropriate remedy is for Staff to file a response to the companies' ACFs. If Staff believes that modifications to the companies' existing rate plans and orders are appropriate, it should make its case in a rate proceeding, where rate case quality data regarding all of the companies' costs and revenues can be fully explored, in contrast to Staff's attempt in this proceeding to pick and choose modifications that only disadvantage the companies. Staff's proposal, to hold hostage a transaction that will provide significant benefits to New York is inequitable and unadvisable, particularly in light of the positive impacts of this Proposed Transaction on the State.

Beyond this overarching objection, we also disagree with the merits of Staff's proposals. Staff proposes hundreds of millions of dollars' worth of "Positive Benefit Adjustments" ("PBAs") through regulatory asset write-offs and reserve increases. After these write-offs, Staff next concludes that the NYSEG and RG&E are over earning. Staf f then overlays a series of rate plan modifications, including an earnings sharing mechanism ("ESM"). Staff's PBA proposals would contravene the existing rate plans and orders authorized by the Commission for NYSEG and RG&E, and they should be rejected.

As for Staff's proposed rate plan modifications, those proposals ignore the fact that NYSEG and RG&E are currently operating under still-valid rate plans and orders that were the result of numerous contested proceedings involving a diverse group of parties and a wide range of complex issues. In its testimony, Staff proposes to fundamentally modify selected provisions of the companies' existing rate plans and orders, ignoring traditional cost of service rate making and imposing a series of financial penalties upon NYSEG and RG&E. Staff justifies its proposals by applying a series of 'adjustments' to NYSEG and RG&E's 2006 returns on equity ("ROE") in an attempt to show that the companies are earning excessive returns.

Staff proposes to significantly modify the terms of NYSEG's and RG&E's existing rate plans and orders. Staff's proposals would impose write-offs, company-financed reserve increases, and earnings sharing mechanisms, resulting in what Staff characterizes as "Positive Benefit Adjustments", totaling over $1.7 billion. Staff's claim that its PBAs will have no cash impact is misleading and incorrect. Staff has essentially proposed two financial scenarios. Under Scenario 1, Staff would impose all PBAs and rate plan modifications with an ESM, but would not require immediate rate reductions. Under Scenario 2, Staff would require immediate implementation of all PBAs, rate plan modifications with an ESM, and rate reductions. The financial impact on the utilities under either scenario is roughly equivalent. Under Scenario 1, the financial impact over five years is $1.71 billion ($753 million for NYSEG and $957 million for RG&E). Under Scenario 2, the financial impact over five years is approximately $1.64 billion ($742 million for NYSEG and $896 million for RG&E). The reason that the results are similar is because Staff has proposed to implement an ESM and not exclude the PBAs from the ESM. Therefore, under either scenario Staff will require the Companies to either immediately build a huge customer liability through earnings sharing – Scenario 1 (with a cash outlay likely to occur when rates are reset – three to five years later), or provide a rate reduction to customers immediately – Scenario 2. Both Staff scenarios should be rejected by the Commission.

Our testimony below is organized into three main parts. Section III below addresses Staff's Positive Benefit Adjustments, and the impact of those adjustments on rates, and explains why they are inappropriate as conditions to approval of the transaction in this proceeding. Section IV of our testimony and exhibits responds to Staff's proposed adjustments to NYSEG's and RG&E's rates. Section V of our testimony discusses other accounting and rate issues addressed by various Staff witnesses.

To be clear, we believe it is highly inappropriate, and contrary to the Commission's authority for determining whether an acquisition or merger is in the public interest, for Staff to introduce these rate issues through its testimony in this proceeding. We are compelled by Staff's testimony, however, to respond here to the lack of merit in these proposed rate modifications, even though they should be considered, if at all, in a subsequent proceeding after consummation of the Proposed Transaction. Obviously, we believe that these issues have no place in this proceeding.

III. STAFF'S POSITIVE BENEFIT ADJUSTMENTS ("PBAs")

A. **Quantification of PBAs**

Q. What amount of PBAs has Staff proposed for NYSEG?

A. On Exhibit JB-4, staff witness Benedict proposes PBAs related to regulatory asset write-offs, reserve increases and purchased power costs absorption of $244.7 million for NYSEG Electric and $63.5 million for NYSEG Gas. In addition, Staff proposes that NYSEG write-off $70.3 million of capitalized software and increase the electric ASGA by $66.7 million for disagreements with the Company's calculation of its prior rate plan earnings sharing. Staff claims that the capitalized software and ASGA adjustments should not be considered PBAs. From the Company perspective, we have included all proposed staff adjustments in our evaluation. The resulting write-off value equals $445.2 million at NYSEG ($369.4 million for NYSEG Electric and $75.8 million for NYSEG Gas) as shown on Exhibit ___ (RAP-2).

Q. What amount of PBAs has Staff proposed for RG&E?

A. On Exhibit __ (RPH-4), Staff witness Haslinger proposes regulatory asset write-offs, reserve increases and decommissioning accrual absorption of $316.1 million for RG&E Electric and $22.2 million for RG&E Gas. The RG&E Electric value differs from the amount shown on Exhibit __ (RPH-4) because Staff double counted the delivery regulatory asset write-off. Staff also proposes that RG&E write-off $71.3 million of capitalized software. These adjustments equal $409.5

million at RG&E ($362.4 million for RG&E Electric and $47.1 million for RG&E Gas). These amounts are also shown on Exhibit ___ (RAP-2).

Q. Please describe the methodology used to prepare Exhibit ___ (RAP-2).

A. We started with a presumption that all of the Staff proposals were adopted. This means that all of the PBAs recommended by Staff were in fact adopted, as well as all other regulatory adjustments noted in Staff witnesses Benedict and Haslinger's testimony and exhibits.

Q. What were these "other" regulatory adjustments?

A. These included a recommendation that certain software investments at both NYSEG and RG&E be written off immediately and that NYSEG immediately add an amount to its Asset Sale Gain Account ("ASGA") to reflect preliminary Staff findings associated with NYSEG Electric compliance filings for 2002 through 2006.

Q. Were there other Staff proposals?

A. Yes. Mr. Haslinger recommended several significant changes to the existing RG&E Commodity program. These changes are reflected in Exhibit ___ (RAP-3). Both Mr. Benedict and Mr. Haslinger recommended significant changes in the ESMs for each Company, and these changes are also reflected.

Q. Did this panel use the data provided in Staff witness exhibits as the source for determining the financial impacts?

A. Yes.

Q. Did this panel use the data provided in Staff witness exhibits as the source for the Return on Equity levels used in calculating the customer share of earnings sharing under Staff's ESM proposal?

A. Yes.

Q. In addition to the $855 million in adjustments above, are there additional Staff proposals which impact NYSEG and RG&E?

A. Yes. In our view, as previously mentioned, Staff has presented two scenarios. Scenario 1 represents the Staff PBA of $855 million plus the Staff earnings sharing mechanism and no immediate rate reduction. Scenario 2 combines the Staff PBA, the Staff earnings sharing mechanism and an immediate rate reduction for all four operating companies. As we will demonstrate, Staff Scenario 1 - without rate reductions - creates an additional PBA of $855 million over the next five years. The total PBA under Staff Scenario 1 is $1.71 billion as shown on Exhibit ___ (RAP-3). Staff Scenario 2 – with rate reductions – creates an additional PBA of $784 million over the next five years. Thus, the total PBA under Staff Scenario 2 is $1.64 billion as illustrated on Exhibit ___ (RAP-3).

Q. Are you stating that Staff's proposed PBA is actually close to $2 billion?

A. Yes. Staff first proposes a number of regulatory asset write-offs and reserve increases. If an asset is written off then the Company will no longer have an expense amortization. Likewise, the Company no longer has the regulatory asset and its rate base is reduced. When a reserve is increased, a future customer liability is pre-funded. Consequently, unadjusted fallout returns are naturally higher since income has increased and rate base decreased. Staff illustrates this point in its revenue requirement schedules. On Exhibits ___ (JB-2) and (JB-3), Staff shows ROEs after "Positive Benefit Adjustments" of 15.32% and 17.69% for NYSEG Electric and NYSEG Gas, respectively. Similarly, Exhibits __ (RPH-2) and (RPH-3) demonstrate ROEs after the PBAs of 35.91% and 15.98% for RG&E Electric and RG&E Gas, respectively. Staff then concludes that the Company's current rates are too high and the Commission could require delivery rate reductions as a condition of the merger. However, even if the Commission does not require immediate delivery rate reductions after the Staffs' suggested $855 million write-off, Staff proposes an earnings sharing mechanism that will capture earnings from the manufactured higher returns. We have calculated the additional customer benefit from Staff's ESM would be about $1.1 billion over the next five years.

Q. Why was a five-year period chosen to prepare Exhibit __ (RAP-3)?

A. Staff witness Benedict's testimony, page 22, lines 11-15, indicates that "...five years...would seem to be reasonable as a proxy for the amount of time that the Commission would normally consider adequate for a stay out period".

Q. What are the ESMs proposed by Staff?

A. Staff has proposed two different earnings sharing mechanisms. For NYSEG, at page 25 of Mr. Benedict's testimony, Staff proposes delivery earnings between

9.0% and 10.0% ROE would be shared 50%/50% (customer/shareholder). Delivery earnings between 10.0% and 11.0% ROE would be shared 75%/25% (customer/shareholder). All earnings above 11.0% would be deferred for the customer. Staff has proposed a slightly different earnings sharing mechanism for RG&E. Mr. Haslinger, at page 37, proposes 50%/50% sharing begin at 9.35% ROE instead of the 9.0% proposed by Mr. Benedict. After this difference, the Staff proposed ESM for RG&E is the same as NYSEG's.

B. <u>Return Impacts of PBA Proposal</u>

Q. What is the potential highest return Company shareholders could receive under Staff's proposed ESMs?

A. Prior to the interest accrual on the customer share of earnings, the highest potential shareholder ROE is 9.75% at NYSEG and 9.93% at RG&E as illustrated on Exhibit __ (RAP-5). However, this "potential" level of return is illusory because as shown on Exhibit __ (RAP-6), the real highest potential ROE dramatically decreases after reflecting the interest expense on the customer share of earnings. By year five, the highest possible ROE is 8.0% for NYSEG Electric and 7.2% for NYSEG Gas, respectively. At RG&E the highest potential ROE is a mere 2.4% at RG&E Electric and 8.0% at RG&E Gas. These ROE levels are far below what has traditionally been deemed a reasonable range by this Commission.

Q. Do NYSEG and RG&E currently have ESMs?

A. Currently there is no ESM for NYSEG Electric delivery earnings since it does not operate under a multi-year rate plan. NYSEG Gas has an ESM which shares earnings above12.5% ROE equally (50/50) between customers and shareholders. The RG&E Electric rate plan provides for 50/50 sharing above 12.25% ROE and the RG&E Gas rate plan provides for 50/50 sharing above 12.0% ROE.

Q. Did Staff propose to exclude the impacts of its PBAs from the ESM?

A. No. Neither Mr. Benedict nor Mr. Haslinger proposes any exclusion to their ESMs.

Q. What is Staff's total PBA value and what percentage of five year delivery revenues does it equal?

A. Under Scenario 1 – no rate reduction – Staff's total customer benefit value is $1.71 billion and equals 26.3% of the Companies five-year delivery revenues. We utilized the Staff Exhibit ___ (Policy Panel- 21), five year delivery revenue amount for this calculation. Under Scenario 2 – immediate rate reduction – Staff's total PBA is $1.64 billion equaling 25.2% of the Companies five year delivery revenues. As discussed by Mr. Meehan, these percentages are staggering and well in excess of other approved mergers.

C. **<u>Specific PBA and Other Staff Adjustments</u>**

1. **<u>PBA Adjustments</u>**

RATE ADJUSTMENTS PANEL

Q. Does this panel accept Staff's PBAs or any of the other adjustments proposed by Staff as appropriate?

A. No. Other witnesses in this proceeding, the JPP and Mr. Meehan explain why the "creation" by Staff of these PBAs as a condition for acceptance of a non-synergy merger is inappropriate and bad policy. Our testimony addresses, from a factual and rate policy perspective, additional reasons why – even if the Commission were to view the PBAs as appropriate for consideration as conditions to approval – the PBAs should be rejected.

Q. Can you please describe each of the Staff proposed PBA adjustments and the reasons why this panel finds them unacceptable and inappropriate?

A. Yes. The following is a description of the proposed adjustments in the order depicted on Exhibit __ (RAP-2), and the reasons why this panel finds them inappropriate and unacceptable.

1. Loss on Reacquired Debt (NYSEG Electric, NYSEG Gas, RG&E Electric, RG&E Gas) – Staff correctly identifies that this item was created by early refunding of various debt issues that were approved by the Commission. NYSEG and RG&E periodically redeem outstanding debt issues when a more economic source of funds is available. Customers benefit from the reduction of the overall weighted average cost of capital. As part of the process of redeeming debt, losses may occur when the debt is reacquired, and these losses are considered in the economic analysis of whether to reacquire or not. To the extent that customers are benefited by the reacquisition of debt, they should bear the costs of the reacquisition. In addition, the accounting that the companies follow for the losses on reacquired debt is in accordance with generally accepted accounting principles ("GAAP").

2. Sarbanes Oxley and Other (NYSEG Gas) – Under its gas rate plan and joint proposal, in Section XV, NYSEG is allowed to defer the incremental costs of

adhering to new accounting mandates, such as Sarbanes Oxley. To not allow collection of these costs from customers is an inappropriate reopening of the rate plan. It is also unclear why the Staff Policy Panel places a high value on Energy East continuing to be subject to Sarbanes Oxley requirements (Staff Policy Panel testimony starting page 301, line 4) and then has other Staff witnesses propose that the costs of adhering to this mandate should not be recoverable.

3. Low Income and MTA Surcharge (NYSEG Electric) – With respect to Low Income, NYSEG spends money on low income programs which the PSC approved as part of its electric rates and a portion of that spending has been deferred. Recovery of these costs should be continued in light of the PSC's approval of this program. To disallow recovery would be an inappropriate reopening of the rate plan. With respect to the MTA Surcharge, Staff provides no specific explanation in its testimony for this item. This is a pass-through item for which the Company is simply acting as a collection agency for another entity, the Metropolitan Transit Authority. There is no logical reason why the Company should be harmed for acting in that capacity.

4. Gas Pension Deferral (NYSEG Gas) - This deferral is a long standing practice that the Commission has followed, as documented in its Statement of Policy on Pensions and OPEBs, which was established in the early 1990s in Case 91-M-0890. The current NYSEG Gas Rate Plan, in Section XVIII,clea rly obligates the Company to defer any differences between the amount allowed in rates for pension costs/income and the amounts actually experienced as the result of two variables – the asset return rate and the discount rate. To have the Company absorb this accumulated deferral would be an inappropriate reopening of the PSC approved gas rate plan.

5. Deferred Gas Costs (NYSEG Gas) – NYSEG's accounting for deferred gas costs is in accordance with long standing Commission approved practice. The gas rate plan provided for a Gas Supply Charge, in Section X, which reconciles gas supply costs and gas supply revenues. At any point in time, NYSEG could have gas costs deferred that have not yet been collected from customers. Staff has not provided any adequate reason why this item was included. This proposed adjustment would force the Company to take a loss on gas supply costs, completely and inappropriately superseding the long standing policies of the Commission.

6. 2006 Flood (NYSEG Gas) – Under Section XV, the gas rate plan, NYSEG is allowed to defer incremental exogenous costs – a flood is an example of such

a cost listed in the JP associated with the rate plan. To not allow recovery of these costs from customers is an inappropriate reopening of the rate plan.

7. Environmental – SIR (NYSEG Electric, NYSEG Gas, RG&E Electric, RG&E Gas) – Staff, in a departure from Commission precedent, has proposed that both NYSEG and RG&E fully absorb the entire estimated remaining costs for environmental cleanup and site remediation associated with assets that have benefited customers through many years of service. Both NYSEG and RG&E have reflected on their books a regulatory asset that effectively matches the environmental and site remediation liabilities known by the Company. Under GAAP, the companies are required to recognize the liability, and the long standing regulatory practice of collecting those costs from customers over a period of time is enabled by the establishment of a regulatory asset for the expected costs. Deferral accounting for environmental costs is provided for on pages 55-57 of the NYSEG Electric Order in Case 05-E-1222, Section XV of the NYSEG Gas JP, Section XV of the RG&E Electric JP and Section XI of the RG&E Gas JP. As environmental costs are collected from customers, or as insurance proceeds or other proceeds from other responsible parties are collected, they are used to offset the environmental regulatory asset or to build up a reserve for environmental costs. It would be inappropriate for this long standing regulatory practice to be overturned at this time. This topic is discussed in more detail below under section III.C.2, "Other Concerns with Staff PBAs".

8. 2003 Ice Storm (RG&E Electric) – These types of restoration costs incurred due to major storm events and to restoring service to customers have traditionally been recoverable from ratepayers. Companies are strongly encouraged by the PSC to act with speed to get customers back on line expeditiously during and after a major storm event. On occasion, the restoration efforts required due to an extraordinary major storm turn out to cost significantly more than what is currently collected from customers in their rates. The long-standing practice of the Commission is to allow regulated companies to defer these excessive costs and recover them from customers over a future period. The 2003 ice storm that impacted the RG&E service territory was just such an extraordinary event. The Company appropriately petitioned the Commission in April 2003 to defer the restoration costs associated with that event. One of the Staff Policy witnesses in this instant proceeding is Mr. Thomas D'Ambrosia, who is also identified on page 2 of Staff witness Haslinger's testimony as the direct supervisor of Mr. Haslinger, specifically opined on the 2003 Ice Storm in a previous RG&E rate proceeding (03-E-0765). On page 69 of his testimony in case 03-E-0765, Mr.

D'Ambrosia describes the 2003 ice storm as "extraordinary" and further states "it is clear that the Commission could not have considered these costs in the 2003 Rate Order" and that "I recommend that the Commission allow RG&E to commence recovery of the $27 million of known 2003 storm costs". He goes on to state, on page 71, that "sound public policy would provide for recovery of storm restoration costs since prolonged storm related service disruptions have the potential for serious adverse impacts on the public ...Cost recovery concerns should not distract the utilities from the crucial task of service restoration." On these points, Mr. D'Ambrosia clearly reflects the long-standing Commission practices noted above, and RG&E should not now have to bear these costs.

9. Property Tax Deferral (RG&E Gas) – This item is identified by Staff on exhibit RPH-4 as an "Annual Compliance Filing Deferral". This deferral was established under the terms of a multi-year gas rate plan, approved by the Commission in May 2004, which allows the Company to defer property taxes incurred in the gas business that are over or under a threshold amount for each year of the rate plan, Section X of the Gas JP. The provisions of that PSC approved plan assume a 4% increase in property taxes from a base year amount that acts as the threshold for deferral. To not allow collection of these deferred property tax costs from customers is an inappropriate reopening of the rate plan.

10. Voice Your Choice O&E (RG&E Electric) - This item is identified by Staff on exhibit RPH-4 as an "Annual Compliance Filing Deferral". This deferral was established under the terms of a multi-year electric rate plan, approved by the Commission in May 2004, Section XV. The rate plan allows the Company to defer costs associated with outreach and education for the newly established commodity rate program to the extent they exceed a $2 million threshold over the five year term of the rate plan. To not allow collection of these deferred outreach and education costs from customers is an inappropriate reopening of the rate plan. This item will be further discussed in this testimony in section III.C.3 below, "Other Staff Issues".

11. Pipeline Integrity (RG&E Gas) - This item is identified by Staff on exhibit RPH-4 as an "Annual Compliance Filing Deferral". This deferral was established under the terms of a multi-year gas rate plan, approved by the Commission in May 2004, which allows the Company to defer the incremental costs associated with new regulatory mandates, Section XII. This was a new PSC mandate for which the Company incurred incremental costs and deferred those costs according to the terms of the RG&E Gas Rate Plan.

To not allow collection of these deferred costs from customers is an inappropriate reopening of the rate plan.

12. Variable Rate Debt (RG&E Gas) - This item is identified by Staff on exhibit RPH-4 as an "Annual Compliance Filing Deferral". This deferral was established under the terms of a multi-year gas rate plan, approved by the Commission in May 2004, which requires the Company to defer the costs associated with variable rate debt incurred for the gas business that are over or under a threshold amount for each year of the rate plan, Section X. To not allow collection of these deferred variable rate debt costs from customers is an inappropriate reopening of the rate plan.

13. Storm Reserve (NYSEG Electric, RG&E Electric) – Both NYSEG and RG&E follow a reserve accounting approach to Storm accounting, which has been approved by the PSC in company-specific proceedings, NYSEG Electric Order in Case 05-E-1222, pages 57-58 and the RG&E Electric JP, Section XI. NYSEG currently accrues approximately $7.5 million per year into a storm reserve account. RG&E currently accrues $2 million per year into a storm reserve account. When storms occur that meet the criteria established in each company's rate proceedings, the costs incurred by the Company to recover from the storm are taken from the reserve. To the extent that the reserve does not have a large enough balance to cover the recovery costs, the balance in that reserve account could become a debit (in which case, conceptually, those costs would be deferred). Mr. Benedict proposes, on page 22 of his testimony, that the electric storm reserve be increased by $50 million, representing his estimate of under funding of about $10 million per year for five years. Mr. Haslinger proposes, on page 35 of his testimony, that the RG&E Storm reserve be increased by $10 million to pre-fund future storm costs. As noted in a previous item in this section of testimony, the previous methodology that a company would follow would have been to defer those storm costs and collect them from customers over a future period. The change to reserve accounting should not in any way change the long standing Commission practice to allow companies to recover costs of storms not already covered in rates. This proposed treatment, whereby the companies are asked to fund storm costs that have not even been incurred is unprecedented and inappropriate.

14. OPEB Top-Off to ASGA (NYSEG Electric) – Mr. Benedict, on page 23 of his testimony, suggests that this instant proceeding triggers a requirement in the Joint Proposal in Case No. 06-M-1413. He correctly states that one of the terms in that Joint Proposal require that if electric rates were reset or

superseded prior to 2010, an amount would be added to the ASGA. He also concludes that "the company's petition in this proceeding creates the need for the Commission to consider the level of NYSEG's electric rates". Mr. Benedict has clearly rushed to a conclusion that is not by any means inevitable. The company's petition in this proceeding clearly does not ask for or indicate that NYSEG electric rates be reset or superseded. The plain language of the Joint Proposal in Case No. 06-M-1413 is simply interpreted – to the extent that NYSEG electric rates are not superseded by the company's instant proposal, there would be no requirement to top off the ASGA. Since the company has not proposed nor does the company expect any change in NYSEG electric rates at this time, this item should be rejected.

15. Stray Voltage (NYSEG Electric) – Mr. Benedict, on page 22 of his testimony, proposes that NYSEG set up a reserve for stray voltage costs that could be incurred over the amount allowed in rates. The requirements associated with implementing the terms of the newly mandated stray voltage program required by the Commission were clearly treated as a deferrable item under the terms of the last NYSEG Electric Order on pages 58-59. In the last NYSEG Electric Case, 05-E-1222, the PSC established reserve accounting for Stray voltage costs similar to what it established for Storm costs, and allowed that approximately $5 million per year would be accrued to a reserve for this item. The PSC-initiated and approved change to reserve accounting for Stray Voltage should not in any way change the long standing Commission practice to allow companies to recover costs of mandates not covered in rates. This proposed treatment, whereby NYSEG is being asked to fund stray voltage costs that have not even been incurred is unprecedented and inappropriate.

16. Saranac IPP Cost (NYSEG Electric) – In perhaps the most egregious example of an attempt to reverse current and long-standing Commission practice and policy, Mr. Benedict, on pages 23 and 24 of his testimony, has proposed that NYSEG absorb the over-market costs associated with an Independent Power Producer ("IPP") contract during 2009. The Commission championed a complete restructuring of the electric industry during the last two decades, including the strong backing of IPPs as a source of electricity. Many companies, including NYSEG, were ordered to enter into long term supply contracts with IPPs, even though prices paid under those contracts were higher than market prices. Certainly, the Commission likely believed the greater good was being accomplished by the existence of these contracts, and to back up that belief, the costs associated with these contracts were fully the responsibility of ratepayers. Now, the Staff of the Commission is suggesting that NYSEG be burdened with the over-market costs of a contract that the

company was required to enter into by the Commission. This would clearly be inappropriate and should be disregarded.

17. Nine Mile 2 Sale (RG&E Electric) – This is one of two items that Mr. Haslinger proposes that are related to sales of generating assets by RG&E. He notes this on page 35 of his testimony. Mr. Haslinger correctly notes that RG&E had deferred losses associated with the sale of its ownership interest in the Nine Mile 2 nuclear plant. What he failed to identify in his testimony is the fact that the PSC strongly encouraged divestiture of generating facilities, with an understanding that sales of these assets could result in either gains or losses to the selling companies. With respect to Nine Mile 2, RG&E actually had exercised its right of first refusal to purchase Nine Mile 2 under terms and conditions of a proposed sale of that plant to a third party (AmerGen). This exercise of rights, while never consummated, caused all parties, including the PSC Staff, to move away from supporting the AmerGen deal, and a new auction of the Nine Mile 2 (and Nine Mile 1) plants ended up benefiting New York State ratepayers by several hundred million dollars (vs. the AmerGen proposed deal). RG&E's role in helping to produce this significant New York State ratepayer benefit was testified to by Mr. D'Ambrosia in the 2003 RG&E rate case (03-E-0765). On page 92 of his testimony in case 03-E-0765, Mr. D'Ambrosia states "RG&E's management's actions in exercising its right of first refusal ignited the process in which all the NM#2 owners (NYSEG and RG&E, et. al.) realized substantially higher auction proceeds than they would have had NYSEG's original proposal gone forward." He goes on to state, on page 93, that "I estimate that because of RG&E's actions, RG&E and NYSEG received $77 million and $100 million more, respectively in gross auction proceeds than they would have". The PSC, as part of its October 26, 2001 order authorizing the Nine Mile 2 sale, already required that RG&E write off $20 million as a condition of the sale, with the remainder of the book value not covered by sales proceeds set up as a regulatory asset. In a separate RG&E proceeding, Case 02-E-0198, Mr. D'Ambrosia testified, on page 72 of his testimony, that "RG&E has requested recovery of a significant amount of costs which were deferred during the term of the COB2 Rate Plan. Amounts included in this rate filing that were deferred include: Nine Mile #2 $282 million, Oswego #6 $63 million, and Kamine IPP buyout costs $105 million." He further states on the same page that "The Commission has approved RG&E's request to defer and recover the above costs". Given all of the evidence noted above and the previous Commission actions with respect to this item, to not allow collection of these deferred costs from customers is inappropriate.

18. Nine Mile 2 Mirror CWIP (RG&E Electric) – Although described on page 35 of his testimony by Mr. Haslinger as an amount associated with RG&E losses associated with the sale of generation plants, this item long pre-dated the sale of the Nine Mile 2 plant and when established clearly contemplated the ownership of the plant through its licensed period. Because of significant construction costs, the PSC wanted the companies involved in Nine Mile 2 to stop accruing AFDC on the Construction Work-in-Progress balance. The companies instead booked a Regulatory Asset and a Regulatory Liability of equal amounts that represented the AFDC amount that would have been accrued over a designated period. After the plant went into service, the regulatory liability was used as a rate moderator by the PSC over a few years until its balance went to $0 and the regulatory asset was deemed recoverable over the remaining license life of the Nine Mile 2 plant at the time, through November 2026. Neither the company nor the ratepayers should be benefited or harmed from this series of actions by the Commission. Ratepayers have already received the benefit of reduced rates from the use of the regulatory liability as a rate moderator, and the recovery of the remaining regulatory liability over the PSC approved period ending November 2026 should continue.

19. Oswego 6 Sale (RG&E Electric) - This is second of two items that Mr. Haslinger proposes that are related to sales of generating assets by RG&E. He notes this on page 35 of his testimony. Mr. Haslinger correctly notes that RG&E had deferred losses associated with the sale of its ownership interest in the Oswego 6 generating plant. Again, he failed to recognize that the PSC strongly encouraged divestiture of generating facilities with an understanding that sales of these assets could result in either gains or losses to the selling companies. Under the guidance of the PSC, RG&E divested its 24% ownership share of the Oswego plant when Niagara Mohawk sold its 76% share. It would not have been feasible for the plant to sell had RG&E retained its share. In a separate RG&E proceeding, Case 02-E-0198, Mr. D'Ambrosia testified, on page 72 of his testimony, that "RG&E has requested recovery of a significant amount of costs which were deferred during the term of the COB2 Rate Plan. Amounts included in this rate filing that were deferred include: Nine Mile #2 $282 million, Oswego #6 $63 million, and Kamine IPP buyout costs $105 million." He further states on the same page that "The Commission has approved RG&E's request to defer and recover the above costs". Lastly, in the Joint Proposal associated with RG&E Case 03-E-0765, section XV.2.c clearly states "The outstanding petition in Case 96-E-0898 associated with RG&E's deferral of the net costs and loss associated with the Oswego Unit 6 sale is resolved". Given the evidence noted above and the

previous Commission actions with respect to this item, to not allow collection of these deferred costs from customers is inappropriate.

20. Allegheny Buyout (RG&E Electric) – Mr. Haslinger, on page 35 of his testimony,correct ly identifies this item as related to the buyout of a Non-Utility Generator purchase power contract. Under the now infamous "6 cent law" an entity chose to build this gas-fired generating plant at a cost per MW capacity far higher than current market prices could support, and RG&E was required to enter into a purchase power contract with that entity. When the entity went bankrupt, RG&E was ordered by the Commission to buy the plant at a price in excess of $100 million, while at the same time told it could only put $15 million of the purchase price on its books as a capital investment (an approximation of the "true" market value for the plant). See Case 96-E-0898, Order and Decision (August 31, 1998). The remaining price paid by RG&E was placed on its books as a regulatory asset. This cost related to state policy/practice ordered by the Commission should not have to be borne by the Company. To not allow collection of these deferred costs from customers is inappropriate.

21. Russell and Beebee Decommissioning (RG&E Electric) – Mr. Haslinger states, starting on page 35, that these amounts are to fund future decommissioning costs of retired RG&E generation plants. Based on long-standing Commission practice and policy, there is no reason that customers should ever be relieved of their obligation to fund the decommissioning of plants which provide many decades of service and low priced power to them. With respect to Beebee decommissioning, RG&E is accounting pursuant to an Order in Case 02-E-0198. Ordering paragraph 9 of the March 7, 2003 order in that case states "Rochester Gas & Electric shall accrue $2 million annually to fund the decommissioning of Beebee Station." The text of the Order notes, on page 20 that "RG&E argues that it is unreasonable to ignore the fact that the facility will inevitably be decommissioned" and goes on to conclude that "We also find the Beebee decommissioning fund reasonable…and such a fund should be accumulated in advance to avoid an undue rate impact later." With respect to Russell decommissioning, the current RG&E rate plan joint proposal clearly contemplated that customers would be responsible for the costs of decommissioning the facility. For example, Section V.4.b.iv states "any costs related to Russell continuing after its retirement (property taxes, residual O&M, **decommissioning** [emphasis added] and remediation) will continue to be recovered through the NBC". To not allow collection of these decommissioning costs from customers is inappropriate and contrary to Commission orders.

RATE ADJUSTMENTS PANEL

Q. Are there any additional problems with some of the PBAs discussed above?

A. Yes, we discuss below more detailed issues associated with the RG&E Voice Your Choice.

2. Environmental Reserve Increases

a. General Background

Q. Referring to Exhibit ___ (JB-4), the Staff's PBA for environmental is called a "Regulatory Asset Cost Elimination". On Exhibit ___ (RPH-4), the corresponding PBA is referred to as a contribution to an "Operating Reserve". Is there any practical difference between the two terminologies?

A. No. Regardless of which term is used, the effect of the imputed pre-funding by the Companies would be a charge to Income with a corresponding amount reserved on the Balance Sheet to cover the future cost for the remediation of existing environmental liabilities.

Q. Please briefly explain how environmental costs are accounted for at RG&E and NYSEG?

A. The basic accounting is as follows:

1. The estimated potential cost of known environmental liabilities is credited to a liability.
2. A corresponding amount is debited to a regulatory asset consistent with long-standing Commission direction.
3. As funds are received from customers, insurance companies or other responsible parties, they are credited to the regulatory asset.

4. As the environmental remediation work is performed, the liability is reduced.

   Based on this accounting, at any point in time, the balance in the environmental regulatory asset shows the remaining amount that needs to be recovered from customers, insurance companies or other responsible parties and the balance in the environmental liability shows the remaining amount of environmental work that needs to be performed. Ultimately, the regulatory asset will go to zero as funds are received and the environmental liability will go to zero as the environmental work is performed. In the meantime, since the timing of the receipts and outlays may differ, there may be a net debit or credit balance between the environmental regulatory asset and liability. The net difference constitutes the Environmental Reserve.

5. To recognize the time value of money, it is customary that either interest be accrued on the (net-of-tax) difference between balances in the environmental regulatory asset and liabilities or that the (net-of-tax) difference between the asset and liability be added to, or deducted from, rate base.

These steps provide a basic outline of how environmental costs are accounted for at NYSEG and RG&E. While the actual accounting includes more steps and involves a number of asset and liability accounts, the net effect is as described.

Q. What are the sources of funding for environmental remediation?

A. There are three sources of funding for environmental remediation:

1. Retail rates,
2. Insurance company proceeds and
3. Other responsible parties.

Q. Does reserve accounting differ materially from the accounting described above?

A. No. The same effect is achieved. While reserve accounting might involve the use of different income or balance sheet accounts, the bottom-line on the income statement remains the same and the net effect on the balance sheet remains the same.

b. Rate Recovery from November, 2007 through December, 2008

Q. Referring to Exhibit __ (RPH-4), please explain what the environmental PBA adjustments, in the amounts of $36.738 million Electric & $15.745 million Gas, represent.

A. The sum of those adjustments is equal to the remaining $52.483 million balance in the regulatory asset that is on RG&E's books at November 30, 2007.

Q. To the extent that it was proper to require the Companies to pre-fund the environmental clean-up costs, are those the correct amounts to require RG&E to add to the Environmental Reserve on December 31, 2007, as suggested by Exhibit ___ (RPH-4)?

A. No. Staff has not recognized the fact that the current RG&E Rate Plans provide for $1,400,000 Electric and $600,000 Gas to be added to the Environmental Reserve annually. Accordingly, an additional $2.167 million will be added to the Environmental Reserve between November, 2007 and December, 2008, reducing the regulatory asset by a corresponding amount.

Q. Referring to Exhibit ___ (JB-4), please explain the source of the Regulatory Asset Cost Eliminations for Environmental - SIRC, in the amounts of $88.906 million Electric & $23.491 million Gas.

A. At page 22, lines 1 through 4 of his testimony, Mr. Benedict states that those amounts, are "the allocated amounts of the deferred environmental clean up expense balance at November 2007".

Q. To the extent that it were proper to require the Companies to pre-fund the environmental clean-up costs, are those the correct amounts to require NYSEG to add to the Environmental Reserve on December 31, 2008, as suggested by Exhibit ___ (JB-4)?

A. No. Similar to RG&E, the current NYSEG Electric Rate Order provides for $3.5 million and the current NYSEG Gas Rate Plan provides for $1.25 million to be added to the environmental reserve annually. Accordingly, an additional $5.146 million will be added to the environmental reserve between November, 2007 and December, 2008, reducing the regulatory asset by a corresponding amount.

c. **Rate Base Treatment**

Q. Did Staff reduce rate base by the amount of the imputed environmental PBAs?

A. Yes. Of course, because Staff has failed to justify the appropriateness of the PBAs, reducing rate base by the amount of the imputed environmental PBAs is inappropriate and should be rejected.

Q. Has this panel commented on the rate base treatment of the imputed Environmental PBAs?

A. Yes. In section III, C.5 we discuss the rate base treatment of all of Staff's PBAs.

3. **Outreach and Education – RG&E Voice Your Choice**

Q. Do you take issue with Staff witness Haslinger's proposal to adjust as a PBA the outreach and education ("O&E") costs associated with RG&E's Voice Your Choice ("VYC") program?

A. Yes. As discussed earlier in this testimony, the Company takes issue with each and every one of the Staff proposed PBAs. With respect to this item, the current RG&E Electric Rate Plan allows the Company to defer Voice Your Choice related O&E over a $2 million base amount.

Q. What is Staff's basic argument with respect to this issue?

A. Staff's basic argument, from page 21 of Mr. Haslinger's testimony, is that the $2 million identified in the RG&E Electric Rate Plan Joint Proposal represents the amount "expected to spend over the entire five year term". He continues on page 22 to state "The $2 million was a guideline for reasonable "required" outreach and education over the five year period of this agreement".

Q. Is there any indication in the Joint Proposal or the PSC Order associated with the RG&E Electric Case 03-E-0765 that the $2 million was a five year guideline or the expected amount to be spent over five years?

A. No. In fact, the Joint Proposal clearly anticipate that spending could exceed the $2 million amount, referencing section XV.3.e.iii, "To the extent that RG&E is required to spend more than $2 million for this purpose, RG&E may defer those incremental costs for future recovery". Appendix N of the Joint Proposal describes the mutually agreed upon approach to O&E for the VYC program.

Q. Was Staff involved in the development of Appendix N?

A. Yes.

Q. What are the main O&E activities identified in Appendix N that RG&E was required to do?

A. Required VYC O&E activities identified in Appendix N include:

1. Provision of information through the Call Center
2. Provision of information through the integrated voice response system
3. Inclusion of information on bill inserts and in bill messages
4. Update of the Company website to include enrollment via the web
5. Radio, newspaper and television media campaigns
6. Community events
7. Direct mail distribution of enrollment kits and enrollment confirmations
8. Conduct of customer surveys
9. Special messaging for certain customer groups (Seniors, Low Income, Retail Access participants, Commercial and Industrial customers)
10. Meetings with suppliers
11. Employee training
12. Meetings with community leaders

RATE ADJUSTMENTS PANEL

Q. Did RG&E work closely with Staff and other parties in the development of the annual enrollment kits and O&E plans?

A. Yes. Numerous meetings were held annually with PSC Staff as well as other parties to review the O&E efforts. During the first three years of the program, the Company worked closely with Staff from the Office of Retail Market Development and conducted several collaborative meetings to develop, review and discuss the O&E materials. Drafts of the enrollment kits were circulated, discussed and revised based on input from Staff and other parties in the meetings. Copies of all O&E materials, including television ads, radio ads, print ads, billboards, bill messages, bill envelopes, bill inserts, internet pages, outbound calling scripts, and IVR scripts were circulated to Staff and other parties before going into production. Because the Office of Retail Market Development was disbanded in early 2007, the Company made the Staff of the Office of Consumer Services aware of the O&E activities for the fourth year of the program.

Q. Did RG&E provide annual reports to Staff of the O&E activities taken following the completion of each enrollment period?

A. Yes.

Q. Did you receive any indication before Mr. Haslinger's testimony in this instant proceeding that Staff was not satisfied with the level of the Company's VYC O&E efforts?

A. No. In fact, it was just the opposite. Many positive comments were received from Staff regarding the O&E materials and efforts.

Q. Were there any other goals of the O&E program that should be discussed?

A. The Staff and the Commission expressed on numerous occasions that there was a strong desire to see migration of customers to non-regulated Energy Services Companies (ESCOs). For example, in Appendix N to the Joint Proposal, the first objective of the program is listed as "(To) educate customers that they may choose a supplier other than RG&E and that customers may purchase their supply separate from their delivery". In the PSC order associated with Case No. 03-E-0765, the Commission stated on page 37 "our competitive goals include … the development and facilitation of business relationships between utilities and ESCOs, and the fostering of retail access".

Q. In meeting the requirements delineated in Appendix N to the Joint Proposal, is it by any stretch of the imagination reasonable to conclude that $2 million would have been an adequate amount to cover five years' worth of related O&E expenditures?

A. No. Keep in mind that RG&E electric customers number approximately 350,000, and each one required multiple contacts for each year of the program. For the first four years of the VYC program, the costs of the production of the enrollment kits, the direct mailings, and the confirmation letters to customers approximated $2.7 million, with one additional year to go in the rate plan. The required media spending on radio, newspaper and television over the first four years was approximately $1.8 million. Additional costs to update the website and IVR system, conduct community outreach, conduct customer surveys, and attend to other requirements listed in Appendix N, while still trying to support the overall goals and objectives of the program contributed to the deferral that exists on the RG&E books today. It is beyond reason to assume that the intent of the $2 million amount was to cover all required costs for five years.

Q. Was the program successful with respect to the number one objective of fostering retail access?

A. Without any doubt. The awareness that was created in the customer community through this VYC O&E effort has resulted in an increase of nearly 40,000 RG&E customers being served by ESCOs, more than doubling the pre-program level. The overall load serviced by ESCOs as of the end of 2007 is nearly 50%, significantly above the pre-program levels.

Q. What can you conclude with respect to the VYC O&E program costs?

A. We conclude that they were reasonable given the size of the RG&E customer population, were reasonable given the requirements delineated in Appendix N of the RG&E rate plan joint proposal, were appropriately deferred under the terms of the RG&E rate plan, and were successful in accomplishing stated Commission goals. We therefore completely disagree with the Staff proposal that they be written off and absorbed by the Company at this time. Additionally, any O&E

costs associated with the VYC program going forward should be appropriately deferred under the terms of the rate plan.

4. **Staff's Additional One Time Adjustments**

Q. Can you please describe each of the Staff proposed additional one-time adjustments and the reasons why this panel finds them unacceptable and inappropriate?

A. Yes. The following is a description of additional one-time adjustments in the order depicted on Exhibit (RAP-2), and the reasons why this panel finds them inappropriate and unacceptable.

1. Capitalized Software (NYSEG Electric, NYSEG Gas) - Staff has proposed that both companies write off certain capitalized software investments. Mr. Benedict, starting on page 17, suggests that NYSEG Gas should be required to write off certain software investments allocated to the gas business that were ordered to be written off in the last NYSEG electric case. While the Company still maintains that the investments made in the IBO and WMS systems were valid, the Company also recognizes the Commission decision made in the NYSEG Electric case, although no such requirement was ordered for NYSEG Gas. The effect of applying that same decision to the NYSEG Gas business (whose current rate plan extends to the end of 2008 and is subject to continuation) is nearly moot, considering that the investments in those specific systems will nearly be fully depreciated by the end of the gas rate plan, and either one of these projects was in service or reflected in the current NYSEG Gas Rate Plans and therefore should not be considered here. Mr. Benedict goes further to suggest that NYSEG Electric and Gas should be forced to write off the software investment in a new Customer Care System ("CCS"). This issue was resolved in the last NYSEG electric rate case. It appears that the PSC Staff does not want to acknowledge this most recent PSC Order and intends on relitigating the issue. Mr. Benedict's untimely argument that the customers have paid for the cost of a new system twice is groundless. Any adjustment should be disregarded.

2. Capitalized Software (RG&E Electric, RG&E Gas) – Mr. Haslinger, on page 31, states that in the latest NYSEG rate case, the Commission has deemed the capitalized software a Cost-to-Achieve item. He concludes that it would be appropriate to treat RG&E's capitalized software in a similar fashion. Mr. Haslinger fails to distinguish between the types of software that the Commission addressed in the NYSEG Electric case, thereby failing to factor in the full Commission decision, particularly with respect to the CCS investment made at RG&E. Additionally, RG&E has a long history of capitalizing software investments, and those investments have always been accepted by the PSC. The adjustment proposed by Mr. Haslinger would represent a complete turnaround from RG&E history on this subject and should be ignored. This topic is more fully discussed in section III.F.4 of this rebuttal.

3. ASGA Adjustments – ACF (NYSEG Electric) – Mr. Benedict includes an Exhibit JB-7, which depicts an annual list of adjustments he proposes be made to the ASGA. While he spends several pages of testimony (page 8 and pages 36-40) on this topic, very little information is provided beyond the total amounts shown on Exhibit JB-7. NYSEG supports the annual compliance filings that it has made, and would expect that any adjustment proposed by Staff would be afforded the highest degree of scrutiny once relevant information is provided. Since that information has not been provided, it would be premature at best and inappropriate to consider any adjustments to the ASGA. As noted elsewhere in this rebuttal, the timeliness of Staff audits and reactions to the Company's compliance filings are problematic and should be addressed by the Commission in a separate proceeding.

5. **<u>Additions to Reserves</u>**

Q. Please quantify the amount that the Companies would be required to add to reserves based on Staff's proposed PBAs.

A. As shown on Exhibit RRP-2, $311.407 million of the PBAs proposed by Staff are to fund reserves.

Q. What is the source of the amounts on Exhibit __ (RAP-2)?

A. Staff Exhibit __ (JB-4) and Exhibit __ (RPH-4).

RATE ADJUSTMENTS PANEL

Q. How did Staff treat the $311.407 million of PBA Company contributions to the reserves in its calculation of the revenue requirement on its Exhibits?

A. As shown on Exhibits __ (JB-3) and (RPH-3), Staff reduced rate base by $305.990 million of the proposed Company contributions ($184.772 million, net of tax). According to Staff, the remaining $5.417 million is to be added to the Asset Sale Gain Account where it would accrue interest.

Q. To the extent that it would be appropriate to require Company-contributed capital to be used to fund reserves, would it be equitable to reduce rate base, as Staff did in its calculation of the revenue requirement?

A. No.

Q. When would it be equitable to reduce rate base by, or require that interest be accrued on, the amounts in a reserves?

A. It is normal and equitable to reduce rate base by the amount of <u>customer</u>-contributed capital that is in the reserves so that the customers receive the time-value of their contributions until the reserves are used to fund the cost for which it was intended. Alternatively, interest could be accrued on the customer-contributed capital in the reserve.

Q. When is it <u>NOT</u> equitable to reduce rate base by,or require t hat interest be accrued on, the amounts added to reserves?

A. It is not equitable to reduce rate base by, or to require that interest be accrued on, <u>Company</u>-contributed capital. Such actions would result in a back-door way of extracting even more from shareholders than was intended by the PBAs.

Q. What other reason can you give for why the Company-contributed PBA additions to the Reserves should not be used as rate base reductions?

A. The compelling argument against reducing rate base by any PBA reserve contributions made by the Companies is that the shareholders should not be penalized by having to pay for a return on their own contributions. In addition, such rate base reductions would assume that none of the Company-funded reserves would be used for their intended purposes. Indeed, for many of the reserves, that would not be correct. The Companies are spending millions annually for Environmental remediation alone and a significant amount of money is also spent on Stray Voltage. Furthermore, if Staff believes that it is necessary to add more to the storm reserves, then it is reasonable to assume, for revenue requirement purposes, that part of the Company-contributed capital in the storm reserve will be spent. Finally, amounts will definitely be spent for decommissioning at either Beebee or Russell Stations.

Q. What adjustment should be made to the Staff rate bases to address this issue?

A. First, we disagree with all of Staff's PBA imputations and they should be rejected. However, to the extent that they are considered at all, at a minimum, the reductions to the rate bases that Staff made for Company-funding of the reserves should be reversed. The rate base adjustments for all of the reserve items are set forth on Exhibit __ (RAP-7). That Exhibit also includes the corresponding deferred tax offset calculated at 39.615% of the reserve amounts.

Q. Please summarize your testimony concerning the PBAs and other one-time adjustments that Staff has proposed in connection with approval of the acquisition?

A. As discussed by other panels, we disagree with the need to create PBAs in the context of this merger proceeding. To the extent the Commission considers any of the Staff PBA proposals, such proposals must ultimately be rejected because as we have demonstrated above Staff's PBAs are expressly contrary to existing Commission precedent and/or the terms of currently-effective rate plans and orders.

IV. RESPONSE TO STAFF'S RATE PLAN TESTIMONY

Q. Are Staff's rate proposals appropriate and equitable given NYSEG's and RG&E's existing rate plans and orders?

A. No. As an initial matter, as we discussed above, it is not appropriate for the Staff to introduce, in piecemeal fashion, downward adjustments to rates in a Section 70 proceeding to consider the approval of this transaction. By responding here on the merits of Staff's proposals, we do not concede that Staff's testimony has any relevance to the issues in this proceeding or that, even if such issues were relevant, it is inappropriate to selectively introduce them here. Nonetheless, because Staff has raised these issues in testimony,we are required to respond, and we explain below that Staff's proposal should be rejected because the existing rates for NYSEG and RG&E were established either under Joint Proposals (NYSEG Gas, RG&E Electric, RG&E Gas) or a one year rate order (NYSEG Electric). Staff's proposal to significantly modify these existing rate plans and orders is inappropriate outside the context of a litigated rate case and review of rate-case quality information. While Staff proposes to modify the gas and electric rates for NYSEG and RG&E, they have made no attempt to comply with the Commission's usual procedures for considering rate changes, including complying with the requirements of the <u>Statement of Policy on Test Periods in Major Rate Proceedings (November 23, 1977) which sets forth the basic ground rules for information to be provided in rate case proceedings.</u> NYSEG's electric rates were set after an intense eleven month litigated cost of service rate case. In that rate case, all financial issues were closely scrutinized and vigorously litigated and NYSEG's existing rates remain in place until NYSEG files for a new rate case. NYSEG Gas, RG&E Electric and RG&E Gas rates are governed by multi-year rate plans. We do not believe that it is appropriate or realistic to seek to modify NYSEG's and RG&E's existing rate plans and orders or impose drastic write-offs and rate reductions in the context of the merger proceeding. Furthermore, as one would expect, shareholder write-offs of legitimate assets and shareholder funding of reserve increases artificially reduce the cost to serve customers at shareholder expense. Shifting this financial burden to shareholders distorts existing rates and return levels, and using such one-time charges to create long term impacts through increased earnings sharing or rate reductions is clearly inappropriate.

Q. If not appropriately addressed in the context of the merger proceeding, where would any rate issues be addressed?

A. To the extent that Staff believes that adjustments to the existing rate plans or rates of the New York utilities are required, such rate-related issues should be addressed in a later proceeding. The outcome of such dedicated, separate rate case proceedings, however, should not be pre-determined by this merger proceeding but should be assessed at a later date under applicable Commission precedents and policies.

A. <u>NYSEG Electric Rates</u>

Q. Does NYSEG's Electric Business operate under a rate plan?

A. No. NYSEG's electric rates were established in Case No. 05-E-1222 for the rate year 2007. That case was a traditional cost of service rate case. There are no rate plan provisions since rates were not set for a multi-year period. All financial and policy issues were fully litigated and NYSEG electric rates will remain in place until the Company files for a new rate case and new rates are approved by the Commission. As discussed later in this testimony, Staff's proposal to require multi-year rate plan provisions in this case is inappropriate and unwarranted.

NYSEG's electric business just completed its first year of operations under new rates. Furthermore a full cost of service and financial analysis is necessary before the rate of any utility can be reset.

Q. Do the delivery rates for NYSEG Electric remain in place beyond 2007?

A. Yes.

Q. What are the Staff's proposed NYSEG Electric rate plan provisions?

A. On pages 24 – 26, Staff has proposed three rate plan provisions for NYSEG electric that would: (1) implement a revenue decoupling mechanism; (2) implement uncontrollable cost provisions similar to NYSEG Gas, but with thresholds modified to be equal to 50 basis points or $4.1 million; and (3) implement an ESM over 9.0% ROE where sharing is capped at an 11.00% ROE. As discussed later in this testimony, the implementation of the rate plan provisions in this merger proceeding is neither just nor reasonable.

B. <u>NYSEG Gas</u>

Q. Has Staff appropriately characterized and reviewed the NYSEG Gas Rate Plan?

A. No. Mr. Benedict provides a cursory overview of a detailed NYSEG Gas Joint Proposal. The NYSEG Gas Joint Proposal ("JP") contains thirty-one sections and nine appendices covering numerous topics. The Gas JP was signed by 15 parties, including Staff, CPB, MI and numerous marketers, and Mr. Benedict was on the Staff team that negotiated and executed the JP.

Q. What is the term of the NYSEG Gas JP?

RATE ADJUSTMENTS PANEL

A. Section VI (Term) provides that the Phase 1 provisions (as delineated in Section IIII) became effective on October 1, 2002 and continue for a term of six years, three months through December 31, 2008. The Phase 2 provisions became effective July 1, 2004 and unless otherwise provided, also continue through December 31, 2008.

Q. Does the NYSEG Gas JP contain language regarding the continuation of the plan beyond December 31, 2008?

A. Yes. Section VI.(2) states that all Gas Rate Plan provisions shall continue beyond December 31, 2008 unless or until a new gas rate plan has been approved by the Commission.

Q. Does the NYSEG Gas Rate JP contain any provision regarding future mergers?

A. Yes. Section XXXI (4) addresses mergers and acquisitions. The provision states that in the event of a merger which is subject to a Petition filed jointly or individually by NYSEG, RG&E, RGS or Energy East, the terms of the NYSEG Gas Rate Plan will survive any such merger. The provision goes on to state that any Commission proceeding addressing such merger will establish the conditions of such merger and may include the disposition of incremental net synergy savings to the extent there are any savings.

Q. Does Mr. Benedict's proposal violate Section XXXI (4) of the NYSEG Gas JP?

A. Yes, it does violate the term of the JP by requiring fundamental changes to the rate plan that are unrelated to incremental net synergy savings.

C. **<u>RG&E Rate Plans</u>**

Q. Has Staff appropriately described the RG&E Gas and Electric Rate Plans?

A. No. Mr. Haslinger presents only a brief overview of RG&E's Gas and Electric Joint Proposals. The RG&E Gas JP includes twenty-two multi-part provisions and eight appendices, and was agreed to by six parties. The RG&E Electric JP contains 22 multi-part provisions and 15 appendices, and was agreed to by eight parties.

Q. What are the terms of the RG&E Gas and Electric JPs?

A. Section III (Term) of both JPs provides that, except as otherwise noted, the provisions of the JP become effective January 1, 2004, and continue for a term of five years through December 31, 2008.

Q. Do the RG&E Gas and Electric JPs address continuation of the rate plan beyond December 31, 2008?

A. Yes. Under Section III (4) of both JPs RG&E may, after consultation with Staff, submit a filing by February 1, 2008, to continue the Gas and/or Electric JP beyond 2008.

Q. Does RG&E plan to make a filing to continue the Gas and Electric JPs?

A. Yes. RG&E has consulted with Staff and plans to file for a continuation of the Gas and Electric JPs on February 1, 2008.

Q. Do the RG&E Gas and Electric JPs contain any provisions regarding future mergers?

A. Yes. As with the NYSEG Gas JP, the RG&E Gas and Electric JPs include a provision (Section XXII (3)) that states that in the event of a merger or acquisition by RG&E, RGS Energy Group, Inc., or Energy East, the terms of the JP will survive any merger or acquisition. The provision also notes that the disposition of any "incremental net synergy savings" from such a transaction will be determined in the Commission proceeding addressing that transaction.

Q. In light of the NYSEG Gas JP, the RG&E Gas JP and the RG&E Electric JP, are Staff's rate and accounting proposals appropriate?

A. No. Staff seeks to modify fundamental terms of the three JPs unilaterally. Thes e JPs were the result of extensive negotiations among a large and diverse group of parties and reflect settlement on a wide range of issues. Staff now proposes to unilaterally make significant changes to certain terms of the JPs – all of which would shift costs to shareholders and have an adverse financial impact on the companies. Under the provisions of each JP, the JP survives any subsequent merger or acquisition of Energy East. The Commission should not consider, in isolation and without rate-case quality information, any isolated modifications to the JPs as proposed by Staff. Considering Staff's proposal, outside of the context of a full rate proceeding,would unilateral ly modify settlements reached by a variety of parties on a host of issues and further undermines the settlement process.

D. **Staff's Audits of Annual Compliance Filings**

Q. Has either NYSEG or RG&E received audit reports about Staff's audit efforts related to the annual compliance filings ("ACFs") filed under the two companies' most recent rate plans?

A. Neither company has received any formal audit reports related to any of their ACFs for the periods noted below. Despite the requirement that ACFs be made annually, Staff has apparently treated inappropriately such annual filings as multi-year filings to artificially build up an IOU to the customer and potentially have the Company accrue multiple years of charges and interest long after the final year of a rate plan is completed. Staff should be directed to review these annual compliance filings in a timely manner.

Q. How many ACFs have the companies made for which no formal feedback has been received?

A. NYSEG Electric has made five such filings for years 2002 through 2006, NYSEG Gas has made four such filings for years 2003 through 2006, RG&E Electric has made three such filings for years 2004 through 2006, and RG&E Gas has made three such filings for years 2004 through 2006. In addition, NYSEG Gas, RG&E

Electric and RG&E Gas will make an additional annual filing for 2007 within the next few weeks. Once those filings are made, there will be 18 NYSEG and/or RG&E ACFs outstanding at the Commission.

Q. What reasons has Staff indicated for not providing feedback?

A. Mr. Benedict notes in his testimony on page 38 that the reason is "Staff has not formally presented its findings on NYSEG's electric rate plan ACFs to NYSEG or the Commission because the ACFs were not completed at the time of NYSEG's last rate case, nor have they been completed at this time". Mr. Benedict does not specifically provide a reason for no feedback on the NYSEG Gas ACFs. Mr. Haslinger notes his reason, covering both RG&E Electric and RG&E Gas, on page 12 of his testimony, that "Given the rate plans are on-going and the pattern of annual revisions to prior year's filings, Staff's audits are ongoing".

Q. Do these reasons comport with past practice of the Commission Staff?

A. No. For example, with respect to the RG&E rate plan that was effective during the period 1997 to 2002, Staff provided both the Company and the Commission with reports associated with RG&E's annual compliance filings long before the conclusion of the rate plan, even though that plan had a true five- year earnings calculation compared to the five, one-year calculations in the current rate plan.

Q. Why is it beneficial to have information related to Staff's audit findings associated with annual compliance filings on a timely basis?

A. As discussed at length in the last NYSEG Electric proceeding, Case No. 05-E-1222, the companies are required to set aside amounts for ratepayers in the event of earnings sharing mechanisms being triggered. By raising issues more contemporaneously, the Company and Staff would have an opportunity to work out differences so that the amount associated with such an issue might not grow disproportionately. In addition, any necessary changes in method or approach could be incorporated in the next year's filing.

Q. Staff has argued that one primary reason no audit information is provided is the companies' tendency to update prior year filings. Does this seem reasonable?

A. No. It is important to update prior year information, especially when earnings sharing thresholds are involved, to assure that the proper amounts are set aside for customers or the proper amount of deferrals are reversed. Given the complexities involved in many areas of finance and accounting, it should be expected that prior year adjustments might take place. Staff even indicates that one very common prior year adjustment deals with truing up actual filed income tax data with estimated year-end data reflected in the ACFs (Staff witness Benedict page 38).

Q. Do external auditors typically audit financial records even if those records are subject to update or completion?

A. Absolutely yes. Many external financial auditors will begin year-end audit efforts long before the end of a fiscal year, and only subsequently audit changes to estimates or expected results after the end of the fiscal year. This makes the audit process less intense, and also provides the Company with early indications of issues that can be addressed before the end of a fiscal period. Additionally, every external financial auditor clearly understands that income tax estimates reflected on a company's books at the end of a fiscal year may change when more detailed work is done in support of the Company's actual tax return filing.

Q. Staff witness Benedict on pages 38 and 39, suggests that NYSEG is aware of Staff disagreements with certain of its computations via the informal data request process. Is this a reasonable conclusion?

A. In general, no. Mr. Benedict may have implied in some data requests that he is interested in obtaining information about a specific subject or type of cost, but absent an audit report from Staff, the Company does not know of the conclusions that have been reached by Staff. Deducing Staff's positions from information requests is not an exact science and certainly is not a practice Staff would rely on in determining the Companies' positions.

Q. In his response to Information Request IBER/EE No. DPS 90 in this instant proceeding, Mr. Benedict states "Staff has also informed NYSEG of at least two errors it has made in its filings, but the Company has failed to correct those errors in subsequent compliance filings or in subsequent revision." Does NYSEG have an audit report from Mr. Benedict relating his opinion on errors in ACFs?

A. No. NYSEG has received no such report, which would be the appropriate vehicle to inform a company that Staff believes there is an issue with an ACF.

Q. Does Staff mention anything in its testimony in this current case regarding ACF related adjustments?

A. Yes. A few examples are noted in Mr. Haslinger's testimony and exhibits, and Mr. Benedict includes an exhibit which totals his calculation of electric adjustments. Both of these areas will be addressed later in this rebuttal.

E. <u>Staff's Rate Of Return Calculations</u>

1. <u>NYSEG Electric</u>

Q. Are Staff's rate of return calculations for NYSEG Electric accurate and consistent with the Commission's order in Case 05-E-1222?

A. No. Mr. Benedict offers an inaccurate and skewed calculation of NYSEG's 2006 ROE, allegedly based upon the "approaches" used by the Commission to set rates in Case 05-E-1222. Referring to Exhibit __ (JB-2), Schedule A, Staff's analysis begins with a column labeled "Commission Decision 2007", but the numbers contained in that column do not match the Commission's decision in Case 05-E-1222. For example, Sales Revenues in the Order are shown to be $586,673 million and Mr. Benedict's Exhibit shows $587,960 million. Staff's calculation of NYSEG's Electric 2006 ROE is also overstated because Staff removes commodity uncollectible expense but includes the comparable merchant function charge revenues.

Q. Is Staff's approach consistent with the Commission Order in Case No. 05-E-1222?

A. No, it differs in many respects. For example, Staff proposes an adjustment for software related to the Customer Care System ("CCS) based upon its litigation position and testimony in NYSEG's last electric rate case, not based on the Commission's final order. Staff's testimony in this case, as it did in Case 05-E-1222, alleges that NYSEG failed to request a change in accounting to capitalize software and continues to seek to penalize the Company for its accounting of CCS that was reviewed and accepted by the Commission in the Company's last rate case.

2. <u>NYSEG Gas</u>

Q. Is Staff's calculation of a 2006 ROE for NYSEG Gas accurate and appropriate?

A. No. As with its calculation of the NYSEG Electric ROE, Staff makes selective and one-sided adjustments which inflate the calculated ROE. For example, Staff eliminates recovery of certain costs such as incentive compensation, yet Staff makes no adjustments for cost increases or rate base increases that NYSEG will experience prospectively. Examples of such costs increases include labor cost, inflation, property taxes, depreciation, and capital expenditures. Staff also eliminates the Gas Cost Incentive Mechanism ("GCIM"). As discussed in more detail later in this rebuttal testimony, the GCIM was a provision that was integral to NYSEG's Gas JP, provides appropriate incentives to lower gas costs and was specifically bargained for by NYSEG, accepted by Staff and approved by the Commission. Elimination of the GCIM is inappropriate and produces an artificially high ROE. Finally, Staff makes adjustments to remove NYSEG's capitalized software which is inappropriate.

3. **RG&E Electric**

Q. Is Staff's calculation of a 2006 ROE for RG&E Electric accurate?

A. No. As with the NYSEG Gas calculations, Staff removes recovery of certain expenses such as incentive compensation and uncollectibles associated with commodity sales, and fails to reflect any cost increases or rate base increases. As explained below, Staff also makes an erroneous adjustment relating to capital software for both RG&E Electric and Gas.

4. **RG&E Gas**

Q. Is Staff's calculation of a 2006 ROE for RG&E Gas accurate?

A. No. In calculating a 2006 ROE for RG&E Gas, Staff inappropriately eliminates incentive compensation and GCIM, while ignoring cost increases and rate base increases, producing a skewed and inflated ROE.

F. **Specific Rate Plan Issues**

1. **Application of Pension Policy Statement**

Q. Does Staff comment on the applicability of the PSC's Statement of Policy on Pensions and OPEBs ("PPS")?

A. Yes. Staff witness Benedict, on page 19, states that "after incorporation of NYSEG's gas OPEB reserve in rate base, that all other aspects of the

Commission's Statement of Policy on Pensions and OPEBs apply to both NYSEG and RG&E except for the accrual of interest and the expense true-up provision".

Q. Do you agree with Mr. Benedict's statement?

A. No. The PPS currently applies to the NYSEG Electric business based on the resolution of issues in Case 06-M-1413, and the application of the PPS to that business is as Mr. Benedict has stated. Mr. Benedict paints with too broad a brush when he then includes NYSEG Gas as well as RG&E Electric and Gas in his statement.

Q. Do you agree that treating the NYSEG gas-related OPEB reserve as an offset to rate base could be appropriate?

A. Yes. However, this treatment would require specific Commission approval as it is a departure from the current practice and the way rates have been set. Mr. Benedict has nevertheless reflected the impact of this change as an adjustment to O&M on his Exhibit __ (JB-3), Schedule B, Page 1.

Q. Do you agree that the simple change of treating the NYSEG gas-related OPEB reserve as an offset to rate base automatically triggers some domino effect whereby the expense true-up provision under the Statement of Policy becomes moot for both OPEBs and Pension as suggested by Mr. Benedict's testimony?

A. Clearly not. There are more ramifications to Mr. Benedict's statement than meets the eye. For example, as discussed below, under the terms of the Gas JP approved by the PSC in Case No. 01-G-1668, the NYSEG Gas business currently conforms

RATE ADJUSTMENTS PANEL

to the PPS for pensions, except that it limits its true up of pension cost to only those changes that result from a change in the assumed return on assets and the assumed discount rate. In that same JP, the NYSEG gas business is specifically exempted from the true-up provision of the PPS for OPEBs.

Q. Why is this issue relevant?

A. As noted in Mr. Benedict's Exhibit __ (JB-4), one of the so-called PBAs for the NYSEG Gas business proposed as a condition of the Proposed Transaction is an adjustment of $24.9 million for "Gas Pension Deferral". While Mr. Benedict proposes that the Company absorb this $24.9 million that was appropriately deferred under the applicable true-up provision noted above, he fails to then apply the financial impact of his statement regarding forward applicability of the PPS except for true-ups on his financial schedules.

Q. With respect to RG&E, what is the current practice followed by the electric and gas businesses regarding the PPS?

A. According to the terms of the current PSC approved electric and gas rate plans, the PPS applies in full to both businesses, with the only exception being the inclusion of the OPEB reserve in rate base.

Q. Do any of Mr. Haslinger's exhibits or testimony reflect the financial impacts of applying Mr. Benedict's statement regarding no longer truing up pension and OPEB costs at RG&E?

A. No. Based on this inconsistent treatment within the Staff's testimony and exhibits for RG&E and for NYSEG Gas, the proposed modification indicated on page 19 of Mr. Benedict's testimony should be disregarded.

2. <u>NYSEG Gas Pension Deferral Rebuttal</u>

Q. Please discuss Mr. Benedict's proposal to eliminate the gas pension deferral on page 34 of his testimony.

A. Section XVIII of the NYSEG Gas JP provides that a true-up for pensions will be limited to the incremental or decremental financial market changes from the assumed 9.0% return on assets and the 6.75% discount rate. Beginning in 2003 and every year thereafter, NYSEG's actuaries have calculated the gas pension deferral. NYSEG submits its gas pension deferral calculations and work papers to Staff in its annual compliance filing. The NYSEG gas pension deferral in 2006 was $6.5 million. Thus, gas customer rates reflect pension income that is $6.5 million higher than actual pension income. This amount is significant for the gas business equaling 14% of gas earnings or 139 basis points on equity using the Company's 2006 annual compliance filing rate base and equity.

Q. Did Staff adjust its gas revenue requirement to reflect its proposal to eliminate future gas pension deferrals?

A. No. Staff fails to reflect the elimination of the gas pension deferral in its gas revenue requirement. The impact of the pension deferral increase to 208 basis points based on Staff's Exhibit __ (JB-4), using Staff's lower rate base and equity. Staff has overstated the NYSEG Gas ROEs by 208 basis points because it failed to adjust operating expenses to reflect its recommendation to eliminate deferred accounting for gas pension costs. Staff's rate of return schedules are incorrect and misleading.

Q. Does the Company agree with Staff's proposal to eliminate the NYSEG Gas pension deferral?

A. No. Deferred accounting for pension costs is provided for in the PPS and the Gas Joint Proposal. Staff has proposed to eliminate the gas pension deferral. This proposed rate plan modification is inequitable and should not be permitted.

3. <u>Commodity Uncollectibles</u>

Q. Did Staff propose to remove commodity uncollectibles in its calculation of NYSEG's ROE?

A. Yes.

Q. Referring to Exhibit __ (JB-2), Schedule B, did Mr. Benedict, who sponsored that exhibit explain in his testimony why he made adjustment 1-a to "remove commodity uncollectibles" in the amount of $5.617 million from operating expenses?

A. No.

Q. Do you agree with the adjustment?

A. No. Mr. Benedict only made one side of the adjustment. These expenses are not gone, it is just geography. The uncollectibles that he removed are recovered through the Merchant Function Charge ("MFC") that was implemented as part of the last NYSEG Electric Rate Decision. The associated MFC Revenue is included in the $588 million of Sales Revenue from the last rate Order that Mr. Benedict used as a starting point for his Revenue Requirement calculation on Exhibit __ (JB-2).

Q. What is the impact of Mr. Benedict making only half of the adjustment?

A. By failing to remove the corresponding amount of MFC Revenue from Sales Revenue to match the removal of the Uncollectibles from O&M expense, the returns in the "As Adjusted by Staff" columns on Exhibit __ (JB-2) are overstated and the negative Revenue Requirement Adjustment is overstated (too negative) by the same $5.617 million.

Q. What is your recommended adjustment to correct this mismatch?

A. The simplest fix is to reverse the O&M expense adjustment and leave both the Uncollectible expense and the matching MFC Revenue in the calculation. Alternatively, an adjustment must be made to remove the Uncollectible portion of the MFC revenues from the Sales Revenues, before the Staff earnings sharing amounts are calculated or the "Revenue Requirement Adjustment" (rate reduction) is calculated.

Q. Does Exhibit __ (JB-2) include other MFC Revenues and costs?

A. Yes. The Sales Revenue and Operating costs in Exhibit __ (JB-2) both include matching amounts of approximately $18 million that are recovered through the MFC.

Q. Did Staff provide any backup to its $5.617 million adjustment to "remove commodity uncollectibles"?

A. No.

Q. Setting aside the fact that either O&M expenses should not have been reduced or a corresponding revenue adjustment should have been made, do you agree that $5.617 million represents the amount of Commodity uncollectibles that are in the O&M expenses per the Commission Decision in Case 05-E-1222?

A. No. As shown on Staff Exhibit (SECOSP-5) in the last NYSEG electric rate case, $4.008 million was identified as Commodity-related and included in the MFC.

Q. Did Mr. Haslinger make a similar expense adjustment in Exhibit __ (RPH-2)?

A. Yes. Mr. Haslinger reduced O&M expenses by $727 thousand "to remove the Commodity portion of Uncollectible Expenses".

Q. Did Mr. Haslinger provide support for that amount?

A. No.

RATE ADJUSTMENTS PANEL

Q. How are Commodity Uncollectible costs recovered at RG&E?

A. Commodity Uncollectibles are recovered through the Non-Bypassable Charge ("NBC").

Q. Please explain where the NBC revenues are shown on customers' bills.

A. The NBC is shown on customers' bills as a Commodity component of the bill.

Q. Please explain where the NBC revenues are shown on RG&E Income Statements.

A. For accounting purposes, the NBC is split between Commodity and Delivery. The portions of the NBC relating to Uncollectibles and fixed generation are shown as Delivery revenue. The balance of the NBC that relates to Commodity costs is shown on the Commodity Income Statement.

Q. Why is the NBC relating to Uncollectibles and fixed generation are shown as Delivery revenue?

A. This accounting matches the revenues with the expenses and obviates the need to separate a myriad of expenses (including Uncollectibles) between Commodity and Delivery.

Q. Does the $370.608 million of Delivery Revenues that is shown in the first column of Mr. Haslinger's Exhibit __ (RPH-2) include the NBC revenues associated with Commodity Uncollectibles (and fixed generation)?

A. Yes. That amount was taken from RG&E's response to Data Request "IBER #218 (DPS-137). The backup to that data request response shows that Delivery revenues include $111.1 million of NBC revenue that was transferred from

Commodity to Delivery. The backup also shows that $1.8 million of the $111.1 million is Uncollectibles and the balance is fixed generation.

Q. Is Mr. Haslinger's adjustment "to remove Commodity portion of Uncollectible Expenses" correct?

A. No. The adjustment is inappropriate for a similar reason as is Mr. Benedict's NYSEG adjustment. Mr. Haslinger only made the expense side of the adjustment. The uncollectibles that he removed are recovered through the NBC, which is part of the Delivery Revenue in Exhibit __ (RPH-2). He did not make an adjustment to remove the corresponding amount of NBC revenues. As a result, the "As Adjusted by Staff" columns on Exhibit __ (RPH-2) are overstated and the negative Revenue Requirement Adjustment is overstated (too negative) by $727 thousand. To correct this error, either the expense adjustment should be reversed or a corresponding amount of NBC revenues should be removed from the revenues before earnings sharing amounts are calculated or the "Revenue Requirements Adjustment" (rate reduction) is calculated.

4. <u>Capitalized Software</u>

Q. Please summarize the adjustments that Mr. Haslinger made relating to Capitalized Software in the RG&E Electric and Gas Rate Bases and Revenue Requirement Exhibits ___(RPH-2) and ___(RPH-3).

A. Mr. Haslinger excluded 100% of RG&E's Capitalized Software, including IBO, WMS, and CCS from rate base and reduced Depreciation expense by the annual amount of depreciation that is accrued on capitalized software. The specific amounts of the adjustments were:

		Electric ($ 000)		Gas ($ 000)		Total ($ 000)
Depreciation	$	(4,865)	$	(2,620)	$	(7,485)
Net Plant		(39,703)		(21,379)		(61,082)

Q. On what basis did Mr. Haslinger justify these adjustments?

A. At page 31 of his testimony, Mr. Haslinger states:

In the latest NYSEG rate case (05-E-1222), the Commission deemed the capitalized software was a Cost-to-Achieve item of the merger of Energy East and RG&E. These Cost-to-Achieve expenses were to be written off by the end of 2008. We have removed capitalized software to reflect it as a cost to achieve in the same manner as the Commission ordered in the 2005 NYSEG electric rate case.

Q. In the NYSEG case, did the Commission deem that all Capitalized Software was a Cost-to-Achieve item of the merger?

A. No.

Q. Please describe the positions taken by Staff regarding Capitalized Software in the NYSEG Electric rate case and the decisions that were reached by the Commission.

A. NYSEG's Capitalized Software relates to three major projects: the Integrated Back Office ("IBO") and Work Management System ("WMS") and the Customer

Care System ("CCS"). For IBO and WMS, Staff argued that these costs were part of the costs to achieve the NYSEG/RG&E merger and, according to the 2002 Rate Plan, were to be fully amortized by the end of the 5-year rate plan (December, 2006). For CCS, Staff attempted to remove 50% of CCS on the grounds that part of the system might provide value to other Operating Companies. For all three, the Staff threw in the argument that NYSEG did not have permission to capitalize Software. In its Order, the Commission was persuaded by the cost to achieve argument that Staff presented for IBO and WMS but did not agree with Staff on the other grounds. Accordingly, 100% of the CCS project was allowed in rates.

Q. If Mr. Haslinger were to be consistent with the Commission Order in the NYSEG Electric rate case, what amounts of Capitalized Software should Mr. Haslinger have removed from the Revenue Requirement?

A. While not agreeing that any amount of Capitalized Software should be removed from rates, based on the Commission Decision, that Mr. Haslinger claims that he relied on, only IBO and WMS should have been removed. CCS and all other Capitalized Software should remain in the Revenue Requirement. The correct amount of those adjustments would be

	Electric ($ 000)	Gas ($ 000)	Total ($ 000)
Depreciation	$ (1,391)	$ (749)	$ (2,140)
Net Plant	(11,626)	(6,260)	(17,886)

Q. Setting aside the fact that CCS and other (non-IBO & WMS) Capitalized Software should not have been excluded from the Revenue Requirement in the first place, are there any other problems with the amount of the adjustments made by Staff to remove Capitalized Software from the RG&E Revenue Requirements?

A. Yes, there are. First, the amounts of the adjustments are overstated. Second, Staff failed to remove from the RG&E Rate Base the deferred tax credit that relates to the Capitalized Software that it removed.

Q. Can you explain why the adjustments are overstated?

A. We have not been able to fully reconcile all of the reasons for the overstatements because the adjustments exceed all of the RG&E Capitalized Software and Staff did not provide any backup to their calculations. Nevertheless, we can explain the apparent reason for much of the overstatements. The major reason for the overstatements by Staff of its adjustments appears to be that Staff did not consider the fact that RG&E CCS went into service in October of 2006. Staff appears to have removed a full year's worth of CCS depreciation from expenses and the rate base adjustment appears to have been calculated as if CCS had been in rate base all year. However, due to the plant going into service in October, only 2 months of CCS Depreciation were actually recorded in 2006 and the average 2006 rate base only included 2½ twelfths of the CCS Net Plant Value. Since Staff started with the 2006 RG&E regulated earning calculation and since that only included a partial year of costs and Rate Base amounts, those are the only amounts that Staff should have included in its adjustments (assuming that it were correct to remove CCS from the Revenue Requirement, which, it is not, based on the Commission Order.)

Q. Considering the facts that (a) CCS is a legitimate capital cost to be included in rates; (b) that RG&E's CCS went into service in October of 2006; and (c) that Staff was using calendar year 2006 data upon which it projected its forward-looking revenue requirements for RE&G, should Staff have made an adjustment to annualize CCS?

A. Yes. Proper ratemaking requires that normalizing adjustments be made for major capital additions such as CCS. Depreciation expense should have been increased by $1.523 million Electric and $820 thousand Gas and rate base should have been increased by $9.623 million Electric and $5.181 million Gas.

Q. Please summarize the adjustments that are needed to correct the RG&E Revenue Requirement for Staff's errors relating to Capitalized Software.

A. First, all of the Staff adjustments should be reversed. Second, the Depreciation and rate base should be increased to annualize the CCS costs. Third, if the Commission deems it necessary to exclude IBO and WMS, Depreciation expense and Rate Base should be reduced to exclude the cost of these items. All of these adjustments are summarized on Exhibit RAP-8.

5. **RG&E Commodity Program**

Q. Has Staff recommended changes to RG&E's Commodity Program?

A. Yes. Staff witness Haslinger has, on page 30 of his testimony, proposed that the RG&E commodity program be modified to be similar to the recently approved NYSEG commodity program. These modifications would include the reduction of the FPO conversion factor, a reconstructed earnings sharing mechanism that provides no downside risk to customers and shares any upside potential on the same basis as NYSEG's, and the adoption of other aspects of NYSEG's program.

Q. Does the Company accept Staff's recommendations?

A. No. The Commodity Program is one of the provisions that continues under the RG&E Electric Rate Plan. It is not appropriate to modify the commodity program in this proceeding. Similar to other staff rate plan modifications, this matter should be addressed in a separate subsequent proceeding.

6. **Property Taxes**

Q. What has Staff proposed with respect to RG&E property taxes?

A. Staff witness Haslinger, on page 38, line 10, of his testimony, has indicated that "property tax … would no longer be eligible for deferral treatment".

Q. What has been the experience of RG&E with respect to property tax costs?

A. Under the current rate plans, RG&E has been deferring property taxes above or below threshold amounts, that included a dead band and were based on a base year amount inflated at 4%, and included adjustments anticipating the sale of the

Ginna nuclear plant and the retirement of Russell fossil plant. In each year since 2004, the annual compliance filings made for RG&E property tax are summarized below:

Year	Business	Low End Threshold	High End Threshold	Actual	Deferral
2004	Electric	$36.636M	$38.515M	$37.4M	None
2005	Electric	$35.454M	$37.272M	$36.4M	None
2006	Electric	$36.872M	$38.762M	$39.872M	$1.11M
2004	Gas	$13.367M	$14.053M	$13.5M	None
2005	Gas	$13.902M	$14.614M	$16.405M	$1.79M
2006	Gas	$14.458M	$15.199M	$17.716M	$2.52M

Q. Did Mr. Haslinger, in concert with his proposal to eliminate the deferral of property taxes over or below a threshold amount, reflect property taxes at an appropriate level in his financial Exhibits __ (RPH-2) and (RPH-3)?

A. No. He ignored the realities of property tax cost being incurred and merely took the calendar 2006 high end threshold as the property tax amount for his schedules. Given that actual property tax has been exceeding the high end threshold in the last couple of years, and is expected to for the remaining two years of the rate plans, and certainly can be expected to increase in each subsequent year, Mr. Haslinger's approach has shortchanged the Company by at least $3 or $4 million annually.

Q. What should be done with Mr. Haslinger's carefully crafted proposal to not allow the Company to recover property tax costs?

A. It should be disregarded along with his proposal to treat the already deferred property tax costs as a PBA write-off.

7. **Stray Voltage Costs**

Q. What has Staff proposed with respect to RG&E stray voltage costs?

A. Staff witness Haslinger, on page 38, line 11, of his testimony, has indicated that "stray voltage costs ... would no longer be eligible for deferral treatment".

Q. What has been the experience of RG&E with respect to stray voltage costs?

A. Under the current RG&E electric rate plan, the costs associated with implementing the terms of the newly mandated stray voltage program required by the Commission were appropriately treated as a deferrable item. RG&E incurred about $5.5 million in stray voltage costs which were deferred during the 2005 through 2007 period. Additional annual costs are expected to be experienced, as the Company has not been given any indication from the PSC that requirements associated with adhering to the requirements of the stray voltage mandate will be relaxed in the future.

Q. Did Mr. Haslinger, in concert with his proposal to eliminate the deferral of stray voltage costs, reflect those costs at an appropriate level in his Exhibit __ (RPH-2)?

A. No. He neglected to recognize the additional O&M costs that would be incurred to continue to meet the requirements of the stray voltage mandate, which by our calculation have averaged nearly $2 million per year, and in fact reached $2.4 million in calendar 2007.

Q. What should be done with Mr. Haslinger's proposal to not allow the Company to recover costs associated with the Stray Voltage mandate?

A. It should be ignored and the Company should still be allowed to defer any stray voltage costs incurred.

8. <u>NYSEG and RG&E Gas Cost Incentive Mechanisms</u>

Q. What is the Gas Cost Incentive Mechanism ("GCIM")?

A. The GCIM provides a sharing between customers and shareholders of gas cost savings derived from optimizing the Energy East utility companies' gas supply assets. There are two categories of GCIMs. The first gas supply cost savings category is GCIM 1 and relates to activities conducted by NYSEG Gas and RG&E Gas on a stand-alone basis and includes migration capacity release, non-migration capacity release, off-system sales and savings from local production. The second gas supply cost savings category is addressed by GCIM 2. GCIM 2 relates to gas cost savings attained through the joint optimization activities of the gas supply portfolios of the Energy East LDCs. The joint optimization activities include storage optimization; transport optimization and joint optimization demand and variable savings associated with turn back of capacity.

Q. Is GCIM sharing part of the NYSEG and RG&E Gas Rate Plans?

A. Yes. Section XII of the NYSEG Gas Rate Plan and Section VII of the RG&E Gas Rate Plan specifically provide for sharing of gas supply savings. The parties to the Gas Rate Plans, including Staff, recognized that it is appropriate to provide a sharing incentive to Companies for creating gas supply savings based on the joint optimization of Energy East LDC gas assets. GCIM 1 savings are allocated as follows: 100% of the savings attributable to migration capacity release are assigned to customers; there is an 80%/20% sharing between customers and shareholders of the savings activities of non-migration capacity release, off-system sales and savings from local production. GCIM 2 savings were initially designed to be shared 50% customers and 50% shareholders.

Q. Has there been a recent proceeding regarding the GCIM methodology?

A. Yes. On October 7, 2005, in Case No. 01-G-1668 and 04-G-1278 the Commission issued an <u>Order Approving Gas Cost Incentive Mechanism Methodology</u>. The Order approved the GCIM methodology by which NYSEG calculates and allocates its GCIM 1 and GCIM 2 incentives. NYSEG and Staff held numerous meetings during 2005 regarding the proper GCIM allocations and ultimately reached an agreement regarding the allocations GCIM sharing. As noted in the Commission Order, NYSEG and Staff worked together to resolve concerns related to GCIM classifications and developed a new method for classifying the gas supply activities and calculating the GCIM incentive. GCIM 2 categories were detailed in the "Interpretation and Application of the Provisions of the Gas Cost Incentive Mechanism" filed with the Commission in June 2005. A new NYSEG GCIM 2 sharing percentage was developed which increased the benefit to customers. The new GCIM 2 sharing equaled 56.25% to customers and 43.75% to shareholders. The new GCIM methodology was approved by the Commission and recognized the benefits for customers.

Q. What is the Gas Staff Rates Panel proposal in this proceeding regarding GCIM?

A. On pages 7 and 8, the Gas Staff Rates Panel proposes to eliminate GCIM 2. Staff states that GCIM 2 "unnecessarily over-compensates the companies" for procuring and managing its gas supply. Staff fails to mention any background of the GCIM, the benefits it has created for customers, the fact that the savings were brought about because of the joint optimization of the combined EE LDC gas supply assets and that merely two years ago the Company and Staff reached agreement regarding the allocation and methodology for the GCIM sharing. ~~[cite]~~

Q. What was the amount sharing of NYSEG GCIM 2 in the Company's 2007 annual gas cost reconciliation filing?

A. The amount of GCIM 2 sharing for NYSEG gas was $1.25 million for customers and $975,000 for shareholders, after alliance costs.

Q. What was the amount of sharing of NYSEG GCIM 2 in the Company's 2007 annual gas cost reconciliation filing?

A. The sharing of GCIM 2 for RG&E gas equaled $840,000 for customers and $840,000 for shareholders, after alliance costs.

Q. Should the GCIM 2 sharing be eliminated as a result of this merger filing?

A. No. The GCIM is part of the respective gas rate plans for NYSEG and RG&E and should not be eliminated because of the merger filing. The Commission and Gas Staff have previously endorsed the gas rate plans as well as the GCIM allocation methodology. The Company has worked hard to create savings in gas supply costs by entering into joint optimization agreements so customers can benefit from a larger portfolio of gas supply assets. The Commission has recognized and approved this incentive mechanism and it should continue.

9. <u>Capital Expenditure Proposals</u>

Q. Has Staff proposed a procedure to reconcile capital expenditures for both gas and electric businesses at both RG&E and NYSEG?

A. Yes. The Staff Gas Rates Panel and Staff witness Dickens include testimony recommending the establishment of "one-way" capital spending reconciliations based on average planned capital spending (after adjusting for certain projects).

Q. Do the Companies accept Staff's proposals?

A. Generally, the Companies would be amenable to such a proposal if there was a symmetrical reconciliation such that any overspending would be subject to a carrying charge as well as any under spending. The exact spending levels and the reconciliation methodology could be the subject of a collaborative meeting of the Companies, Staff and other parties.

V. OTHER STAFF ISSUES

A. Storm Accounting

Q. Has Staff raised issues with RG&E's accounting associated with Major Storms?

A. Yes. Mr. Haslinger raises essentially three points. The first, on page 19 of his testimony, is whether a heat wave meets the definition of a major storm. The second, on page 20, suggests that the company has deferred non-incremental costs associated with a major storm. The third, on page 25, is an interpretation question of what costs constitute "counting" toward the total costs of a major storm.

Q. Do you agree with the first of Mr. Haslinger's points regarding the heat wave event?

A. No. While Mr. Haslinger correctly notes that the Company has deferred $354,605 associated with the restoration efforts caused by the heat wave event, he changes the definition of a major storm from both the joint proposal and the order associated with case 03-E-0765. In his testimony on page 19 he states that "in the case of the major storms, the company is allowed to charge to the major storm reserve costs of storms that affect at least 10% of its customers and/or results in service interruptions and cost more than $250,000 to restore service". The actual definition of a major storm on page 29 of the joint proposal is "a period of <u>adverse weather</u> during which service interruptions affect at least 10% of RG&E's customers within an operating area and/or result in customers being without electric service for a duration of at least 24 hours unless RG&E receives a determination from the Commission that such event does not constitute a Major Storm." (emphasis added). This definition is effectively replicated in footnote 29 of the May 20, 2004 Order associated with Case 03-E-0765.

Q. Does Mr. Haslinger suggest that the heat wave event is not a storm?

A. Yes, on page 20 of his testimony. He goes on to state that it is a predictable, recurring event. This event was in reality an unprecedented heat wave causing numerous outages affecting 39,156 customers, about 11% of RG&E customers over a period of 4 days (July 11, 2005 to July 15, 2005). It clearly meets the definition of "adverse weather" that is included in the Commission approved definition of a Major Storm. Also, the concept that such an unprecedented event is predictable and recurring is without merit.

Q. What else does Mr. Haslinger posit in his testimony associated with the heat wave event?

A. He states that the company billed customers for their use of increased consumption during the event and that perhaps those "extra" revenues should be counted as an offset to the costs of the event. While the fact that some customers were billed for increased consumption, this is only true for customers who did not have interrupted service during the event. It was not true for all customers and there are no data immediately available to determine how usage would have balanced out between interrupted and non-interrupted customers during the time of the event. Additionally, this comment by Mr. Haslinger would suggest to the company that they should include in their storm related incremental costs the lost revenues that occur during a storm event and count those toward an amount to be recovered from customers. This is not something the company has done in the past but, to be symmetrical with Staff's proposals for heat, we would be willing to consider.

Q. Mr. Haslinger follows his points regarding the heat wave event with a statement, on page 20, that "The company included labor, benefits, and costs of its transportation equipment to calculate the heat "storm" costs…Removal of these non-incremental costs would decrease its costs below the $250,000 expense deferral threshold". Do you agree with that statement?

A. No. The $354,605 deferred by the Company related to the heat wave event represented only incremental O&M costs incurred to restore service during and as a result of this event. The total costs including non-incremental O&M exceeded $700,000.

Q. The third point raised by Mr. Haslinger, on page 25 of his testimony, is that the Company re-interpreted the joint proposal language related to major storms and began to count all costs, including both capital and O&M, as an amount to compare to the $250 thousand threshold for purposes of deferring incremental O&M costs. Is he correct?

A. No. Mr. Haslinger correctly identifies the Company's interpretation of the costs that count toward the $250,000 threshold. The Company reads the definition to say restoration efforts costing more than $250,000 constitute a major storm – the definition does not state incremental O&M restoration costing more than $250,000. It is important to point out that in the last four years there has been only one event, a May, 2004 thunderstorm, that accumulated over $250,000 in total costs and at the same time less than $250,000 in incremental O&M costs. The company has deferred about $115,000 of incremental O&M associated with that event.

Q. Do you believe that RG&E is following an appropriate methodology for its storm related accounting?

A. Yes.

B. <u>Site Remediation Allocation</u>

Q. What is Staff's position with respect to the allocation of Site Remediation costs?

A. Mr. Haslinger, starting on page 25 of his testimony, claims that RG&E has modified the allocation of common site remediation costs from a 70% electric, 30% gas allocation implicit in the RG&E electric and gas Joint Proposals, to an 80% electric, 20% gas allocation in the Company's annual compliance filings.

Q. Is Staff correct in their assertion?

A. Yes, but only to a point. In the annual compliance filings submitted to the Commission for calendar year 2004 and 2005, RG&E inadvertently reflected an 80% electric, 20% gas allocation of site remediation costs incurred through November 2005. Subsequent to November 2005, the Company used a 66% electric and 34% gas allocation of these costs, which reflected the sale of Ginna during 2004.

Q. What would be the financial implications of the use of an 80% electric/20% gas allocation through November 2005?

A. The implication would be that approximately $700 thousand would be shifted between electric and gas deferred amounts. Since both the RG&E Electric and the RG&E Gas rate plans exclude site remediation deferrals from consideration for offsets due to earnings sharing, this would be a balance sheet only transfer between the electric and gas businesses, and would not impact RG&E's income statement or RG&E's customers as a group.

Q. What do you conclude with respect to this issue?

A. The Company would be willing to make the balance sheet transfer indicated in the prior response to reflect the deferred site remediation costs on its balance sheet between the electric and gas businesses, although in doing so, we would not concede that it is an appropriate issue to be addressed in this proceeding. This would create a shift of approximately $700 thousand between the two businesses.

Since the Company is not accepting any of Staff's proposed PBA adjustments, including those related to site remediation, this issue is effectively and materially irrelevant.

C. **Security Cost Deferral**

Q. Does Staff suggest that RG&E's deferral of security costs greater than a target amount included in the electric and gas joint proposals was not correct?

A. Yes. Mr. Haslinger covers this topic on page 23 of his testimony.

Q. Do you agree with Staff's suggestion?

A. No. Staff inexplicably bases their conclusion on their statement that says "The Joint Proposals set targets for the costs of obtaining security services from outside vendors". This statement is not backed up by the language in the joint proposals. In fact, footnote 2 of Appendix K of the electric joint proposal specifically states that "Security Costs are reconciled in total".

Q. Has RG&E experienced an increase in security costs over the past several years?

A. Yes. RG&E, like many other companies, has become even more security focused than ever. Much of the deferral amount that exists on the Company books resulted from increased security costs experienced in 2004 at the company's Ginna nuclear plant. As everyone knows, the need for heightened security at critical facilities is a real issue for our times. The Staff Policy Panel has focused on the security of the transmission and distribution system and of company data in their testimony in this proceeding, on pages 28 & 29, further supporting the need for security costs.

Q. What should be done with Mr. Haslinger's suggestion that RG&E not be allowed to recover security costs over the joint proposal threshold amount?

A. It should be ignored and RG&E should still be allowed to defer and recover any security costs incurred to protect the assets of the company.

D. <u>ASGA Depletion</u>

Q. Do you share Staff witness Haslinger's concerns related to the utilization of the ASGA balance as an offset to the costs paid for power under the Ginna PPA?

A. No. Staff witness Haslinger has identified that the current balance in the ASGA could be depleted sometime in 2010 due to ~~the~~ its utilization as an offset to the prices paid for power under the Ginna Purchase Power Agreement ("PPA"). This is an assumption that electric commodity market prices over the next three years are comparable to those experienced in the last couple of years. He has also concluded that RG&E rates would have to increase when the ASGA is depleted, which is generally true.

Q. What else could happen to affect customer rates or minimize the impact of the ASGA depletion on customer rates?

A. There are several possibilities. First, the Commission could act within its authority to hold current rates constant while adding to a regulatory asset that could be recovered over a future period of time. Second, the electric commodity market pricing could change such that the draw from the ASGA due to the prices paid under the Ginna PPA will be minimized over the next several years, leaving a positive balance in the ASGA. Third, the ASGA balance could increase by the operation of other terms in the RG&E rate plan, thereby staving off the time frame when it would otherwise be depleted.

Q. Do you agree with Mr. Haslinger's approach of treating the end of 2008 ASGA balance as a deduction to rate base?

A. To the extent that the ASGA is no longer used as an offset to the Ginna PPA and the customer rates better reflect the costs incurred, then moving the ASGA to rate base, as long as any variances from the assumed rate base balance accrue a return, makes little difference to the company.

E. <u>Standby Lost Revenues</u>

Q. Does Staff take exception to NYSEG's calculation of the amount of lost revenues associated with a specific standby customer?

A. Yes. Staff witness Dickens identifies an issue of which "otherwise applicable rate" should be used when calculating the amount of lost revenues to be applied by NYSEG when determining the draw from the ASGA. Staff witness Benedict has identified that the amount calculated by Mr. Dickens is included in his JB-7 amounts of ASGA adjustments.

Q. Do you agree with Staff's position?

A. No. As discussed in the Rate Design and Retail Access Panel rebuttal testimony, we disagree with Staff's adjustment.

F. **Under Spending on Capital**

Q. On page 32 of his testimony, Staff witness Benedict suggests that based on his review of the last NYSEG report on capital expenditures submitted to the Commission, NYSEG might be under spending on capital. Is that allegation accurate?

A. No. As Mr. Benedict noted, his review was of data through September 30, 2007 that was reflected on the required quarterly capital report to the Commission. NYSEG has completed a preliminary draft of the fourth quarter capital report to the Commission, which reflects the full year of capital spending. This preliminary draft is included as Exhibit RAP-9. As noted on the exhibit, NYSEG has spent 100% of the rate case allowed amount of capital during 2007.

G. **NYSEG Debt Cost Adjustment**

Q. Does Staff claim that the Proposed Transaction had a negative impact on NYSEG's recent financing?

A. Yes. On pages175-176 of its testimony the Staff Policy Panel asserts that the investment community rendered an assessment on Iberdrola's effect on NYSEG and RG&E. Staff alleges that it is the "risk of a potential relationship with

Iberdrola that accounts for the discrepancy in yields" between NYSEG and a select peer group. As explained below, Staff's allegation is unfounded.

Q. Do you agree with the Staff Policy Panel's recommendation on page 178 that there should be a 30 basis point adjustment to NYSEG's cost of debt "to remove the effects of Iberdrola from the company's cost of debt"?

A. No. We emphatically disagree. The 30 basis point differential was caused by several factors including ratings differences in the proxy group and issues relating to the relative size and frequency of NYSEG offerings compared to the proxy group.

Q. What are the size and frequency issues that caused NYSEG's offering to price higher than Staff's proxy group?

A. The size of an offering is important because any deal over $250 million in size is an "index eligible" deal, which opens up the issuance to more potential buyers and makes the deal more liquid in the secondary market. Investors are willing to pay a price premium (i.e., tighter spread) for this secondary market liquidity. The $200 million NYSEG transaction was not index eligible. Given the recent volatility in the market, the "liquidity premium" for a non-index eligible deal like NYSGE's has been significantly higher than has been experienced in several years. Of the three comparables the Staff Policy Panel focused on, all were over $250 million and were "index eligible" and all would be expected to price tighter and have a more liquid secondary market than the NYSEG.

Q. How does the frequency of an issuer in the market affect pricing?

A. Those names that come to market more frequently – including the three comparables that the Staff Policy Panel identified – can command a slight price premium (i.e., tighter spread), because investors are more familiar with the issuer and as a result are required to do less up-front credit review before purchasing. The frequent issuer premium tends to be manifest during periods when the market is particularly busy and/or volatile, as was the case during the period from November 27, 2007 to November 29, 2007 when NYSEG was in the market. During such periods of volatility, those companies that come to market frequently attract more investor interest.

Q. Can you explain the ratings difference between NYSEG and Staff's proxy group?

A. Of the three comparables the Staff Policy Panel utilized, two were on review for a potential upgrade and have subsequently been upgraded. Dominion was upgraded by S&P from BBB to A- on December 27, 2007 and Pacific Gas and Electric was upgraded by Moody's from Baa1 to A3 on December 27, 2007. It is highly likely that the pricing for these two "comparables" anticipated the impending upgrades resulting in somewhat tighter spreads. Therefore, two of the three comparables priced their offerings with the anticipation that the issuers would carry at least one A-rating in the near future. In comparison, NYSEG priced its offering with the overhang of the negative outlook on its Baa1 / BBB+ ratings, which has been in place since the Commission's decision in NYSEG's rate case in August 2006.

RATE ADJUSTMENTS PANEL

Q. Are there earlier comparables that demonstrate that the proposed transaction with Iberdrola is not the most likely explanation for NYSEG's spread difference?

A. Yes. NYSEG priced a $100 million, non-index eligible 10-year bond on December 14, 2006 at a spread of 110 basis points over the treasury. Southwestern Electric Power (SWEPCo), one of the three companies the Staff Policy Panel chose as a December 2007 comparable, came to market three weeks later with an index eligible 10-year bond that priced at 93 basis points over the treasury. NYSEG and SWEPCo share the same Moody's rating (Baa1); NYSEG's S&P rating is one-notch above SWEPCo (BBB+ versus BBB). Despite NYSEG's superior S&P rating, SWEPCo priced inside of NYSEG. We would attribute this primarily to the liquidity premium and to the negative outlook overhang on NYSEG (which, as noted by Mr. Fetter, was due to the August 2006 rate order in the NYSEG Electric proceeding). In December 2006, the market was not factoring in "the risk of a potential relationship with Iberdrola" yet the pricing differential between NYSEG and SWEPCo still existed.

Q. In response IBER/EE IR No. 45 Staff responds with an additional argument that they believe explains the spread discrepancy. "... it could be because NYSEG no longer files financial statements, in conformance with Energy East's strategies that have led to a lack of transparency, and this lack of information is perceived as creating additional risk". Do you agree with Staff's assertion?

A. No. A 144A transaction, such as the December 2007 NYSEG deal, includes all of the information which, in a public transaction, would be included by reference to SEC filings. Further, NYSEG continues to make available on its website its interim and annual audited financial statements and the SEC filings made by Energy East continue to include significant disclosure and management discussion and analysis (MD&A) pertaining specifically to NYSEG. In fact, the decision to cease filing NYSEG reports with the SEC resulted in very little change in the amount and quality of information on NYSEG reaching potential and existing investors.

H. **Cost of the Imputed Debt**

Q. Do you agree with Staff's use of the average embedded cost debt to calculate the cost of the debt that is imputed into its capital structure as a result of the 38% cap on common Equity that Staff used to calculate its revenue requirements?

A. No. NYSEG and RG&E both have significant amounts of pollution control notes in their capital structures. The cost of those notes is significantly below the cost of the remainder of the Companies' debt and has the effect of reducing the average embedded cost of debt. By pricing the imputed debt at the average cost of the embedded debt, it is presumed that more debt capital could be raised through low-cost pollution control notes. However, that presumption is false. The Companies cannot finance more through pollution control notes. Furthermore, any new debt would be priced at the current market price and not at the average cost of the embedded debt with or without the pollution control notes. This fact was recognized by the Staff and the Commission in the last NYSEG Electric rate case and that is why the imputed debt in that case was priced at 6.54%.

I. Advanced Meter Infrastructure ("AMI") Calculations

1. Significance of AMI

Q. How does Mr. Benedict characterize the importance of the Automated Metering Initiative?

A. Mr. Benedict states on page 27 of his testimony:

> …the companies AMI filings are a major new initiative pending before the Commission. These AMI proposals will have significant impacts on the rates customers pay and will represent a commitment of hundreds of millions of utility funds. It would be unwise to ignore this issue as the Commission will surely be examining the adequacy of the companies' rates in this proceeding. (Emphasis added)

Q. Do you believe that this case is the proper forum in which to determine the financial outcome of such a major initiative?

A. No. As Mr. Benedict stated, the Commission already has proceedings in progress to review the NYSEG and RG&E AMI initiatives. Those proceedings will determine how and when AMI will be implemented and what vehicle will be used to recover costs from, and flow benefits to, customers.

2. Staff Proposes No AMI Surcharge and Does Not Provide for AMI in Rates

Q. Given that Mr. Benedict stated that "it would be unwise to ignore this issue… in this proceeding", how did Staff provide for AMI rate recovery in this case?

A. It didn't. Mr. Benedict simply stated at page 29 of his testimony:

> The surcharge proposals appear unjustified. First, the net costs of AMI are immaterial, if you consider the deprecation impact discussed below. Also, both NYSEG gas and RG&E's current rate plans have provisions that address the costs of mandates, such as AMI.

Then he proceeded to create AMI revenue requirements that he purports are insignificant and therefore should not be recovered through a surcharge.

Q. Since Staff is recommending against a surcharge for AMI, did it provide for AMI in its revenue requirement calculations (Exhibits ___(JB-2) & ___(RHP-2))?

A. No. With the exception of not removing depreciation on the existing meters, which it claims will cease at the time AMI is implemented, leaving the revenues that are supporting the existing meters to offset part of the cost of depreciation on the new AMI facilities, Staff made no adjustments to include AMI in its revenue requirement calculations. However, as explained below, rate recovery of the existing meter investments, whether through continued depreciation or future depreciation rates is imperative for the Company. NARUC's AMI Resolution recommends that commissions consider providing for the timely cost recovery of prudently incurred AMI expenditures, "including accelerated recovery of investment in existing meter infrastructure." Mr. Benedict's proposal to simply retire the existing meter investment and address the undepreciated value in a future depreciation proceeding does not provide timely recovery, as recommended by NARUC.

Q. What reasons did Mr. Benedict give in his testimony in this proceeding for concluding that the Commission should not authorize NYSEG and RG&E to implement a surcharge to recoup incremental AMI costs?

A. Starting at page 26 of his testimony, Mr. Benedict argued that NYSEG and RG&E should not be allowed to implement a surcharge to recoup incremental AMI costs for the following three reasons:

1. the accuracy of estimated costs and savings is questionable,
2. the use of a surcharge to collect a financially immaterial amount is unjustified and directly conflicts with existing provisions in the company's current rate plans which were already designed to accommodate these types of program costs, and

3. the reconciliation provisions of the surcharge proposal do not allow for accountability,in that there is no mechanism for review of the companies' performance in managing AM1 program costs.

3. Staff Concern About Accuracy of AMI Cost Estimates

Q. Please address Staff's first concern about the accuracy of estimated costs and savings.

A. The filings that NYSEG and RG&E currently have before the Commission include **estimates** of the surcharge rates based on (a) estimates of the net costs and (b) estimates of the timing of the implementation of the project. These are only estimates. These estimates will be refined after the responses that have been received to the Requests for Proposal ("RFP") are reviewed and again after the Commission has issued an Order that will enable the project to be implemented. The actual surcharge rates will be based on actual capital costs and will be reconciled at the end of each year. Indeed, accuracy of the estimates of net costs and the timing of the implementation are two key reasons why the Companies have proposed that net AMI costs, at least in the early stages, be recovered through a surcharge instead of base rates and that the revenues received be reconciled with actual costs and adjusted accordingly.

4. **Staff Claim of Immaterial AMI Net Costs**

Q. Please explain how Staff determined that the cost of AMI to be immaterial and, therefore, should not be recovered through a surcharge.

A. As described, starting on page 29 of his testimony, and as shown on Exhibits ___(JB-5) and ___(JB-6), Mr. Benedict made five adjustments to reduce the estimated 2009 AMI revenue requirements from the amounts presented in the NYSEG and RG&E AMI filings to $3.5 million and $3.2 million, respectively:

A) Mr. Benedict reduced the depreciation on the new AMI facilities by the amount of depreciation currently being accrued on the existing meters that he claims will cease at the time AMI is deployed.

B) He imputed estimated savings that might materialize if uncollectibles and theft of service can be reduced as a result of AMI.

C) He imputed a 38% common equity cap instead of the 41.6% cap that was imputed in the most recent NYSEG Electric rate Order and the 45% equity cap that was provided for in the currently-effective and Commission-approved NYSEG Gas and RG&E Electric & Gas Rate Plans.

D) He reduced the Return on Equity from the returns allowed in the most recently-approved NYSEG & RG&E Rate Decisions and Rate Plans to 9.0% in this case.

E) He reduced the cost of the imputed debt from the 6.54% rate, approved in the last NYSEG Rate Decision, to the embedded cost of the actual debt.

RATE ADJUSTMENTS PANEL

(Imputed debt is the amount of artificial debt that is added to the capital structure supporting Rate Base as a result of Staff's reduction in common equity below the actual equity levels at each company that results from the 38% equity cap.)

Using the resulting reduced revenue requirements, Mr. Benedict deducted taxes and then divided the net-of-tax balance by the Common Equity that is currently supporting Rate Base (41.6% NYSEG Electric and 45% for the three other departments, as noted above) to arrive at the basis points which he purports to be immaterial. Based on this calculation, as noted at page 31 of his testimony, Mr. Benedict claims that the earnings impact from AMI would only reduce RG&E's Electric and Gas earnings by 23 and 49 basis points, respectively. He does not state the basis points for NYSEG, however using the same math, the earnings impact from AMI would be 17 and 38 basis points for NYSEG Electric and Gas, respectively. It should be noted that, even though he used the 38% equity cap proposed by Staff in this case to calculate his claimed AMI revenue requirement shortfalls, Mr. Benedict did not divide by the common equity that would be left after Staff's PBA imputations and after the imputed 38% common equity ratio.

Q. Performing the same calculation, but using the common equity that would be left after Staff's PBA imputations and Staff's imputed 38% common equity cap,b y how many basis points would earnings be reduced based on Mr. Benedict's calculated AMI revenue requirements?

A. NYSEG Electric & Gas earnings would be reduced by 21 basis points and 57 basis points, respectively. RG&E Electric & Gas earnings would be reduced by 38 basis points and 72 basis points, respectively.

Q. What level of earnings impact does the Commission consider materials?

A. Section 48.1 of the Public Service Law states that 0.05 percent of common equity is considered material. That is 5 basis points.

5. **<u>Staff Concern About Reconciliation Method</u>**

Q. Please comment on Staff's concern that the reconciliation provisions of the surcharge proposal presented in the Companies' AMI filings do not allow for accountability, in that there is no mechanism for review of the companies' performance in managing AMI program costs.

A. This is a concern that should be addressed in the AMI proceedings. Accountability is a factor that needs to be addressed in most reconciliation processes and the Staff and the Companies usually work together to develop procedures that are satisfactory to both parties. There is no reason that same process cannot take place in the AMI proceedings. However, to categorically claim in this case that an AMI surcharge should not be provided for in another proceeding would be unfair and inappropriate.

6. **Uncollectibles and Theft of Service**

Q. At page 28 of his testimony, Mr. Benedict states that one of Staff's concerns about the accuracy of the AMI net cost estimates is that the potential cost savings associated with better control of theft of service and uncollectible accounts that had been identified as potential cost savings in the Companies' February filing had been eliminated in the Companies' updated May filing. Can you please explain the significance of those potential savings and why they were removed?

A. Yes. In February, the Companies indicated that an AMI system would virtually eliminate estimated bills and, as a result, fewer disputed bills and associated write-offs could be expected. As the Companies prepared for the May filing, it became clear that it would be difficult to reasonably estimate the amount of any potential savings that might result from fewer disputed bills and that the amount would probably not be material. In February, it was also thought that the AMI system could assist companies in more accurately identifying when the consumption of customers in arrears reached the point where a shutoff was appropriate. Quicker shutoffs could mean that less energy would be provided "for free", thereby leading to a resultant reduction in revenue requirements. Subsequently, it was determined that the existing processes should be as effective at identifying when arrears get to the point that service should be disconnected and therefore this potential savings attributable to AMI was removed. As a side note, if AMI were able to provide information that led to earlier shut-offs, an initial spike in shut-offs could be expected to lead to greater initial write-offs which were also not included in the AMI forecast. Similarly, with respect to theft of service, it is difficult to determine with any degree of accuracy how much might actually be saved as a result of AMI; however it is not expected to be material.

Q. To the extent that AMI does enable the Companies to reduce uncollectibles and/or theft of service, how will such savings benefit customers?

A. The portion of such savings that relate to commodity will be flowed through to customers via the MFC and the NBC and be reflected in the POR discount rate. Delivery savings, while not expected to be material, will be reflected in future revenue requirements.

7. **Depreciation of Existing Meters**

Q. Please identify the annual amount that NYSEG and RG&E are currently depreciating existing meters?

A. Based on the amounts shown on Exhibits __ (JB-5) and ___(JB-6), NYSEG is depreciating existing meters at the annual rate of approximately $3.9 million and RG&E is depreciating at the annual rate of approximately $2.1 million.

Q. Do you agree with Mr. Benedict's proposal that depreciation on the existing meters should cease when AMI is implemented and that the revenues that are currently supporting that depreciation can then be used to offset part of the cost of the depreciation on the new AMI facilities?

A. No. Staff's retirement approach, while generally consistent with normal retirement accounting, does not provide for the timely and accelerated recovery of the existing meter investment as recommended by NARUC and preferred by the Companies. As Mr. Benedict testified, the cost of depreciating the existing meters is currently in rates. AMI represents a significant technology change in our industry and properly providing for the recovery of historical meter investment is important. From a ratemaking point of view and financial integrity point of view, it is most appropriate to continue depreciating, or amortizing, the existing meters at the current rate and to continue to recover that cost through rates as it is today. At the time that NYSEG and RG&E filed their AMI proposals with the Commission, it was indicated that the Companies and Staff would work together in those proceedings to determine how the remaining cost of the existing meters would continue to be recovered through rates. When the Companies filed their AMI revenue requirements, they did not forecast ceasing depreciation of the existing meters (as Staff has done in this case) because the Companies believe that those existing assets should continue to be depreciated or amortized and recovered through rates at, at least, the existing level. In fact, NARUC recommends that commissions consider an accelerated recovery of the existing investment.

8. **Cost Recovery Provided for Under Existing Rate Plans**

Q. As noted earlier, Mr. Benedict stated that both NYSEG gas and RG&E's current rate plans have provisions that address the costs of mandates, such as AMI. D oes his testimony indicate that the NYSEG Gas and RG&E AMI shortfalls would be deferrable or otherwise offset based on the provisions of the current rate plans?

A. That is not clear, given Staff's proposed changes in the deferral thresholds.

Q. Did Mr. Benedict indicate if the NYSEG Electric Rate Order includes any such recovery provisions and, if not, how he proposed that NYSEG Electric would recover its AMI revenue requirement shortfall if a surcharge is not provided and the cost is not included in base rates?

A. No. Mr. Benedict was silent on the issue.

Q. Referring to page 33 of his testimony, Mr. Benedict makes several suggestions that the Commission might want to consider relating to recovery of net AMI costs. Do you want to comment on those statements?

A. Yes. First Mr. Benedict suggests that the Commission might want to require the Companies to "proceed with AMI deployment without additional recovery assurances from the Commission" "since both companies are over earning at current rate levels". Mr. Benedict fails to point out that it is Staff's proposed PBA imputations, changes in common equity cap and changes in the sharing provisions that would throw the Companies into excess earnings positions. He also does not point out that if rates are reduced based on the revenue requirements that he and

Mr. Haslinger present on Exhibits ___(JB-2) and ___(RPH-2), there would be no earnings sharing to absorb AMI. Mr. Benedict further suggests that "another [way] would be to assume that the cost of deployment would be absorbed by the utilities, which then can constitute a positive benefit of the acquisition". He goes on to say that "given the downward revisions to the net cost of AMI deployment and other possible adjustments (such as slippage), it should be valued at a zero cost and therefore be given little weight in the decision for approval. These statements should be disregarded. The Companies have presented the AMI proposals pursuant to Commission direction. These programs are key steps in achieving the Governor's "15 by 15" clean energy strategy. No attempt should be made here or elsewhere to force the Companies to absorb the cost.

9. **Summary of AMI**

Q. Please summarize the Companies' Position.

A. The Commission has separate proceedings where the NYSEG and RG&E AMI proposals are being considered. No action should be taken in this proceeding that would in any way inhibit, pre-determine how the Commission will equitably provide for rate recovery of prudently incurred AMI costs or otherwise jeopardize the AMI program.

VI. **CONCLUSION**

Q. Do you have anything further to add?

A. Yes. For the reasons stated above, the Commission should reject Staff's recommendation to transform this Section 70 proceeding, regarding whether the Proposed Transaction is in the public interest, into an investigation of Staff's proposal to impose hundreds of millions of dollars worth of asset write-offs, company-financed reserve increases, rate reductions and earnings sharing. Staff's proposals are beyond the proper scope of this case and would contravene the existing rate plans and orders authorized by the Commission for NYSEG and RG&E. In light of Staff's testimony,NYSE G and RG&E have been compelled to respond to the Staff's punitive proposals, but we urge the Commission not to delay this proceeding by consideration of Staff's many rate issues. As explained in detail in this testimony, Staff's proposals are without merit and should be dismissed or, at the very least, deferred for consideration in an appropriate rate proceeding.

Q. Does that conclude your testimony?

A. Yes.

BY MR. MUELLER:

Q. And, Panel, attached to your testimony, is it true, that there were nine exhibits, RAP-1 through 9 beginning with RAP-1, which contains the Panel's qualifications and then RAP-2 through 8, which explains -- contains certain explanatory schedules?

A. (Walker) Yes.

Q. And do you have any changes or updates to those documents?

A. (Walker) No.

MR. MUELLER: Your Honor, I would like to ask that those nine exhibits that are -- that were attached to the prefiled rebuttal testimony of the Rate Adjustment Panel be marked as the next sequential exhibits.

JUDGE EPSTEIN: Okay. Those will be Exhibits 25 through 35 -- I am sorry, 27 through 35.

MR. MUELLER: And the panel is available for cross-examination.

JUDGE EPSTEIN: And I think if you would just give us a moment, do you want to mark those?

THE REPORTER: Yes.

(The documents above-referred to were marked as Exhibits 27 through 35 for identification.)

JUDGE EPSTEIN: Mr. Van Ryn, do you want to go first?

MR. VAN RYN: Yes, Your Honor.

CROSS EXAMINATION

BY MR. VAN RYN:

Q. Good afternoon, Panel.

A. (Adams, Syta, Walker) Good afternoon.

Q. Could you please turn to your exhibit, RAP-3, page 1 and there you show two positive benefit adjustment scenarios and we will call that PBA, okay?

A. (Walker) Sure.

Q. And one is labeled no rate reduction and one is labeled with rate reduction; is that correct?

A. (Adams) That is correct.

Q. And the totals are about $1.7 billion for the no reduction scenario and about $1.6 billion for the with reduction scenario; is that correct?

A. (Adams) That is correct.

Q. Now, in both scenarios, you begin with the same one-time charges; is that correct?

A. (Adams) Yes.

Q. And those one-time charges include both Staff's proposed PBA adjustments and its proposed regulatory

adjustments; is that right?
A. (Adams) That is correct, as detailed on RAP-2.
Q. And you did not divide your one-time charges into two categories, one for PBAs and one for regulatory adjustments; is that right?
A. (Adams) Not on this schedule. We did on RAP-2.
Q. Could you please turn to page 2 of RAP-3. And there you attempt to capture the effects of earnings sharing under Staff's earnings sharing mechanism when calculating the rate reductions; is that correct?
A. (Adams) Yes.
Q. And in that exhibit, you assume an equity ratio of 38 percent; is that correct?
A. (Adams) We used the Staff numbers for that, yes.
Q. Could you tell me where you got the 38 percent out of Staff's testimony or exhibits?
A. (Adams) Sure. It is probably referenced in numerous different places, but an easy location -- well, here is one reference, page 34 of Bob Haslinger's testimony, line 13.
Q. Thank you. Is that rate making earnings sharing mechanism normally used --
MR. VAN RYN: Excuse me, strike that.
Q. Is that rate making equity ratio normally used

when implementing an earnings sharing mechanism?
A. (Adams) Which one, the 38?
Q. The 38 percent?
A. (Adams) I don't know, is that Staff's proposal or not? It is not clear to me, but we would use whatever would either be authorized or allowed in a multi-year rate plan.
Q. But there is no rate plan here yet; is that correct?
A. (Adams) There is no rate plan as a result of this proceeding. The Companies have rate plans in place for three of the utilities and we have rates in place for NYSEG Electric based on the decision in its last case.
Q. But as of here, no one has developed a prospective rate plan yet in this proceeding?
A. (Adams) As we sit in our testimony, we don't believe that one is necessary.
Q. Under your current rate plans, what are you currently using as the equity ratio in doing sharing?
A. (Syta) We used the lower of 45 percent or the Company's actual equity ratio.
(Adams) I think it is detailed in each of the rate plans. If you want specific references, we can point you to those.

Q. That is not necessary at this time. And recently have you had any -- in any of the rate plans, have you had any reason to use less than 45 percent?

A. (Adams) No.

Q. Now, you took your earnings sharing calculation from page 2 of RAP-3 and you moved that calculation to page 1; is that correct?

A. (Adams) Yes.

Q. And then you held that Staff earnings sharing mechanism number constant for the period 2009 through 2013; is that right?

A. (Adams) That is correct, we showed that I think on the third line down.

Q. And the earnings sharing would remain constant in that amount only if NYSEG and RG&E did not experience any earnings attrition or erosion during that period; is that right?

A. (Syta) Or any growth.

(Adams) I think the earnings sharing would be that level based on Staff's calculations of the pro forma rate. And so if it stays constant during that entire time period, this is what it would be. If costs change or sales change, it would be different, yes.

Q. If you could turn to page 74 of your testimony.

And there you describe the effect of the Ginna contract on the asset sale gain account, and describe that once that contract comes to an end, the ASGA will become depleted; is that correct?

A. (Syta) During the course of the contract, not at the end.

Q. During the course of the contract, thank you. And once the AGS -- excuse me, once the ASGA is depleted, rates will either have to rise or a regulatory asset will have to be created; is that correct?

A. (Adams) That is how the mechanism works, yes.

Q. And the regulatory asset would be created through a deferral; is that the appropriate mechanism?

A. (Adams) Yes.

Q. And did you show the effect of that deferral anywhere on page 1 of your RAP-3?

A. (Adams) We didn't show any effect of any ASGA changes or any other cost changes in RAP-3.

Q. Now, in your testimony generally you claim that the regulatory adjustments that Staff proposed are overstated; is that correct?

A. (Adams) I think overstated and we disagree with them.

Q. And Staff presented its recommended adjustments in exhibits to its witnesses, Benedict and Haslinger's testimony, and you referred to those testimonies in exhibits?

A. (Syta) Yes, we did.

Q. Now, when you prepared page 1 and page 2 of RAP-3, did you reflect any of Staff's proposed regulatory adjustments?

A. (Syta) Could you give an example of one of those?

Q. Let's break that question down into pieces.

A. (Syta) Okay.

(Adams) I would say, yes.

Q. Now, even though you disagreed with Staff's regulatory adjustments, did you propose reductions to those regulatory adjustments if your disagreement were not accepted?

A. (Adams) Maybe we did in one clarification here. Regulatory adjustments meaning the non-PBA adjustments from Staff? Specifically, the CCS or the software capitalization adjustment as well as the prior year annual compliance filing?

Q. Right.

A. (Adams) Now, can you repeat your question?

Q. Could you hang on a second. Now, the largest of the regulatory adjustments were the capitalized software and the prior accounting for the prior over earnings accounting. Were there other regulatory adjustments that you are aware of for items like property taxes, stray voltage, gas pension expense, and how did you categorize those?

A. (Syta) Those are -- you are referring to them as regulatory adjustments, but I don't believe they show up on the Staff exhibits to Staff witness Haslinger nor Staff witness Benedict's exhibits.

Q. So --

A. (Syta) So we didn't do -- we tried to take the numbers directly from those Staff exhibits and use those in the preparation of the -- of this Panel's exhibits.

(Adams) And to the extent that they are, those three items, we talk about each three -- each one of them in our testimony. Stray voltage would be a discussion about whether or not stray voltage should be -- the reserve should be increased and should be classified as a PBA. And then we also discussed the pension deferral as well as property taxes. So I think we have covered those in here. To the extent that Staff presented them as a PBA, they were either a reserve increase. On the pension deferral, they included, I think, the NYSEG Gas pension deferral in here. We would have picked it up there as a PBA.

(Walker) And I think we noted on some of the items where Staff proposed that the deferral accounting end, that any kind of revenue requirement would have to reflect the corresponding expense adjustments to reflect inflated -- increased costs that would go out into a forecast year. Staff didn't make those adjustments and we didn't try to make those here.

Q. If you could look to page 1 of your exhibit --

A. (Syta) Which exhibit?

Q. RAP-3, let's stay with that one. And under both scenarios you show a line, reserve accruals and reduced amortizations?

A. (Adams) That is correct. I think we showed those amounts come from one of our other schedules, RAP-4.

Q. And that is a positive number that you're adding back in; is that correct?

A. (Adams) That is correct.

Q. And what is the purpose of that?

A. (Adams) We recognized that upon the write-off or Staff's proposed write-offs of regulatory assets, that the Company would no longer have an expense amortization or the need to accrue certain amounts into its reserves. So we thought that was appropriate to recognize that as a -- as an avoided cost per se by the Company.

Q. Okay. If you could turn to page 32 of your testimony. And in there you discuss the PBAs that Staff proposes through funding reserves; is that correct?

A. (Syta) It starts the discussion on page 32.

Q. And then during that discussion, you state at page 34 that rate base should not be reduced by this increased funding of reserves; is that correct?

A. (Walker) Yes.

Q. When you prepared page 2 of RAP-3, did you reverse Staff's rate base reductions?

A. (Walker) We -- RAP-3 reflects Staff's adjustments. We didn't try to make any kind of corrections to them. We pointed out problems with them in their testimony.

Q. So that means that those rate based reductions are reflected in scenario one. Are they also reflected in scenario two in any way?

A. (Adams) Yes, they are.

(Walker) Yes.

Q. Now, if you look back to page 1 of RAP-3, you have a line labeled, interest on customer sharing, is that correct, for scenario one?

A. (Walker) Yes.

Q. And the rate of interest assumed on that line is between 10 and 11 percent, correct?
A. (Syta) Depending on which business you're talking about, that is correct.
(Adams) Yes.
Q. Assume the Company does not earn excess earnings, does that mean it will be able to use the cash represented by the interest supporting the excess earnings for its own purposes?
A. (Adams) Could you repeat that question?
Q. Sure. Assume that the Company does not actually experience over earnings under this scenario, that means that it will not need to expend this interest and it can use the monies it represents for other purposes; is that correct?
A. (Adams) Depending on -- if the Company does not have over earnings under its rate plans, the Company would not have to accrue interest on any ASGA addition or customer reserve, an addition that is associated with the customer share of earnings. That is not what Staff schedules is referencing.
Q. And will the Company be able to invest that cash in other investments or include it in rate base or use it for some other purpose?

A. (Syta) I think there is a little misconception in your question. There isn't really a cash issue going on here. This is just a book accrual of interest that is represented on page 1 of our RAP-3.

(Walker) Are you asking under scenario one whether or not --

Q. What --

A. (Walker) -- the Company, if it just had an earning sharing mechanism and not deliver a rate decrease, what we would do?

Q. Yes.

A. (Walker) I guess I am kind of confused on what you are asking.

Q. Yes, I am asking under scenario one, and the Company has excess earnings --

MR. VAN RYN: Excuse me, strike that.

Q. Let's turn to another topic. Please turn to page 89 of your testimony. In there you discuss depreciation on the existing customer meters that will be replaced if your automated metering initiative is implemented; is that correct?

A. (Adams) Yes. Here is where we discussed, we provide the rebuttal to Mr. Benedict's proposal related to the depreciation -- on ceasing the depreciation on existing meters.

Q. And it is your theory that normal retirement accounting, which would be that the depreciation on those meters would cease, is not appropriate under these circumstances; is that right?

A. (Adams) We state that is not the preferred approach by the Companies on page 9.

Q. Do you believe that continuing depreciation on the retired meters would be a material accounting change?

A. (Adams) Certainly it is an accounting change and that is why we would ask that the Commission approve that change.

Q. And have you asked the Commission to date to approve that?

A. Only to the extent that it is through its review of the Company's AMI filing.

Q. And you made that filing in conformance with the Commission's Order issued August 1st, 2006 in case 94E0952?

A. (Syta) We will accept that subject to check.

Q. And doesn't that Order say at page 19, that cost recovery for metering initiative should be considered through a separate petition for cost deferral or through development of a cost -- a cost recovery mechanism in a rate case?

A. (Syta) We can accept that subject to check.

Q. And so you made your AMI filing for the meter program without that separate petition; is that correct?

A. (Adams) We made our filing with -- we made two filings actually. We made the original filing and an updated filing, and the updated filing actually included tariffs. Those tariffs as well as a series of cost information. I think that that, whether or not you consider that a petition per se, I think it was filed in compliance with the Commission's Order and we would hope that the Commission would consider it the request that the Company laid out for its cost recovery mechanism.

Q. And your AMI proposal provides for the replacement of meters for all gas customers; is that correct?

A. (Adams) We would have to check whether or not we do it for the daily meter, the current daily meter customers. I -- we would to have to check with someone else.

Q. Okay. And you can get back to us on that, we will treat that as an on-the-record request?

A. (Adams) Sure.

Q. Could you please turn to page 51 of your testimony, gas pension deferral expense of $6.5 million. I show you a letter from NYSEG dated February 29, 2008, labeled the Annual Compliance Filing for Earnings Sharing.

MR. VAN RYN: I would like this document marked as an exhibit.

JUDGE EPSTEIN: Number 36.

(The document above-referred to was marked as Exhibit 36 for identification.)

Q. And if you could turn to Schedule D?

A. (Syta) Yes.

Q. And there it shows a pension expense of approximately $5.1 million; is that correct?

A. (Syta) It shows pension deferred expense, yes, of $5.1 million.

Q. And that figure is supposed to be the same figure as the $6.5 million?

A. (Syta) Not at all. The $6.5 is reference to testimony, it is a 2006 number. The $5.1 number is a 2007 number.

Q. And those are just the deferral numbers, correct, for 2006 and 2007 and they are not the actual amount of gas pension expense?

A. (Syta) That is correct.

Q. And where could we find the actual amount of gas pension expense? And if it is not an easy reference, could you provide that to us?

A. (Adams) Yes. It is actually pension income and we could provide that. What years would you like?

Q. 2006 and 2007.

A. (Adams) Sure. I think the -- in fact, I think it is included in the work papers that we submit that support these compliance filings.

Q. And for 2007, could you supply the same type of work papers that you supplied for 2006?

A. (Adams) Yes. I think they are getting ready to be submitted if they weren't -- if they haven't been already.

Q. If you could turn to page 52, where it states that deferred accounting for pension costs is provided for in the PPS and the gas joint proposal. The PPS is the Commission's Pension Policy Statement; is that correct?

A. (Syta) Yes, circa 1991, I believe.

Q. Does the PPS apply in its entirety to NYSEG gas pension expense?

A. (Adams) No, the true-up is limited as stated in the gas joint proposal.

(Syta) And on page 51 of our rebuttal testimony, lines 11 through 13.

Q. Are there any other elements of the PPS that do not apply to NYSEG Gas?

A. (Adams) Regarding the PPS as it relates to pensions?

Q. Yes, and not just pensions, but also OPEBs?

A. (Adams) I would just reference you back to the gas JP. It pretty much states what is going to apply for the policy statements in Section 38. And NYSEG Gas has certain limitations relating to the PPS related to the true-ups and the changes in treatment for gains and losses since 2002 and then the waiver in effect for the policy on true-ups for OPEBs that continues in effect.

(Syta) And just to correct, it was Section 18.

(Adams) Sorry.

Q. If you could turn to page 42 of your testimony. In there you state that Staff has not provided you with any audit reports on your annual compliance filings; is that correct?

A. (Syta) Yes.

Q. Is it also correct that you told the Securities and Exchange Commission that this proceeding is the first time you have heard of any problems with your annual compliance filings from Staff?

A. (Syta) We disclosed the Staff indication in this proceeding to the Securities and Exchange Commission, yes.

MR. VAN RYN: Now, Your Honor, I would like to have that disclosure marked as an exhibit.

JUDGE EPSTEIN: 37.

(The document above-referred to was marked as Exhibit 37 for identification.)

MR. VAN RYN: Your Honor, I would also like to have marked as an exhibit a document entitled, Prepared Testimony of John Benedict in Case 03-M-0084 dated June 3, 2003.

JUDGE EPSTEIN: 38.

(The document above-referred to was marked as Exhibit 38 for identification.)

Q. And if you could turn to page 18 of that testimony?

A. (Syta) We have done so, but which case is 03-M-0084?

Q. It was a NYSEG tax refund case.

A. (Syta) Thank you.

Q. And if you look at line 17, it states that --

line 17 and following, it states that Staff does not agree with NYSEG's computation on its regulated electric operations. And that is because it states there that NYSEG has computed its earnings base on the higher of its rate base -- excuse me, has computed its earnings base on the higher of its rate base or common equity, and that the Commission would use instead the lower of either a Company's rate base or the capitalization actually supporting regulated operations.

MR. MUELLER: Objection, the question is argumentative. We just had a statement by counsel without a question. Argumentative.

MR. VAN RYN: I am waiting for the witnesses to read and react. What I am doing is simply paraphrasing what the document says and I will ask them now:

Q. Do you agree with that paraphrasing?

A. (Adams) So the testimony is out of John Benedict and his position. At the very end it says that the -- it discusses regarding the tax refunds that the issue related to the calculation of over earnings in 2002 and beyond should be addressed in another proceeding.

Q. Is it correct to state that NYSEG has computed its earnings base on the higher of its rate base or common equity when making its annual compliance filings?

A. (Syta) I think in its earnings filing, NYSEG has used rate base and I believe it was, for the years in question here, used the 45 percent limit as we discussed earlier.

Q. Let's turn to the topic of capitalized software, IBER 0359. It states that approximately $6.3 million of capitalized software expense originally charged to electric and tangible plant has been transferred to common plant; is that correct?

A. (Walker) Yes.

Q. Was that amount subject to depreciation prior to its transfer to common plant?

A. (Walker) I would have to take -- to check on that, but I expect so. It was charged to -- initially charged to the wrong department and then it was corrected, but I would have to believe that it was being depreciated, but we can check that.

Q. Thank you. Is it correct that in late 2006, the Company requested approval from the Director of Accounting and Finance to capitalize internally developed software costs?

A. (Syta) I believe the Company asked the Director of Accounting and Finance to reach the conclusion that the Company had reached in its analysis of the August

23rd, 2006 Order. And that conclusion the Company had reached was that the -- there was authority to capitalize and I believe that was the request to the Director of Accounting and Finance.

MR. VAN RYN: Your Honor, I would like that marked as an exhibit, the Director's response to that request.

JUDGE EPSTEIN: 39.

(The document above-referred to was marked as Exhibit 39 for identification.)

Q. And if you could turn to page 3 of that letter. The conclusion reached there is that the Director is not going to grant the request until he receives further information; is that correct? If you look towards the middle of the page?

A. (Syta) He is saying that he can't grant the request to capitalize additional software beyond the amount already embedded in rates.

Q. Turning to another topic. Could you turn to page 71 of your testimony. And this relates to a disagreement over the $250,000 threshold for major storm expense.

A. (Syta) Starting at the bottom of page 70?

Q. Yes.

A. (Syta) Okay.

Q. Okay. I am going to quote now from the RG&E current joint proposal. Section 11, Subsection 2A on reserve accounting. And it states there that restoration efforts costing less than $250,000 will not be included in the definition major storms and will be charged to RG&E operating expense. Did you take that subject to check?

A. (Syta) I am looking at it. I will accept it.

Q. If only operating expenses can be included if the storm costs less than $250,000, would it be appropriate to charge costs other than operating expenses if the storm costs more than $250,000?

A. (Syta) I have to admit, I didn't completely follow the question.

Q. Let's break it down then.

A. (Syta) Yes.

Q. All right. The statement from the joint proposal limits recovery of -- excuse me, provides for accounting of storm costs of less than $250,000 as only an operating expense. Should that same definition be used if the storm costs more than $250,000 thereby limiting recovery to only operation and maintenance expense?

A. (Syta) When you say recovery, do you mean deferral?

Q. Yes.

A. (Syta) Because clearly in my view, capitalization implies future recovery. So I guess, yes, if it is over $250,000, it would be deferred or recovered through a reserve.

Q. And so you would agree that capital expenses --

MR. VAN RYN: Excuse me, strike that.

Can I have his prior answer read back?

(The last answer was read back by the reporter.)

Q. Let's see if we can explore the "it" in that answer. If you have a major storm and you incur both O&M expenses and capital expenses in repairing the damage, do you believe that you can recover the capital expenses as well as the O&M expenses through a deferral?

A. (Syta) I thought I stated the capital expenditures would be capitalized. Any non-capital expenditures incurred to restore service after or during a major storm would be subject to or eligible for deferral assuming the total of those costs exceed the $250,000 -- in this case, the $250,000 threshold.

Q. So let's take an example, a hypothetical that is admittedly a little extreme. So if the Company incurred

$300,000 in capital costs from a storm, but no O&M expense, they would be able to defer the entire $300,000 amount and recover it as an operating expense?

A. (Syta) No, that was not my testimony nor is it reflective of the answers I previously gave. $300,000 of capital costs would be capitalized. That is it.

Q. And would later be covered in capital accounts not in O&M accounts?

A. (Syta) Correct.

Q. Would you agree that storm cost recoveries are limited to incremental expenses?

A. (Syta) No.

Q. So would you agree -- so that if an employer's -- excuse me, so if an employee's regular base labor costs are incurred in repairing for a storm expense, you would recover that expense?

A. (Syta) To the -- we would recover the expense in one of two ways. One, if the storm as a storm event had less than $250,000 of non-capital costs as indicated in the JP, those costs would be charged to operating expense. And to the extent that, you know, revenues were set to recover those types of baseline expenses, we would recover the costs there. To the extent that the event created costs, operating costs above $250,000, it would be eligible for deferral of the incremental costs associated.

So I think an example stated in the rebuttal testimony or the single example stated in the rebuttal testimony reflecting the only time in reality that this has occurred in the term of this RG&E rate plan, reflects a storm where we did incur, I believe it was something larger than $300,000 of operating expense to recover and restore from the storm of which $100- and -- I think it is $115,000 was incremental and deferred, and the residual, the difference between those two numbers, would have been viewed as being recovered in the rates that were set.

Q. Just a moment. If you could turn to page 26 of your testimony.

A. (Syta) Yes.

Q. In there we discuss spending on the outreach and education efforts for the Voice Your Choice program?

A. (Syta) For RG&E's Voice Your Choice program?

Q. Yes.

A. (Syta) Yes.

Q. Okay. At page 28, you state that numerous meetings were held with PSC Staff on the O&E efforts?

A. (Syta) Yes.

Q. Did PSC Staff from the Office of Retail Market and Development review all of the materials used in the outreach and education program?
A. (Syta) I believe so.
Q. And was their purpose to review those materials or to discuss the cost of those materials?
A. (Adams) You would have to ask them.
Q. You seem to assume here that it was -- their purpose was to review the costs. Is that incorrect?
A. (Syta) Where are you reading that assumption?
Q. Numerous meetings were held annually with PSC Staff, RG&E worked closely, RG&E provided annual reports. Did you receive any indication that Staff was not satisfied with the level of the Company's VYC efforts? That is not meant to imply that the Office of Retail and Market Development Staff reviewed the costs?
A. (Adams) We assumed that Staff would probably speak with other Staff within the department.
Q. And you also state that you had no indication of Staff's dissatisfaction with Voice Your Choice spending before this proceeding?
A. (Syta) That is correct.
MR. VAN RYN: Your Honor, I would like to have marked as an exhibit a Staff Information Request to the

Company outside the scope of this proceeding in the performance of Staff's general auditing duties.

JUDGE EPSTEIN: Number 40.

(The document above-referred to was marked as Exhibit 40 for identification.)

Q. Now, on page 45 of your testimony you state that you do not consider information requests notice of staff dissatisfaction; is that right?

A. (Syta) Are you referring to this specific information request?

Q. Now, I am just referring to your general statement on page 45?

A. (Syta) I think the statement says, deducing Staff's positions from information requests is not an exact science.

(Adams) This response relates to the annual compliance filings, and you just handed us something related to the outreach and education effort.

Q. Yes, you are correct. And I am assuming that you would apply the same argument to both cases?

A. (Adams) Well, I think that is generally correct. This related to the treatment of the items or as Mr. Benedict has testified related to their Staff's positions for annual compliance filings. To the extent

that there is a Staff position related to outreach and education or the deferral of costs associated with outreach and education, then, yes that would apply.
Q. Would you at least agree that if Staff is asking a question that may mean that it has not accepted the Company's position?
A. (Adams) No, Staff asks a lot of questions. We answer a lot of them. Some of them they accept, some of them they don't. I mean this response is fairly comprehensive, it is even quoting the Chairman of the Commission regarding the outreach and education efforts. So we wouldn't assume that just because we receive a question from Staff that it means it disagrees with the Company's position.
Q. Okay. If you could return to IR response, IBER 340. And that sets forth the O&E spending on Voice Your Choice for both RG&E and NYSEG for the years 2004 through 2007; is that correct?
A. (Syta) Yes.
Q. And subject to check, spending over the four years for RG&E was about $8.3 million and for NYSEG was about $2.5 million?
A. (Syta) That is correct.
Q. And subject to check, RG&E has approximately

320,000 customers for that period while NYSEG has approximately 750,000?

A. (Syta) I think the RG&E numbers are a little higher than 320,000. It is probably closer to 350- or 360- -- 350,000 or 360,000.

Q. Let's limit that to residential customers and check it through the PSC annual reports?

A. (Syta) If it is limited to residential, then those numbers might be more in line.

Q. So proportionately RG&E Company with half the customers of NYSEG has spent approximately three times as much in outreach and education for Voice Your Choice; is that correct?

A. (Syta) In round numbers, yes.

Q. Thank you.

MR. VAN RYN: That is all I have.

JUDGE EPSTEIN: Okay. Thank you, Mr. Van Ryn.

And I believe the chart indicates that there is additional cross from CPB multiple intervenors and Nucor.

BY MR. BREW:

Q. Good afternoon, gentlemen. This will be real brief. The -- one of the issues that the Petitioners' Revenue Decoupling Panel talked about in terms of revenue decoupling was the need to avoid making sure that any RDM didn't produce a cross class reallocations for revenues. And my question to you is: With respect to your AMI proposal, I take it in your testimony you object to Staff's opposition to collection of the AMI costs through a surcharge; is that right? Testimony beginning at page 74.

A. (Adams) We rebutted Staff's testimony as it related to the calculation. I don't know -- as well as to a surcharge to the extent that they have placed that, yes.

Q. Well, just your AMI proposal asked, in another docket asked to collect your AMI costs through a volumetric surcharge; is that right?

A. (Adams) I think it is a cost through a charge per meter.

Q. Per meter or per kilowatt hour; if you know?

A. (Adams) Hang on and we will check. And we will take it subject to check, but I am looking in our file and we are adding it to the customer charges.

Q. To the customer charge?

A. (Adams) Yes.

Q. Is that in your May filing?

A. (Adams) Yes.

Q. Okay. All right. Would you agree then that the AMI costs should be recovered inasmuch as possible in relation to cost causation?

A. (Adams) We always believe that.

Q. Thank you.

MR. BREW: That is all I have.

BY MR. MAGER:

Q. Good afternoon, Panel. Panel, I have a -- I guess I want to start with a clarifying question. I am okay if counsel wants to weigh in on this too. The Joint Petitioners filed a partial acceptance document and I understand that the Policy Panel will be sponsoring that. However, would this panel or the Policy Panel be the appropriate persons to answer questions as to the rate impacts of the proposed positive benefit adjustments?

A. (Adams) The Policy Panel.

Q. That is fine, as long as they don't kick it back to you. Okay. In response to questions by Staff, there was discussion about positive benefit adjustments and regulatory adjustments. Can you just, for the record, clarify exactly what you understand both of those terms to mean in relation to this case?

A. (Syta) I think in our preparation of rebuttal testimony, we tried to use Staff's depiction on their exhibits of what they termed positive benefit adjustments. And I believe their interpretation was things that wouldn't happen if this was -- if there wasn't a merger pending here. And I believe they had other adjustments that they termed either other adjustments or something other than positive benefit adjustments that they deemed could happen in the absence of a merger. And they combined the two, I believe on their schedules or exhibits attached to Mr. Haslinger's and Mr. Benedict's testimonies.

Q. Okay. And starting on the bottom of page 12, top of page 13, you start addressing Staff's proposed positive benefit adjustments or PBAs, correct?

A. (Syta) I think on the top of 13, just to be completely clarifying here, Mr. Mager, we do say PBAs or any of the other adjustments proposed by Staff. Again, just given that we just went through that definition process, this covers more than just what Staff called PBAs.

Q. Okay. And so from page 13 to page 21, are those one-time adjustments in there or are those all PBAs?

A. (Syta) I believe, for example, most of them are what Staff deemed PBAs, I think there is a --

(Adams) We would say that they are PBAs.

(Syta) Yes, the other adjustments that Staff had are discussed elsewhere.

Q. Okay.

A. (Syta) Not on pages 13 to 21.

Q. Okay. And it is fair to say that the Panel opposes Staff's proposed PBAs, correct?

A. (Adams) That is fair.

Q. Thank you. Now, what if the Public Service Commission determines that quantifiable financial benefits are needed for customers for this merger to be in the public interest, would it make a difference to the Company which specific PBAs are adopted as long as the total amount was consistent with the Commission's findings?

A. (Syta) Your question implies that the form that the Commission would take to find positive financial benefits are these PBAs?

Q. Yes.

A. (Adams) Sir, first we disagree that those are required.

Q. Understood.

A. (Adams) There are certain items that would be more preferable than others and probably provide a larger potential customer impact or benefit to the extent that those PBAs were flowed back to customers. A case in point, the Nine Mile 2 amortization because that amortization is one of the largest ones that we have out there. But those are -- I think those are the items that have been included on the acceptance document.

Q. Okay. And let's say that the Commission determines that more PBAs are needed than what is on the partial acceptance document. Then is it possible that the Company would want some of Staff's proposed PBAs to be included?

A. (Adams) So our testimony definitely goes against the PBA proposals and so to the extent that there are any certain -- you're asking questions about choices of PBAs, we would defer that to the Policy Panel.

Q. Okay. Now, you talked about different PBAs having different impacts on customers and rates. Can you explain what you meant by that?

A. (Adams) Simply whether or not a PBA is included in or being -- currently being amortized and the level of that amortization would have an impact on the amount or the rate impact of that PBA.

Q. Okay. And to the extent -- to the extent no expenses were written off and rates were simply reduced by a certain amount, the benefit of that would only last so long as the Company's next rate case; is that understanding correct?

A. (Syta) Can I clarify that?

Q. Sure.

A. (Syta) Because you're saying if there was no such thing as a PBA adjustment? You said if nothing gets written off?

Q. Yes.

A. (Syta) So in other words, no PBA adjustment and an alternative financial arrangement of just simply a rate reduction imposed would deliver some kind of a benefit?

Q. Right, that would only last until the next rate case potentially?

A. (Adams) I guess it depends on what the item would be and certainly to the extent that there are cost increases, those cost increases will really drive what occurs in the next rate case.

Q. Well, let's -- let me see if I can get at it this way. The one-time adjustments that are proposed by Staff, those are not merger related, but have been proposed to be adopted in this case?

A. (Adams) Staff has proposed those and, yes, we agree they are not merger related.

Q. Okay. Now, to the extent they were captured for customers in this proceeding, couldn't that also be seen as a benefit to customers flowing from the proposed merger?

A. (Adams) There are many things that could be perceived as a benefit. I think the Petitioners laid out what those benefits would be and then there are certain concessions that have been included in the acceptance document.

Q. Okay. And your position is that if the Commission does not rule on Staff's one-time adjustments, all of those issues would remain open until conceivably the next rate case?

A. (Adams) Yes, the one -- the two items that I believe that you are referring to of the one-time adjustments versus PBAs, I would say regulatory adjustments, the treatment of the capitalization of software, I think we explained in our rebuttal that we believe that that was already addressed in the last proceeding. And then the annual compliance filings, we would say as well as I believe Staff did that it would be addressed in subsequent proceedings.

Q. Now, you have taken a position that Staff is somehow proposing modifications to existing rate plans by its testimony; is that understanding correct?

A. (Adams) Yes.

Q. Okay. Now, is it your understanding that Staff's adjustments could be imposed in this case if the merger is rejected?

A. (Adams) We would defer to our --

Q. Legal --

A. (Adams) -- counsel --

Q. Okay. Well, let me rephrase --

A. (Adams) -- on that, but we would -- my opinion is always no.

Q. And so isn't what Staff is proposing is PBAs and other adjustments that -- upon which the merger would be conditioned?

A. (Adams) I believe that is correct. Are you asking me what Staff's testimony is?

Q. Yes, your understanding of it?

A. (Adams) They are -- Staff testified that these are items that could be considered by the Commission. And I believe that is how they have actually framed that in Mr. Haslinger's and Mr. Benedict's testimony.

Q. In fact, isn't their testimony basically that the Commission should reject the proposed merger, but if it was to consider approval of the merger, it should condition such approval on certain PBAs and other one-time adjustments?

A. (Adams) I think that Staff proposes that there be conditions upon the merger, yes.

Q. And so for -- and so if Iberdrola accepted those conditions, the merger would go forward under that scenario?

A. (Adams) I think that that would be a question better asked to the Policy Panel.

Q. Well, I guess what I am trying to understand is that if Iberdrola accepts conditions in exchange for merger approval, how is that a violation of any existing rate plan?

A. (Adams) I think to the extent that things are accepted that it wouldn't be a violation.

Q. Okay. So --

MR. MAGER: Withdrawn.

Q. And you're not -- you are not in any way in your testimony challenging the Commission's authority to impose conditions on merger approval; are you?

A. (Adams) No, not in our testimony, we haven't challenged the Commission's authority.

MR. MUELLER: That would probably be a matter for brief.

MR. MAGER: I don't have anything further.

Q. Thank you.

JUDGE EPSTEIN: Okay. Thank you, Mr. Mager.

Mr. Prestemon, how much do you think you have?

MR. PRESTEMON: 15 minutes at the most I would think.

JUDGE EPSTEIN: Okay. We will take a recess for 15 minutes.

MR. PRESTEMON: What if I said 10?

(A short break was taken.)

JUDGE EPSTEIN: Okay. We are back on the record. There has been some discussion among some of the parties which led to the conclusion that what we should do today is complete the cross and redirect, if any, and recross, if any, of this Panel and with that we will adjourn for the day. There is also -- so unless anyone has any problem with that, that is what we will do.

And there also has been some sentiment to start tomorrow at 9:00 o'clock, if nobody has a problem with that.

And I don't know if I want to get into reciting the entire order of witnesses, but there has been an understanding that the next witness after the Petitioners' witnesses would be Mr. Younger for IPPNY.

But when this schedule was so kindly sent around by Staff, it came with a cover note saying that after we get through the Petitioners' witnesses, this order of witnesses doesn't necessarily apply anyway so we may be shoveling those around up and down the list as we go. Okay.

So Mr. Prestemon, please.

MR. PRESTEMON: Thank you, Your Honor.

BY MR. PRESTEMON:

Q. Panel, the questions that I am going to ask have to do with your testimony concerning gas cost incentive mechanisms which I believe is at about pages 64 to 67 of your rebuttal testimony. Do you have that in front of you?

A. (Syta) Yes.

(Adams) Yes.

Q. Am I correct that these incentive mechanisms are concerned with the Companies, and I will refer to the Companies together as RG&E and NYSEG. If you feel you need to differentiate your answers between them, go ahead and do so. But these incentive mechanisms have to do with the Companies managing their gas supply contracts and their contracts for pipeline services such as storage and transportation; is that correct?

A. (Adams) Yes, it is for not only NYSEG and RG&E, but also Southern Connecticut Gas, C&G and Berkshire Gas.

Q. And that has to do with GCIM 2, I take it?

A. (Adams) It did. I didn't realize you asked for the decision.

Q. I wasn't trying to distinguish them now. I am just trying to -- I am just asking you generically what the -- what this work has to do with. And is it correct that the objective of this management is to extract as much value as possible from these contractual assets for the benefit of rate payers?

A. (Adams) Yes, we would say that. That certainly is an objective.

Q. And that effort is consistent with your obligation to provide gas supply at the least cost -- least reasonable cost under the Public Service Law?

A. (Adams) Yes.

Q. Good, thank you. The opportunities for really recovering some of these costs through the management of these contracts began really with the unbundling of the pipeline systems about late '80s, early 1990s?

A. (Adams) Well --
Q. To any extent?
A. FERC 636.
Q. Right, back to order 636. About how long have the Companies been releasing capacity or actively seeking capacity released transactions with capacity that they don't need?
A. (Adams) I don't know if it is capacity that we don't need. We have --
Q. At the time you release it, I am assuming it is capacity that you don't need?
A. (Adams) Right, and that would be during off-peak time periods. Since -- we have been doing it ever since the market has been open.
Q. And would you say that this is a valuable tool for managing these assets and extracting some of the value from them or recovering some of the cost of the contracts?
A. (Adams) I think it is a tool to, yes, to lower the cost for customers.
Q. And could you say that you were performing your function adequately as manager of these assets on behalf of rate payers if you did not engage in capacity release transactions?

A. (Adams) I think that whether it is a capacity release transaction or a storage or an optimization or off-systems sale, the Company should look at all available opportunities to utilize its assets in the most efficient manner.

Q. So these are all valuable tools for minimizing the cost of your gas supply and pipeline transportation contracts?

A. (Adams) That is correct.

Q. Is that correct?

A. (Adams) That is correct.

Q. And you have been doing -- and you have been doing this for about 15 years now you say, would you say?

A. (Adams) I don't know if it is 15 years. I am not sure exactly when the wholesale capacity release market began. I think that really with any significance occurred at the end of the '90s and the beginning of the 2000 time period.

Q. Okay, fine. And as these are valuable techniques for reducing the cost of your gas supply, would you be doing this in any event even if there were no incentive mechanism that allowed you to keep a share of the proceeds?

A. (Adams) I think the Commission has recognized the importance of having an incentive mechanism so that the Company will try to pursue its most optimum level of efficiency for these assets.

Q. Okay. Obviously that doesn't answer my question, but you would agree then that the objective of an incentive mechanism is to induce the Company to perform well or hopefully very well in this area?

A. (Adams) Yes, an incentive mechanism does a number of different things. It allows the Companies' employees to try to pursue areas and efficiencies where it can share in the reward of such pursuit.

Q. All right. And then back to my other question: Assuming this gas cost incentive mechanism were no longer available, would the Company still feel that it was necessary to pursue these types of transactions in order to keep its gas supply costs to the lowest reasonable level?

A. (Adams) I think the Company has an obligation to pursue least cost supply.

Q. Okay.

A. (Adams) But I believe that an incentive mechanism allows the Company to be very creative in how it goes about pursuing that.

Q. Okay. And with respect to the GCIM 2 specifically, what -- can you define alliance costs as that term is used on pages 66 and 67?

A. (Adams) They're costs that are shared with and/or paid to the alliance provider either, I believe now it is Shell, previously it was BP Energy for -- based on the alliance contract.

Q. So you have an asset management contract with Shell right now?

A. (Adams) They do not, the agreement does not allow them to take over control of assets. They do help manage, I believe, the combined assets of Energy East and LDCs. And that is about the extent of how far I would go without having to go --

Q. To look at the contract?

A. (Adams) To go through the contract.

Q. Right. Do you have any idea what the cost -- the alliance costs were for 2007?

A. (Adams) It is on our annual reconciliation filing, but I do not know offhand, no.

Q. Okay. And what types of activities are associated with what you call optimization under this GCIM 2?

A. (Adams) In the -- in case 4G1278 there is an exhibit that kind of lays out all of the items that would be included in GCIM 2. So there is a whole list of them. If you want me to read a couple of them, I would be happy to do so.

Q. No, I don't think that is necessary. Can you say looking at it generally, do these also reflect strategies which would be reasonable for the Companies to pursue to minimize their gas supply costs or to reduce their gas supply costs?

A. (Adams) I think these are strategies under GCIM 2 that are reasonable to pursue as a group of assets for the Energy East and LDCs.

Q. Can you describe which of these strategies could not be pursued without the alliance?

A. (Adams) Storage --

Q. By contractual means?

A. (Adams) Storage optimization would be one example. The Connecticut LDCs as well as Berkshire and the two New York LDCs all have storage contracts. The ability to optimize storage by including a much larger base of storage contracts with all of them combined would not be available on a single basis.

Q. Okay. But this type of arrangement could be done contractually among the LDCs; could it not?

A. (Adams) Whether or not we have to have someone, I -- the Companies have evaluated different items and different -- whether or not to do it as a sole source. I believe that using a very large supplier and one that is even larger in the market was determined to be the most optimal way to provide a benefit.

Q. Thank you.

MR. PRESTEMON: I have no further questions.

JUDGE EPSTEIN: Okay. Thank you, Mr. Prestemon.

Redirect?

MR. MUELLER: Can I have a minute?

JUDGE EPSTEIN: Yes.

MR. MUELLER: Thank you.

(A short break was taken.)

MR. MUELLER: The Joint Petitioners have no redirect for the Panel.

JUDGE EPSTEIN: Okay. Thank you very much. You are excused.

And if there is no other business, we are adjourned until 9:00 a.m. tomorrow in this room.

(WHEREUPON, the hearing in the above-entitled matter was adjourned until March 18, 2008 at 9:00 a.m.)

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Q. Thank you.

MR. PRESTEMON: I have no further questions.

JUDGE EPSTEIN: Okay. Thank you, Mr. Prestemon.

Redirect?

MR. MUELLER: Can I have a minute?

JUDGE EPSTEIN: Yes.

MR. MUELLER: Thank you.

(A short break was taken.)

MR. MUELLER: The Joint Petitioners have no redirect for the Panel.

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INDEX OF WITNESSES

INDEX OF EXHIBITS

15	RDRA-1 (CONFIDENTIAL)	188
16	RDRA-2 (CONFIDENTIAL)	188
17	GSRP-1	227
18	GSRP-2	227
19	IRs staff is relying on	228
20	IRs staff is relying on- Confidential	228
21	IRs staff is relying on- Trade secret	228
22	Letter from NYSEG dated 3/1/06	239
23	Letter from NYSEG dated 3/11/08	242
24	Quarterly report from NYSEG and RG&E 2007	243
25	RDM-1	282
26	RDM-2	282
27	RAP-1	412
28	RAP-2	412
29	RAP-3	412
30	RAP-4	412
31	RAP-5	412
32	RAP-6	412
33	RAP-7	412
34	RAP-8	412
35	RAP-9	412
36	Letter from NYSEG dated 2/29/08	426.