BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

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.

Case 07-M-0906

January 2008

Prepared Testimony of:

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REDACTED

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INTRODUCTION OF WITNESS

Q. Please state your name and business address.

A. John W. Benedict. My business address is 3 Empire State Plaza, Albany, New York.

Q. Mr. Benedict, by whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Public Utility Auditor III in the Office of Accounting and Finance.

Q. Mr. Benedict please describe your educational background, qualifications, and experience?

A. I graduated from Washington and Lee University with a Bachelor of Science Degree in Accounting and Business Administration. Upon graduation in 1973 I went to work for RKB Enterprises as an accountant and in 1978, I was employed by Babcock Industries also as an accountant. Since June 1981, I have been employed by the Department of Public Service and have progressed to my current position by means of competitive examination. In May 1982, I received a Masters Degree in Business Administration from the State University of New York at Binghamton.

Q. Do you hold any professional licenses?

A. Yes. I am a Certified Public Accountant.

Q. Mr. Benedict, have you testified before the Public Service Commission?

A. Yes. I have testified in all of NYSEG's electric and gas rate cases from 1983 to the present. I have also participated in audits of Niagara Mohawk Power Corporation (now known as National Grid) and Corning Natural Gas.

Q. What is the purpose of your testimony?

A. The purpose of this testimony is to present: 1) an overview of existing NYSEG's electric and gas rate plans/orders, 2) an estimate of NYSEG's forward looking rates of return based upon its

2006 compliance filings, including proposed modifications to that claimed return for regulatory purposes, 3) the identification and quantification of potential regulatory adjustments that the Commission may wish to consider as tangible positive benefits to ratepayers as consideration for its approval of the proposed acquisition, 4) concerns and suggested modifications to NYSEG's gas rate plan and 2006 electric rate order, and 5) a review of Staff's preliminary findings on revisions to NYSEG's electric earning sharing computations for the years 2002-2006.

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

A. Yes. Responses to Staff Information Requests are attached as Exhibit ___(JWB-1).

SUMMARY

Q. Please summarize your findings.

A. Based on my review, I find that:

1. NYSEG's regulatory adjusted rates of return on equity (ROE) are currently about 13.0% (Exhibit___JB-2) for electric and 15.4% for gas (Exhibit____JB-3) which are excessive considering Staff's estimate of the current fair ROE of 9.0%.
2. Exhibit____(JB-4) provides a listing quantifying potential regulatory adjustments that the Commission could consider as tangible customer benefits as justification for its approval of the proposed acquisition. When combined with the adjusted rates of return above, the Commission could consider requiring NYSEG maintain its existing rates for an extended period beyond 2008 or decreasing NYSEG's rates.
3. NYSEG's Asset Sale Gain Account should be increased by about $66.8 million including interest through June 2008 as a result of Staff's preliminary review of its annual electric compliance filings for the years 2002-2006.

OVERVIEW of ELECTRIC RATE ORDERS

Q. Please briefly discuss the Commission's orders that currently affect NYSEG's electric rates.

A. On September 30, 2005, NYSEG proposed to increase delivery rates by $91.6 million and continue its commodity program starting January 1, 2007. On January 9, 2006, NYSEG updated its request to increase rates by $103.6 million and also proposed to make refunds to electric customers from the Asset Sale Gain Account (ASGA) during 2006. The Commission's Order in Case 05-E-1222 issued on August 23, 2006 decreased NYSEG's electric delivery rates by $36.2 million for the rate year ended December 31, 2007 and provided for $77.1 million in customer refunds from the ASGA. NYSEG was allowed to include in its electric commodity service rate options a fixed-price option (FPO) with retail electric commodity prices set using a "conversion factor" of 117.5% of wholesale prices, plus a 4 mil mark-up, for calendar years 2007 and 2008; afterwards, that option would continue only if authorized by a further Commission Order. An annual reconciliation of gains or losses on the FPO of greater than plus or minus $5 million (pre-tax) from the fixed-price service would be accounted for in the ASGA. These gains or losses would be shared equally between customers and shareholders. The Order also provided an alternative to the fixed priced price offering, based upon a hedged portfolio of supply sources that would be the default electric commodity service.

Q. Has the Commission subsequently modified NYSEG's electric fixed-price commodity option established in Case 05-E-1222?

A. Yes. On April 5, 2007, NYSEG filed new tariff leaves and supporting testimony (Case 07-E-0479) to alter its supply service beginning January 1, 2008. On July 10, 2007 a Joint Proposal Settlement was reached that, among other things, changed the conversion factor to 116.9% plus 6 mils and extended the program through December 31, 2010. In addition, the annual reconciliation of gains and losses was modified. The company now absorbs all losses and shares gains exceeding $10 million (pre-tax) 85% with customers and 15% with shareholders.

Q. Did the Commission orders provide for any other significant rate or service quality mechanisms?

A. Yes. The Rate Order in Case 05-E-1222 provides for deferral or reserve accounting on the following items: stray voltage, storm damage, and site investigation and remediation costs (SIRC). Responding to certain concerns, the Commission required additional reporting on the following items: staggered meter reading hours, commodity hedging transactions, transmission upgrades on the Ithaca load pocket, progress on filling apprentice positions, a proposal for an ESCO referral program, and the quarterly status of capital construction spending. The Commission also ordered $3.6 million in rates be made temporary and that a separate proceeding be commenced to examine NYSEG’s accounting for other post employment benefits (OPEBs).

Q. How were NYSEG's electric rates established for the period prior to the 2005 Rate Case?

A. NYSEG's electric rates were established for the years 2002-2006 pursuant to an Electric Rate Joint Proposal in Case 01-E-0359.

Q. What was the outcome of the 2002-2006 proceeding?

A. Under the 2002-2006 Rate Plan, NYSEG's reported that its electric operations achieved annual rates of return on equity of 15.8%, 16.4%, 17.5%, 20.0% and 16.2%, respectively, in the Annual Compliance Filings (ACFs) for those years. In addition, NYSEG deferred $17.046 million of environmental remediation costs.

Q. Notwithstanding NYSEG's reported results from its 2002-2006 ACFs, does Staff concur with NYSEG's reported results?

A. No. NYSEG's ACFs significantly understated the amount of earnings it achieved. This issue will be discussed later in this testimony.

Q. What was the outcome of the separate proceeding (Case 06-M-1413) related to OPEBs?

A. A Joint Proposal (JP) approved by the Commission on September 30, 2007 provided $17 million in refunds to customers by December 31, 2007 and required that NYSEG deposit $112 million into an externally managed trust fund dedicated to the payment of employee retirement benefits. In addition, the JP provides that if the company fails to make the required funding as scheduled or if rates are reset before 2010, certain "top-off" payments amounts be deposited into the ASGA for the benefit of customers.

OVERVIEW of GAS RATE PLAN

Q. Please briefly discuss the Commission's orders that currently affect NYSEG's gas rates.

A. On October 19, 2001, NYSEG filed a gas rate case (Case 01-G-1668) and proposed to increase delivery rates by $21.4 million. NYSEG also filed a deferral petition (Case 01-G-1683) in which it sought permission to defer an estimated $31 million related to the difference between fixed gas costs embedded in its residential gas sales rates and actual gas costs incurred during the period November 1, 2001 to September 30, 2002. On September 12, 2002 a Joint Proposal was reached that fixed gas delivery rates through December 31, 2008. In addition, the JP approved by the Commission provided a bill mitigation plan that allowed NYSEG deferred gas cost recovery of up to $14 million.

Q. Did the Commission orders provide of any other significant rate or service quality mechanisms?

A. Yes. The Rate Order adopting the JP in Case 01-G-1668 provides for an affordable gas rates program and a weather normalization adjustment. Specific incentive mechanisms were established for gas cost savings, earnings sharing, and service quality. Uncontrollable costs may be deferred for future recovery subject to category limitations. A specific deferral mechanism was established for R&D and for changes in pension costs related to financial market changes from the levels set in rates (9% return on assets and a discount rate of 6.75%).

Q. What has been NYSEG's performance under its 2002 gas rate plan?

A. Under the 2002-2008 gas Rate Plan, NYSEG has reported that its gas operations achieved annual rates of return on equity of 10.5%, 10.0%, 9.4%, and 10.1% respectively, in the Annual Compliance Filings (ACFs) for the years 2003-2006. In addition, NYSEG deferred $28.751 million in storm, environmental remediation, pension, and other minor cost changes from thresholds established in the rate plans.

Q. Have Staff's audits concerning these gas results been completed?

A. No. Contrasted with NYSEG's electric rate plan which ended in December 2006, its gas rate plan will end in December 2008 and the review of the gas rate plan will not be completed for at least two years, since we expect the compliance filings will not be finalized until late 2009. As with the electric compliance filing, NYSEG continues to revise its gas filings, primarily for income tax changes and the reclassification of environmental costs. Given that NYSEG's gas rate plan is on-going, and the company's pattern of making annual revisions to prior year's filings, Staff's audits are ongoing.

REVIEW OF 2006 RATES OF RETURN

Q. What rate of return on equity did NYSEG claim for the calendar year 2006 in its electric compliance filing of March 30, 2007?

A. NYSEG claims that its electric delivery rate of return on equity was 6% and total equity return including commodity earnings was 16.2% based upon net income of $126,997,000 and equity of $783,948,000.

Q. What rate of return on equity did NYSEG claim for the calendar year 2006 in its gas compliance filing of March 30, 2007?

A. As shown on Exhibit____ (JB-3), NYSEG claims that its gas rate of return on equity was 10.04% based upon net income of $28,097,000 and equity of $279,626,000.

Q. What is the company currently earning in 2007?

A. Using eleven months of actual results and an average of those results as a placeholder for the month of December results in an electric unadjusted return of 10.4% (as compared to 6% for delivery in its compliance filing for 2006) and a gas return of 13.2% (as compared to 10.04% reported by NYSEG in its compliance filing for 2006).

Q. What level of electric commodity earnings has been achieved by NYSEG through November 2007?

A. To date, it has achieved $[redacted] million of commodity earnings, or about [redacted] basis points on ROE. Approximately, [redacted] of these commodity earnings have been set aside for customers representing customers' share of commodity earnings.

Q. What ROE did the Commission allow NYSEG in its last electric rate case?

A. As shown on Exhibit____(JB-2)for the rate year ending December 31, 2007, the Commission (Case 05-E-1222) authorized a 9.55% ROE for NYSEG electric delivery, assuming a 41.6% common equity ratio applied to a $1.460 billion electric rate base. This implies a $607 million level of electric equity for setting rates.

Q. What is the 2006 equity ratio that results from NYSEG's claimed combined equity amount of $1,063.5 million (electric $783.9 million and gas $279.6 million)?

A. Substituting the $1,063.5 million of equity claimed by NYSEG for the historic average of $1,100.1 million into the total capital structure of $2,161.7 million results in the effective use of a 49.2% equity ratio.

Q. Did the prior electric Joint Proposal that governs the computation of the earnings sharing limit the equity ratio to the lower of the actual ratio or 45%?

A. Yes.

Q. How has NYSEG justified the effective use of a 49.2% equity ratio for its 2006 earnings sharing computation?

A. NYSEG has claimed an excessive rate base amount in its calculation by use of a positive Earnings Base Capitalization Adjustment of $196.7 million.

Q. Didn't the Commission reject this approach in NYSEG's latest electric proceeding (Case 05-E-1222)?

A. Yes. For example, NYSEG has claimed an electric rate base amount of $1,742.1 million for 2006 as compared to $1,460 million utilized by the Commission for 2007. A significant reason for the large difference in NYSEG's 2006 claimed electric rate base is the allocation of $145 million for a claimed Earnings Base Capitalization Adjustment (EBCap) <u>increase</u> of $196.7 million. As explained in the testimony of the Staff Revenue Requirement Panel in Case 05-E-1222, a significant reason for the over statement of the EBCap was the inclusion of other comprehensive income, temporary cash and other investments.

Q. Did the Commission adjust the 2007 electric rate base in NYSEG's latest electric proceeding (Case 05-E-1222) for the EBCap adjustment?

A. Yes. The Commission, in its earning computation, <u>reduced</u> NYSEG's 2007 electric rate base by $1.7 million as compared to NYSEG's proposed $145 million increase to rate base for 2006.

Q. Setting aside NYSEG's earnings computation under the electric and gas Joint Proposals, what would NYSEG's actual 2006 returns on equity be if the approaches used by the Commission to set rates in Case 05-E-1222 were utilized?

A. Using the types of adjustments made by the Commission in setting rates in Case 05-E-1222 NYSEG's electric delivery rate of return would be about 13.0% (exhibit ____JB-3) and its gas rate of return would be about 15.4% (exhibit___JB-4).

Q. Please explain the major adjustments you made to arrive at that those rates of return.

A. Using the Commission's approach for setting 2007 electric rates, the 2006 rate base was reduced by $1.7 million for the EBCap as compared to NYSEG's proposed $145 million increase to rate base. Rate base and depreciation expense were reduced to reflect the elimination of software which should have been expensed rather than capitalized. Uncollectible expense was normalized. In addition, a 9.0% return on equity and a 38.0% equity ratio was utilized as testified to by Staff witness Barry.

Q. Please further explain the regulatory adjustment for capitalized software.

A. NYSEG has capitalized software that for rate purposes was forecasted as an expense item. This has the effect of requiring customers to pay for the cost twice, once as a rate year expense in the year forecasted and then again over time when rates are reset through depreciation and a return on the remaining un-depreciated cost. Although the company has written off the electric amounts related to some of its software projects as ordered by the Commission in Case 05-E-1222, the company has not written off the amounts allocated its gas division, which it should. In addition, software amounts related to its customer care system should also be written off since customers also paid for these costs as an expense in a previous rate case.

Q. Please further explain the basis for the software related to the customer care system as a regulatory adjustment.

A. As discussed in the rate panel testimony in the last electric rate case (Case 05-E-1222), NYSEG has never requested a change in accounting to capitalize software. In addition in this instance, NYSEG has received full compensation from customers for new customer care software ($32.5 million IT plan costs allowed in Case 96-E-0891) as shown in the response to information request D-129 dated December 9, 1996 Exhibit___ (JB-1). In addition, as discussed by the Staff Policy Panel in this proceeding, these costs may eventually be shared if the underlying service becomes shared among affiliates in the future or they may become obsolete and will no longer be used and useful.

Q. What other adjustments did you make to arrive at the rates of return stated above?

A. Consistent with the Commission's approach setting electric rates for 2007, incentive pay was eliminated and the effects of temporary cash investments were eliminated. Gas O&M was increased by the elimination of the credit for OPEB interest and rate base was decreased by including the OPEB reserve. This treatment is consistent with the Commission's treatment in NYSEG's last electric Case 05-E-1222. It should also be noted after the 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 fully apply to both NYSEG and RG&E except for the accrual of interest and the expense true-up provision. The adjusted gas return also reflects the elimination of the Gas Commodity Incentive Mechanism (GCIM) as testified to by the Staff Gas Rate Panel. The regulatory adjustments noted above suggests NYSEG's electric and gas rates are overstated by about $49.3 million and $26.5 million, respectively.

Q. Would acceptance of the Staff adjustment to eliminate NYSEG's capitalized software constitute a benefit of this acquisition?

A. A portion of the software adjustment for the CCS system could be considered a positive benefits if it is shared with affiliates.

POSITIVE BENEFIT ADJUSTMENTS

Q. Why are you proposing these positive benefit adjustments (PBAs)?

A. It is my understanding that positive benefits are a requirement for Commission approval of an acquisition.

Q. How did you select your proposed list of PBAs?

A. The list of PBAs is comprised of a combination of regulatory assets (debits) and increases to provide for adequate regulatory reserves (credits), both of which will or may require additional future funds from customers. A significant benefit of the elimination regulatory assets or the creation of increases in regulatory reserves is that they do not affect the company's current cash flow or have any impact on operating expenses. This should enable NYSEG to maintain service quality.

Q. If the Commission were to adopt some or all or your proposed PBAs, would that affect the company's level of ratemaking equity?

A. Yes. However, as noted earlier the company's book equity (50.89%) is far above the level that has been utilized by the Commission (41.6%) and that currently recommended by Staff witness Barry (38.0%).

Q. Please explain the Positive Benefit Adjustment listed as Loss on Reacquired Debt on Exhibit___ (JB-4).

A. NYSEG has deferred the losses associated with refunding of various debt issues. These costs are amortized and are included in the interest cost rates and are part of the overall return that is applied to the rate base in determining the revenue requirement.

Q. Please explain the remaining Positive Benefit Adjustments listed on Exhibit___ (JB-4).

A. NYSEG has deferred various costs that are allowed under the Joint Proposals.

Q. Please explain the proposed increases to reserve items listed on Exhibit___ (JB-4).

A. The electric storm damage reserve was increased by $50 million to counteract an estimated under-funding of about $10 million per year for five years.

Q. How did you determine the $10 million average under-funding level and why use five years?

A. This was done by comparing the costs of actual damages over the last five years to the amount allowed in rates. A pre-funding of five years worth of this amount 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. How was the increase of $26.1 million to the electric reserve for stray voltage determined?

A. This was the company's estimated amount, which it submitted in Case 05-E-1222, above the amount that is currently allowed in rates.

Q. How were the environmental liability amount determined?

A. These amounts ($88.9 million electric and $23.5 million gas) are the allocated amounts of the deferred environmental clean up expense balance at November 2007.

Q. How was the OPEB external reserve top off amount of $5.4 million determined?

A. This amount was based upon the Joint Proposal in Case 06-M-1413. The terms of the OPEB Joint Proposal required that if electric rates were reset or superseded prior to 2010, an amount would be added to the ASGA. The company's petition in this proceeding creates the need for the Commission to consider the level of NYSEG's electric rates.

Q. Please explain the PBA adjustment of $49.2 million related to above market commodity costs for purchases from independent power producers (IPP).

A. The company has estimated that it will incur $49 million of above market independent power producer (IPP) contract costs during 2009. Absent Commission recognition of his proposed

PBA adjustment, customers would pay for this estimated cost in the first half of 2009 in their non-bypassable wires charges (NBC). The IPP power purchase contract that creates the over market IPP cost expires thereafter.

Q. What are the resulting rates of return on equity when the proposed PBAs are combined with the adjusted regulatory return?

A. The electric return on equity increases from 13.0% to 15.3% resulting in an increase in annual excess earnings of about $52.2 million when compared to the 9.0% fair ROE. Similarly, the gas return on equity increases from 15.4% to 17.6% resulting in annual excess earnings of about $27.1 million.

MODIFICATIONS TO ELECTRIC ORDER AND GAS PLAN

Q. What additional rate provisions should be considered for both electric and gas rates if the Commission were to approve the acquisition?

A. First, the Commission has ordered that a revenue decoupling mechanism (RDM) be implemented. The Staff RDM recommendation is set forth in the testimony of other Staff witnesses. Second, uncontrollable cost provisions for both the electric and gas departments should be implemented similar to that currently in place for the gas division but modified for the aggregate deferral threshold set at a dollar amount equal to 50 basis points (or about $4.1 million electric and $1.6 million for gas).

Q. What do you propose for an earnings sharing mechanism?

A. Delivery earnings above 9.0% would be shared 50% customer and 50% to shareholders. Earnings above 10% would be shared 75% to rate payers and 25% to shareholders. All earnings above 11% would deferred and be returned to customers. The current electric commodity earnings sharing for NYESG should be maintained.

Q. The current gas and prior electric plans shared earnings equally between customers and shareholders (50/50) above a threshold. Why do you recommend a change from that methodology?

A. Since the companies have claimed the level of synergies resulting from the acquisition of Energy East by Iberdrola is unknown, customers should be compensated for and protected from the companies' retention of the unknown cost reductions as a condition of approving the acquisition.

Q. NYSEG and RGE have proposed a surcharge for its advanced metering initiative (AMI). What is the status of that proposal?

A. In February, 2007 NYSEG and RG&E filed estimated surcharges to implement the AMI programs. These estimates were later reduced in May 2007. That proposal is pending.

Q. Does Staff have concerns with the companies' proposals to implement a surcharge for AMI?

A. Yes. There are three concerns with NYSEG/RG&E's surcharge proposals: 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 AMI program costs. Without such a mechanism, ratepayers are exposed to overcharges and the potential for the recovery of imprudently-incurred costs.

Q. Why are you raising these AMI issues in this proceeding?

A. As noted above, 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.

Q. Describe Staff's concerns with the companies' estimated costs and savings.

A. There are many concerns. First, one of the alleged benefits of AMI will be better control of theft of service and uncollectible accounts. However, in the company's updated May filing, those savings, which had been reflected in the February filing, were eliminated. In addition, the companies assume that their outdated capital structures (e.g., for RG&E, a 45% equity ratio and 10.5% ROE) should be used to set AMI surcharge rates, instead of the most recent Staff estimated equity ratio of 38% and an ROE of 9.0%. Exhibits____(JB-5) and _____(JB-6) show the full deployment, steady state revenue requirement as filed by the companies, adjusted to reflect the additional savings and an updated NYSEG electric cost of capital (9.0%) and consolidated capital structure (38.0% equity ratio) recommended by the Staff Policy Panel. Imputing these recent figures to RG&E reduces its projected annual electric revenue shortfall for AMI from about $5.5 million to $3.0 million and its annual gas revenue shortfall from $4.0

million to $2.3 million. NYSEG's projected annual electric revenue shortfall is reduced from about $13.4 million to $5.0 million and its annual gas revenue shortfall is reduced from $3.8 million to $2.5 million.

Q. Describe Staff's concerns with the surcharge proposals.

A. 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.

Q. Explain why the utilities AMI proposals are financially unjustified.

A. When you consider that the depreciation on the old meters will cease and that current rates include the depreciation on the existing meters, the change in the utilities' income will be minimal. RG&E's combined electric and gas request of $9.5 million is reduced to $3.2 million and NYSEG's surcharge request of $17.3

million is reduced to $3.5 million. Therefore the financial impacts underlying the AMI surcharges proposed by the utilities are significantly overstated.

Q. Describe the provisions in the rate plans that address costs such as AMI.

A. RG&E's rate plans allow it to defer the costs of mandated programs exceeding $250,000 (electric) and $100,000 (gas) annually. Deferred costs are recovered first by netting them against deferred credits, then by using the customer share of earnings sharing, and lastly by using half of the company's share of earnings sharing. A review of the three year's of compliance filings made by RG&E shows that it has routinely used these rate plan provision to recover mandated costs and, in fact, has already recovered other costs similar in magnitude to the adjusted costs of AMI via the rate plan provisions. In addition, an argument to afford AMI extraordinary rate treatment outside the rate plans cannot be supported based on the company's earnings. RG&E is over-earning when compared to either the ROE cap from the electric rate plan or a fair return for gas using current ROE estimates. In its most recent filings for 2006, RG&E indicated that it was earning 14.66% for electric and 9.88% for gas (on a per book basis, RG&E gas reported a 11.57% ROE). As filed, RG&E's electric ROE exceeded its ROE cap of 12.25% by 241 basis points. Further, recent estimates of a fair ROE for RG&E indicate that 9.0% would be adequate for gas. Estimated AMI-related revenue requirements for 2009 are $1.5 million electric and $1.7 million gas and would only reduce RG&E's 2006 electric and gas ROE by about 23 and 49 basis points, respectively. Thus, based on ROE considerations, RG&E would be earning an adequate return even after the AMI investments were made.

We are continuing to review NYSEG's compliance filings, but based on a current fair return of 9%, NYSEG would be similarly situated with respect to earnings and it may be under spending its capital expenditures. However while NYSEG's gas rate plan has a government mandate provision similar to RG&E's, it does not have a rate plan in place for electric at this time. NYSEG's electric rates for 2007 were established as a result of a one year litigated rate case. NYSEG's most recent report on electric CAPEX for September 2007 shows that it has spent $60.6 million year to date when the annual rate case allowance was $92.3 million. This suggests that NYSEG may be under spending on capital.

Q. Describe your concerns about the absence of accountability under the surcharge proposals.

A. As already noted, the companies' surcharge proposals would be fully reconciled based upon actual costs and savings. We find this aspect of the proposal inadequate to provide accountability. Among other things, "actual savings" will be impossible to identify with precision and will need to be hypothesized. Limits and controls are therefore needed on any reconciliation proposal, so that the utilities face at least some risk for not achieving projected costs and savings. On the other hand, the reconciliation procedure should not be so over broad that it raises the kind of disputes that exist in rate cases, because it would then be difficult to implement.

Q. What other concerns do you have about NYSEG's and RG&E's surcharge proposals for AMI?

A. The estimated surcharge amounts may change because the Commission may adopt minimum functionality standards that may conflict with the estimates currently proposed by the companies.

Q. Since both companies are over earning at current rate levels, shouldn't the companies proceed with AMI deployment without additional recovery assurances from the Commission?

A. This could be one approach that the Commission could take. Another 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. However, 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.

CONCERNS AND MODIFICATIONS TO GAS PLAN

Q. What provisions in the Gas Joint Proposal should be modified if the Commission approves the acquisition?

A. Consistent with the PBA proposals above, which minimized NYSEG's deferred costs, the potential for future deferred (stranded and unfunded) costs should be minimized if the Commission approves the proposed acquisition. First, the gas pension deferral and Gas Cost Incentive Mechanism (GCIM) should be eliminated, for the reasons discussed in the Staff Gas Rate Panel's testimony and to eliminate the complexity of the computations and general administrative burdens associated with these mechanisms. Second, uncontrollable cost provisions should be modified to establish the aggregate deferral threshold to a dollar amount equal to 50 basis points (or about $1.6 million).

ADJUSTED ELECTRIC EARNINGS SHARING FOR 2002-2006

Q. Has NYSEG filed an electric earnings sharing computation for each of the years 2002-2006?

A. Yes. On March 31 following each of the years of the electric rate plan, NYSEG files its Annual Compliance Filings (ACFs) which present its electric and gas earnings sharing computations, deferrals, and CAPEX, among other things. These computations are only preliminary because in every subsequent year, NYSEG has continually revised its computations for all prior years. For example in its March 30, 2007 filing concerning the 2006 rate year, NYSEG recomputed its earnings sharing for each year from 2002 to 2005.

Q. In order to clarify, with regards to the computation of earnings for calendar year 2002 which NYSEG first provided in March 2003, did the company re-compute the earning sharing for that year (2002) and provide a different level of earnings in each of the five filing years including its latest 2006 electric compliance filing made on March 30, 2007?

A. Yes. And as a result of the Commission's Order of August 23, 2006 in Case 05-E-1222, further adjustments are needed to the company's 2002 computations.

Q. What were the nature and causes of the company's re-computations to its annual earning sharing?

A. The company's adjustments to 2002 earnings sharing initially included adjustments to conform estimated income tax expenses to the actual tax return and to out of period items, but have been later expanded to adjust for the expensing of software.

Q. What further adjustments need to be made to the company's computations to its 2002 earning sharing computation?

A. Similar to the 2006 earnings computation discussed in the beginning of the testimony, the company's 2002 earnings sharing includes: 1) an excessive amount of rate base and 2) an excessive level of equity. The customer share of these adjustments is about $55 million, before interest.

Q. What other adjustments should be made to NYSEG's electric compliance filings for the years 2002-2006?

A. As noted in Staff witness Dickins' testimony, the company has claimed lost revenue from standby rates that the company has taken from the ASGA. I have included that amount in the computation of the amount owed to customers and recommend it be returned to the ASGA account.

Q. Have you included interest on the amount to be returned to the ASGA for electric compliance filings for the years 2002-2006?

A. Yes. Staff's total preliminary adjustment for the years 2002-2006 would increase the ASGA balance by $66.8 million including interest through June 2008 and is shown on Exhibit ____(JB-7).

Q. You state above that "these computations are only preliminary because in every subsequent year, NYSEG has continually revised its computations for all prior years." Has Staff previously presented its formal filings on NYSEG's ACF? If not, please explain why.

A. 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. This is because NYSEG's electric ACFs for 2002-2006 were not final during the rate case and may not be final yet. Consistent with past practice, NYSEG may attempt to file a revised final year (2006) to conform estimated income tax expenses to the actual tax return that was just filed in September 2007.

Q. Is NYSEG aware of Staff's disagreements with its calculations?

A. While no formal filing has been made by Staff yet, NYSEG is aware that Staff disagrees with certain of its computations via the informal data request process.

Q. When does Staff expect to provide its response to NYSEG concerning NYSEG's 2002-2006 ACFs?

A. No later than NYSEG's next electric rate case and sooner if practicable.

Q. Given that Staff has not finished its audit of NYSEG electric's compliance filings for 2002-2006, why is this testimony relevant at this time?

A. This shows that there are significant unresolved regulatory liabilities associated with Iberdrola's acquisition of Energy East that Iberdrola should be aware of. In effect we are putting Iberdrola on notice that we intend to pursue these adjustments in the near future. Further, presentation of this information at this time provides further support that NYSEG's electric rates are too high since it owes significant customer credits that can be used to reduce or stabilize those rates, in the absence of the proposed acquisition.

Q. Would acceptance of the Staff adjustments to

NYSEG's 2002-2006 compliance filings constitute a benefit of this acquisition?

A. No. These adjustments can be made in the absence of this acquisition.

CONCLUSION

Q. Please summarize your position.

A. NYSEG's electric and gas rates are currently above the level that the Commission would allow in a rate proceeding. Consequently, the Commission could require lower rates as a condition of the acquisition. In addition, the proposed elimination of deferred charges and increases to reserves would help sustain rates at lower levels or at the current rate levels for an extended period beyond 2008.

Q. Does this conclude your testimony?

A. Yes, at this time.