BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Consolidated Edison Company of New York, Inc.

Case 07-E-0523

September 2007

Prepared Testimony of:

Andrew Harvey
Principal Economist
Office of Accounting, Finance,
and Economics

Anping Liu
Principal Econometrician
Office of Accounting, Finance,
and Economics

Michael J. Rieder
Utility Engineer 3
Office of Electricity and
Environment

New York State
Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

Q. Please state your names and business addresses.
A. Andrew Harvey, Anping Liu, and Michael J. Rieder, New York State Department of Public Service, Three Empire State Plaza, Albany, New York 12223.
Q. By whom are you employed?
A. We are employed by the New York State Department of Public Service (Department).
Q. Mr. Harvey, please briefly state your educational background and professional experience.
A. I received a Bachelor of Arts and Master of Arts degrees in Economics from the State University of New York at Albany. I joined the Department in 1974. I am currently a Principal Economist in the Office of Accounting, Finance, and Economics.
A. My current responsibilities include Article VII proceedings, retail choice matters, and implementation of revenue decoupling mechanisms (RDMs).
Q. Mr. Harvey, have you previously submitted testimony before the New York State Public Service Commission (Commission)?

A. Yes. This marks the fiftieth proceeding that I have provided testimony before the Commission.

Q. Mr. Liu have you already discussed your educational background, professional and testimonial experience, and responsibilities?

A. Yes, that information is included in my individual testimony in this proceeding.

Q. Mr. Rieder have you already discussed your educational background, professional and testimonial experience, and responsibilities?

A. Yes, that information is included in my individual testimony in this proceeding.

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

A. We are addressing the testimony of Company Witness Rasmussen with regard to the proposed implementation of a revenue decoupling mechanism.

Q. In your testimony, will you refer to, or otherwise rely upon, any information produced during the discovery phase of this proceeding?

A. Yes. We will refer to, and have relied upon, several responses to Staff Information Requests. They are attached as Exhibit ___ (RDM-1).

Q. Has the Commission addressed the necessity of a

RDM?

A. Yes. In its Order Requiring Proposals for Revenue Decoupling Mechanisms, issued April 20, 2007, (RDM Order) the Commission directed the utilities to develop proposals for true-up based delivery service RDMs. Specifically, the Commission ordered that RDMs should incorporate the following:

"1. The mechanism should be designed to true-up forecast and actual delivery service revenues for a given time period.

2. The mechanism should be designed to prevent gaming by the utility (e.g., shifting customers to different classes).

3. The recovery of any net lost revenues component of the mechanism should not, in and of itself, produce inter-class revenue re-allocations between customer classes (such re-allocations should only be made purposefully after considering a current fully-allocated cost of service study).

4. All remaining design and implementation issues should be addressed in individual rate proceedings." (RDM Order, page 16)

In addition, the Commission also identified a number of design and implementation issues that should be considered when developing an effective RDM. Specifically, whether the RDM need be applied to all or only some customer classes and whether allowed revenues should be calculated on a per customer basis rather than a total revenue basis.

Q. Why would an RDM be applied to only some customer classes and not all customer classes?

A. One reason would be the differences between the class rate designs. If the rate design for one customer class recovers utility fixed delivery costs substantially on a volumetric or marginal consumption basis, there is a potential net lost revenue and profit effect that could act as a disincentive to the utilities’ promotion or support of energy efficiency programs. Conversely, if a rate design for another customer class recovers utility fixed delivery costs predominately on a fixed charge basis, the potential for net lost revenues from energy efficiency initiatives is significantly reduced. Standby service delivery rates, for example, have been designed to meet this objective and are, therefore, proposed to be excluded from the RDM in this case.

Q. Has the Company proposed an RDM in this proceeding?

A. Yes. Company Witness Rasmussen proposes and discusses a Revenue Accounting and Rate Incentive Mechanism (RARIM) in both his initial and supplemental testimony.

Q. What does Mr. Rasmussen claim are the primary goals of the RARIM?

A. Mr. Rasmussen states the intention of the RARIM is to decouple the impact of sales on revenue growth (earnings) and to encourage and promote continued economic expansion in the Con Edison service territory and electric sales that provide environmental benefits. He also states that “[i]f designed properly, the RARIM can result in real energy efficiency, excellent service and economic development.” (Rasmussen supplemental testimony, p. 2)

Q. Does the Staff Panel agree with Mr. Rasmussen’s characterization of the intent of an RDM?

A. No, we do not. As the Commission articulates in its RDM Order, the intent of a revenue decoupling mechanism is to reduce or eliminate delivery rate disincentives, caused by the recovery of utility fixed delivery costs via volumetric rates, against the utilities' promotion of energy efficiency, renewable technologies, and distributed generation. We believe that other programs, specifically designed for targeted results, could be used to further the goals of energy efficiency, customer service, and economic development. For example, performance incentives could be developed as part of the Company's energy efficiency program, customer service performance and reliability incentives could be developed to encourage the Company to excel in customer service, and specific economic development programs could be designed to encourage economic expansion in the Company's service territory. We do not believe that these goals should be intertwined with a mechanism designed essentially to true-up forecasted and actual delivery service revenues. Our concerns with the Company's proposed RARIM focus on how to best realize the Commission's

RDM vision; that is, the separation of sales from earnings, so that any potential disincentive that would discourage the promotion of energy efficiency, renewable technologies and distributed technologies is eliminated.

Q. What incentives does the Company propose be incorporated into the RARIM?

A. Mr. Rasmussen proposes that the RARIM provide revenue incentives to the Company for adding additional customers as well as to build and strengthen the electric infrastructure and promote service reliability.

Q. Does the Staff Panel concur with the efficacy of these incentives?

A. No, we believe that the Company's statutory obligation to provide safe and adequate service is enough of an incentive for it to build and strengthen its electric infrastructure and an RARIM should not be required to bolster this objective. Nor do we believe that an RDM needs to take on the function of providing incentives for economic development. Again, the main goal of an RDM should be to eliminate or substantially reduce the rateable linkage between sales and revenues and/or profits, and the inherent utility disincentive this might otherwise induce when end-use customers chose to pursue energy conservation initiatives.

Q. Please briefly describe the provisions of the Company’s proposed RARIM.

A. Mr. Rasmussen proposes that the RARIM include the following provisions:

1. Actual delivery service revenues would be compared to the base revenue levels established in this proceeding for each service class, including NYPA, on a weather normalized basis.

2. Shortfalls would be subject to real-time recovery to maintain the financial integrity of the Company.

3. Over-collections would be retained to offset any future shortfalls or used as rate moderators in the future.

4. Con Edison would continue to be at risk for weather-related sales.

5. Increased revenues associated with growth in the number of customers would be retained by the Company.

6. Timely recovery of cost reconciliations (e.g., interference and property taxes) would be included.

7. Revenues from new environmentally-sound programs such as plug-in electric vehicles would be excluded.

Q. What is the Staff Panel’s evaluation of these proposed Company provisions?

A. With regard to provision number 1, we agree that actual delivery service revenues be compared to the base delivery revenue levels established in this proceeding for each service class, including NYPA, on a weather-normalized basis. That is, forecasted sales, and the associated forecasted delivery service revenues, should be based on normal weather as explained in the testimony of Staff Witness Liu. The forecasted delivery service revenues should then be reconciled with actual delivery service revenues on a class-specific basis. We do not agree that actual sales be adjusted to reflect normal weather, as proposed by the Company in provision number 1, nor should the Company be allowed to retain the additional revenues that would likely result from warmer than normal weather, as is intended with the Company's proposed provision number 4.

Q. Please explain.

A. The overall perspective of the Staff Panel is that a revenue decoupling mechanism should not be designed to segregate out a factor over which the Company has no control (e.g., the weather). If the overall rate plan allocates a given amount of risk to the Company, it is better to allocate risks that can induce the Company to behave more efficiently. If the influence of weather upon sales is built into the forecast in an unbiased manner, there will be a comparable probability that revenues could be lower due to weather deviations as there is that revenues could be higher due to weather deviations. As such, utility investors will have no expectation that the utility will profit from the weather, unless rates are set improperly (i.e., the influence of weather is intentionally under-forecasted). By including sales deviations caused by abnormal weather in the reconciliations, the dysfunctional incentive to "game" the sales forecast in the rate case is greatly reduced or eliminated.

Q. Are there any other reasons why the Company's proposed RDM weather normalization should be rejected?

A. Yes. From an administrative perspective, Con Edison's proposal requires close on-going regulatory over-sight auditing efforts that would incur unnecessary costs for both the Company and Staff. The Company proposed weather normalization mechanism is based on a sophisticated statistical methodology that is applied on a monthly basis and involves very complicated weather impact allocations between sales and sendout, calendar days and billing days, among days and months, between months and quarters, and among service classes. These multi-stage allocations at such high frequencies would introduce mismatches and create complexities and potential areas of disagreement, which would make the Company's proposal operationally cumbersome, if not entirely unworkable.

Q. Why does the Company's weather normalization procedure for RDM require regulatory oversight?

A. The regression method proposed by the Company may give a biased estimate for weather impact if the model is not properly specified. In addition, the Company's assumption for normal weather is flawed, as addressed in the testimony of Staff Witness Liu. The Company's assumption for normal weather is inconsistent with the 30-year average of actual number of cooling degree days. As such, there will always be "above normal" sales volumes for some months and days that would give the Company extra revenue.

Q. Relating to weather normalization, is it reasonable that the Company would incur greater delivery costs when the weather is extreme and fewer delivery costs when the weather is below normal?

A. That would appear to be a reasonable proposition, but history does not support this conclusion. In response to Staff IR No. DPS-253, the Company states it incurred incremental costs of $2.1 million in 2005 and $8.2 million in 2006. The summer of 2005 was warmer than normal and the summer of 2006 was generally cooler than normal, yet incremental costs were reported in each year.

Q. Does the Company's claim that there are incremental costs associated with hot weather support its proposal to retain revenues associated with abnormal weather?

A. No, it does not. In its response to Staff IR No. DPS-253, the Company estimated that for 2005 and 2006 the incremental costs associated with above-normal weather was $10.3 million. It also estimated that the incremental revenues associated with the summer months of 2005 and 2006 totaled $68.1 million. Thus, the benefits associated with warmer than normal weather related sales greatly outweighs the costs. Further, the costs incurred in 2006 are incorporated in the test year, yet the sales forecast is based on normal weather. This, in essence, includes higher costs related to warmer than normal weather in the Company's revenue requirement but only bases the sales revenues on normal weather.

Q. What evidence does the Company provide in support of Mr. Rasmussen’s contention that “investors recognize that the Company has the potential for higher earnings during periods of above normal temperatures and have invested based upon the risk/reward profile?” (Rasmussen supplemental testimony, pages 9-10).

A. In response to Staff IR No. DPS-444, the Company states that it has performed no studies or analyses to support its contention in the Company Witness Rasmussen supplemental testimony.

Q. What evidence does the Company provide in support of its claim that investors in Con Edison have invested based upon the potential for higher earnings during periods of above normal temperatures?

A. In response to Staff IR No. DPS-445, the Company again indicates that it has performed no studies or analysis.

Q. Does the Panel agree with proposed provision numbers 2 and 3 relating to the recovery and distribution of under and over recoveries?

A. Yes, we agree that both under and over recoveries should be treated in the same manner.

In his initial testimony, Mr. Rasmussen states that shortfalls would be subject to real-time recovery and overcollections would be retained for future distribution. However, in supplemental testimony, Mr. Rasmussen states that "[t]he shortfall or excess in each service class would be surcharged or refunded to customers in each service class on a volumetric basis over the next 12 months." (Rasmussen supplemental testimony, page 8). As we previously stated, we agree that both under and over recoveries be treated in the same manner as stated in Mr. Rasmussen's supplemental testimony.

Q. How often should the forecasted revenues be compared and trued-up with actual revenues?

A. Class-specific forecasted delivery revenues and actual revenues should be compared on a monthly basis. The true-up of forecasted and actual amounts should be done six and twelve months from the beginning of the rate year. Waiting until the end of the rate year to true up actual and forecasted amounts could cause the accrual of potentially substantial amounts to be either credited or collected from customers. Performing the true-up at six and twelve months will limit the accruals, thus reducing the subsequent bill impacts of the resulting recovery or credit. The amount to be credited or collected from customers should be amortized over a 12-month period.

Q. Do you agree that the Company should be allowed to retain increased revenues associated with growth in the number of customers, as it proposes in provision number 5?

A. No, we oppose the Company's per-customer RDM model and instead recommend that total delivery revenues be trued-up on a class-specific basis. A strong potential for gaming the estimated number of customers exists with a per-customer RDM model. Under Staff's proposal, the Company would retain no increased revenues related to growth in the number of customers, thus eliminating the potential for gaming. A concern over unintended consequences, complications, and gaming weigh heavily in the Staff Panels' recommendation that a total class delivery revenue reconciliation model (comprehensive RDM) is preferable to revenue per-customer RDM approach.

Q. Could you provide additional rationale for the Staff Panel’s preference for a total class RDM instead of the revenue per-customer RDM that Company Witness Rasmussen has proposed?

A. Yes. Assume that a forecast is made of the number of customers, sales and the average net revenues per customer, for each service class. If the actual number of customers in a service class deviates from the forecast number, the Company is compensated (or must refund) the <u>average</u> revenue for each customer over (or under) the forecast, regardless of how large or small that customer actually is. This provides the utility with an <u>ex</u>-<u>ante</u> incentive to underforecast the number of customers. With a total RDM, that incentive would be eliminated. The revenue per-customer RDM also provides an <u>ex</u>-<u>post</u> gaming incentive with respect to the Company’s customer count. For example, if the Company had a customer that had a number of facilities under one meter (<u>e.g.</u>, newspaper stands; apartments), a per customer RDM would provide an inappropriate incentive to the utility to encourage that customer to treat each newsstand or apartment as a separate customer, thereby increasing the Company's customer count without actually producing any real economic or revenue growth. This concern is exacerbated when applied to customer classes that contain customers with wide variations of demands and usage, such as the Company's Service Classification No. 9 – General – Large, comprising customers with demands ranging from 10 kW to over 1,500 kW.

Q. Would the revenue Per Customer RDM proposed by the Company give it a better incentive to care about customer growth and retention than the total revenue RDM proposed here by Staff?

A. Yes, in theory; however, Con Edison proposes excluding all contract and negotiated rate customers, and their associated sales, from the RDM. These are the types of customers for which Con Edison can exert its most potent and direct influence — the price of its product — to either retain or attract customers. Since these customers and their associated sales would be excluded from the Company's proposed RDM, the need to apply a per-customer RDM to the remaining classes is greatly reduced; leaving primarily the ex-ante and ex-post "gaming" concerns previously discussed outweighing any remaining incentive Con Ed would have to increase the customer count for remaining customer classes.

Q. Do you agree that incremental delivery revenues from new environmentally-sound programs such as plug-in electric vehicles be excluded, as proposed by provision number 7?

A. No, we recommend that revenues from any new environmentally-sound programs be included in total revenue reconciliation.

Q. Do you propose that a RDM continue after the rate year in this case?

A. Yes. Staff's proposed RDM should be administered beyond the rate year to coincide with and continue to support the Commission's pursuit of end-use customer energy efficiency initiatives. Determination of the necessary filing and updating requirements, however, is largely dependant on the outcome of this proceeding. We are not, therefore, proposing a specific process to allow for the continuation of the RDM at this time. Rather, we are informing the record of our position that a RDM should continue beyond the rate year and that additional processes are necessary to effectuate its continuation.

Q. Does this conclude your testimony?

A. Yes, it does.