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:

Robert P. Haslinger
Public Utilities Auditor III
Albany, New York
State of New York
Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

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INTRODUCTION OF WITNESS

Q. Please state your name and provide your business address.

A. Robert P. Haslinger. My business address is Three Empire State Plaza, Albany, New York 12223-1350.

Q. By whom are you employed and in what capacity?

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

Q. What is your educational background and experience?

A. I graduated from Niagara University in May 1980 with the degree of Bachelor of Business Administration. I majored in Accounting. Since 1980, I have been employed by the Department of Public Service as a Public Utilities Auditor.

My work involves examinations in electric, gas and telephone proceedings, compliance filing audits, financings, and other general accounting matters.

Q. Have you previously testified before the New York State Public Service Commission?

A. Yes. I have testified in numerous proceedings before this Commission, including New York State Electric and Gas's (NYSEG) most recent electric rate case (Case 05-E-1222), as well as all of Rochester Gas & Electric Corporation's (RG&E) rate cases over the last decade, including RG&E's 2003 electric and gas rate case (Cases 03-E-0765 and 03-G-0766).

Q. What are your responsibilities in this proceeding?

A. Under the direct supervision of Mr. Thomas D'Ambrosia, C.P.A., I assisted in the examination of the books, records, and accounts of Rochester Gas & Electric Corporation.

Q. What is the purpose of your testimony?

A. I will provide: 1) a general overview of RG&E's current Electric and Gas Rate Joint Proposals (see cases 03-E-0765, 02-E-0198, and 03-G-0766),

2) recent performance under the rate plans, 3) an estimate of RG&E's forward looking rates of return based upon its 2006 compliance filings including proposed modifications to that claimed return for regulatory purposes, 4) the identification and quantification of potential regulatory adjustments that the Commission may want to consider as tangible positive benefits to ratepayers as justification for its approval of the proposed acquisition, and 5) concerns and difficulties concerning these rate plans and suggested modifications.

Q. Mr. Benedict is providing some additional information on Staff's review of the NYSEG electric rate plan compliance filings for 2002-2006. Are you going to address RG&E's rate plan compliance filings results?

A. No. Contrasted with NYSEG's electric rate plan which ended in December 2006, RG&E's rate plans will end in December 2008 and the review of such plans will not be completed for at least two years, since we expect the compliance filings will not be finalized until late 2009.

Q. Are you sponsoring any exhibits?

A. Yes. Exhibit __ (RPH-1) contains certain information requests, Exhibit __(RPH-2) contains RG&E's Electric Income Statement, , Exhibit ___(RPH-3) is RG&E's Gas Income Statement and Exhibit __(RPH-4)consists of Gas & Electric potential Positive Benefit Adjustments.

SUMMARY

Q. Please summarize your findings.

A. (1) RG&E's staff's regulatory adjusted return on equity (ROE) is currently about 16.99_% for electric delivery (RPH-__) and 14.96% for gas. These ROEs are excessive considering Staff's estimate for a fair rate of return, as testified to by the Policy Panel.

(2) Exhibit ___(RPH -4) provides a listing of potential regulatory adjustments that the Commission could consider as tangible customer positive benefits in consideration for approval of the proposed acquisition. When combined with the adjusted rates of returns above, the Commission could consider requiring RG&E to maintain its existing rates for an extended period beyond Calendar Year 2008 or decreasing RG&E's rates. (3) RG&E's fixed price electric

commodity rates are excessive and should the Commission consider extending this rate option beyond 2008, it must be reduced.

OVERVIEW OF ELECTRIC RATE PLAN

Q. Please provide a general overview of RG&E's Electric Rate Joint Proposal (Case 03-E-0765 and 02-E-0198) that it is currently operating under.

A. The Electric Rate Joint Proposal froze delivery rates for a five year period - January 1, 2004 through December 31, 2008. The Joint Proposal also provided for the establishment of an Asset Sale Gain Account (ASGA) from the net proceeds of the sale of RG&E's Ginna Nuclear Power Plant. The proceeds from the Ginna sale provided refunds to customers of $110 million over the first four years of the Electric Rate Joint Proposal. The Joint Proposal also enhanced choice and flexibility by establishing multiple commodity options. In addition, the Joint Proposal provided for the unbundling of supply, non-bypassable wires charges (NBC), and delivery rates beginning in Calendar Year 2005. This created a single delivery rate while allowing for numerous commodity options from RG&E and retail choices from other energy service companies (ESCOS).

Q. Does the Electric Joint Rate Proposal provide for earnings sharing?

A. Yes. RG&E's earnings sharing is based upon the total electric earnings for supply and delivery. Earnings sharing is measured for each calendar year of the agreement (2004 - 2008) based upon regulatory earnings exceeding the 12.25% return on equity (ROE) sharing cap. The earnings threshold may be increased by 0.25% based upon the company meeting certain criteria regarding customer awareness and migration. However, this aspect of the Joint Proposal has not been implemented. Equity for computing earnings sharing is limited to 45% of the company's capitalization and is capped at the company's actual equity balances. Earnings in excess of the sharing cap are shared equally (50%/50%). The company is allowed to petition the Commission for rate relief if earnings fall below an 8.5% ROE, subject to conditions.

Q. Are there provisions in the Electric Joint Rate Proposal addressing differences between cost projections and actual expenditures during its term?

A. Yes. Under certain circumstance the company may defer differences between actual results and forecasts and may defer unexpected costs.

Q. Explain the general conditions and provisions for deferral of these differences.

A. The company is allowed to defer cost variances for future recovery or pass back variances in costs such as: property taxes, annual inflation exceeding 4%, security costs, and interest costs of variable rate debt. These deferrals are potentially offset by 75% of the incremental excess earnings if the company exceeds the earnings sharing threshold during each applicable period.

Q. Is the company also permitted to defer costs associated with exogenous costs?

A. Yes. The company is allowed to defer costs or savings associated with changes in accounting, regulatory, legislative, and tax changes which individually exceed $250,000. In addition, it may defer the costs of exogenous events exceeding $250,000 such as floods, riots, terrorism, state or federal disasters, and Acts of God, but only if they exceed $2 million in the aggregate.

Q. Did the rates established by the electric Joint Proposal provide for funding the costs of reserves and amortizations of regulatory assets?

A. The Joint Proposal provided amounts for funding environmental site remediation costs, major storm reserves, and generating plant decommissioning. It also provided approximately $44 million on an annual basis, for the amortization of supply related regulatory assets recovered through RG&E's electric rates.

OVERVIEW OF GAS RATE PLAN

Q. Please summarize RG&E's Gas Rate Joint Proposal (03-G-0766) currently in effect.

A. Like electric, the current gas agreement is for a term of five years (January 1, 2004 through December 31, 2008). The rate plan provided for an implementation of a Merchant Function Charge (MFC) to collect indirect gas supply costs, which was implemented on May 1, 2004. The implementation of the MFC, coupled with delivery rates remaining constant, increased rates by

$7.21 million. The company was also allowed to implement a Weather Normalization Adjustment, effective October 1, 2004.

Q. Does the Gas Joint Rate Proposal provide for earnings sharing?

A. Yes. Earnings sharing is based upon the total gas earnings for supply and delivery. The earnings for sharing is measured for each calendar year of the agreement (2004 - 2008) based upon regulatory earnings exceeding the 12.00% return on equity (ROE) sharing cap. The earnings threshold may be increased by 0.25% based upon the company meeting certain criteria regarding customer awareness and migration. Like electric, this provision was not implemented. Equity for computing earnings sharing is limited to 45% of the company's capitalization and is capped at the company's actual equity balances. Earnings in excess of the sharing cap are shared on an equal basis (50%/50%). The company is allowed to petition the Commission for rate relief if earnings fall below 8.5 % ROE, subject to conditions.

Q. Are there provisions in the Gas Joint Rate

Proposal for addressing differences between cost projections and actual costs during its term?

A. Yes. Under certain circumstances, the company may defer differences in forecasts and also unexpected costs.

Q. Explain the general conditions and provisions for these differences.

A. The company is allowed to defer cost variances for future recovery or pass back variances in costs such as: property taxes, annual inflation exceeding 4%, security costs, and interest costs of variable rate debt. These deferrals are potentially offset by 75% of the incremental excess earnings if the company exceeds the earnings sharing threshold during each applicable period.

Q. Is the company also permitted to defer exogenous costs?

A. Yes. The company is allowed to defer costs or savings associated with changes in accounting, regulatory, legislative, and tax changes in excess of $100,000 and exogenous events such as flood, riots, terrorism, state or federal disasters, and Acts of Gods in excess of

$850,000.

REVIEW OF THE RATE PLANS

Q. Is the company obligated to submit any reports detailing its financial performance under the Joint Proposals?

A. Yes. The company is required under the Joint Proposals, to file Electric and Gas Annual Compliance Filings (ACF) subsequent to the completion of each calendar year of the agreement. Rochester Gas & Electric has submitted filings for calendar years; 2004, 2005 and 2006.

Q. Are the company's Annual Compliance filings subject to change and recalculation?

A. Yes. The company annually revises prior calendar year filings with changes and modifications. In the instance of the last company filing made for Calendar Year 2006, the company also submitted revised compliance filings for calendar years 2004 and 2005.

Q. Are the company revisions minor in nature?

A. No. For example, in its latest submittal for Calendar Year 2006, the Company submitted a revised Calendar Year 2005 filing for electric.

Per the revised 2005 electric filing, it reduced Calendar Year 2005 Balance Available for Common Equity by over $3 million, from its original filing.

Q. Have you completed your audits of the company's past compliance filings?

A. No. Given that the rate plans are on-going and the pattern of the annual revisions to prior year's filings, Staff's audits are ongoing.

Q. Given your statement that Staff has not finished its audit of RG&E electric's and gas compliance filings for 2004-2006, why is this testimony relevant at this time?

A. This shows that there are significant unresolved regulatory liabilities associated with Energy East that Iberdrola would not be aware of. 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 RG&E's electric rates are too high since significant customer credits will be enabled that can be used to reduce or stabilize those rates, in the absence of the proposed acquisition.

Q. Would acceptance of any Staff adjustments to RG&E's 2004-2006 compliance filings constitute a benefit of this acquisition?

A. No. These credits owned ratepayers will be pursued sometime in 2009, regardless of this acquisition.

Q. Describe RG&E's reported financial performance during the time the company has been subject to the Joint Proposal for the Gas Department.

A. The latest Annual Compliance Filings submitted by the company show that for the Gas Department that it earned a return on equity (ROE) of 9.96%, 8.69% and 9.88% for the Calendar Years 2004, 2005 and 2006 respectively. The Company reported 3 year average (2004-2006) ROE for Gas was 9.51%.

Q. What do the latest Company's annual filings show for the Electric Department?

A. The Company submitted Annual Compliance Filings for the Electric Department indicate a ROE of 6.08%, 15.20% and 14.66% for the Calendar Years 2004, 2005 and 2006 respectively. The average for the 3 year period (2004-2006) was 11.98%. These results reflect RG&E's combined electric delivery and commodity businesses.

Q. Did the ROE produced during the first 3 years of the Electric Rate Joint Proposal generate excess earnings in any of the years?

A. Yes. In Calendar Year 2005, the Company's ROE calculation of 15.20% produced excess earnings of $21.3 million. The customer's 50% share of this amount was $10.65 million. In Calendar 2006, the Company's ROE calculation produced a return of 14.66%, which produced $16.76 million of excess earnings, of which customers 50% share amounted to $8.38 million.

Q. Has the RG&E deferred any costs for future recovery from ratepayers under the Joint Proposals?

A. Yes. As noted above, the Joint Proposals permitted the company to seek deferral of costs above or below specified forecasted target amounts (i.e. property taxes, inflation, variable rate debt, etc.) and also allowed to RG&E to seek deferrals of the costs of unforeseen exogenous events (i.e. accounting, tax or regulatory mandates etc.).

Q. What was the magnitude of these deferrals claimed during the first three years of RG&E's Joint Proposals?

A. Under the Electric Rate Joint Proposal, the company deferred approximately $5.9 million of items subject to reconciliation in excess of targeted amounts and $6.7 million of exogenous costs. These deferral amounts were almost entirely offset with the ratepayer's share of excess earnings in Calendar Years 2005 and 2006. Under the Gas Rate Joint Proposal the company has recorded deferrals of approximately $4.7 million of items subject to reconciliation to forecasted target amounts and a $1.7 million ratepayer credit for exogenous costs (due mostly to a favorable IRS audit). The gas deferred costs remain on the company's books since RG&E claims that it has not achieved excess earnings as defined in the gas rate plan.

Q. Please describe reserve accounting.

A. Reserve accounting allows the company to establish funds supported by ratepayers to pre-fund known but difficult to quantify future liabilities. An example of this would be environmental site remediation and clean up costs. Generally, it is preferable to begin funding such liabilities in advance rather than wait, even if all future events have not occurred and amounts are not known. The approach helps avoid future rate shock and yields a more equitable allocation of cost responsibility between current and future customers.

Q. Did the Electric and Gas Joint Proposals provide for reserve accounting for certain items?

A. Yes. The Electric Joint Proposal provided an annual expense accrual of $1.4 million for environmental site remediation, $2 million annually for major storms, and $2 million per year for decommissioning of a retired power generating plant (Beebee). RG&E was also provided with a $2 million reserve to fund customer outreach and education (O&E) associated with the transition to competitive choice, over the entire five year term of the agreement. The Gas Joint Proposal provided for a $600,000 annual accrual for environmental site remediation. The net differences between the accrued expense amounts provided for in rates and the amounts actually incurred by the company are reflected as an asset or liability in a reserve account balance for each item.

Q. Are these reserves adequately funded?

A. No. Staff is concerned that the reserves are insufficient, due to the rising costs of environmental site remediation, storm cost restoration, and decommissioning costs of retired generation plants. An increase in reserve funding would facilitate spreading the funding of these potential high costs of these items over a period of time, rather than when the final exact costs are ultimately known.

Q. How did the Electric Rate Joint Proposal resolve the issues concerning Russell Station?

A. The Joint Proposal anticipated the eventual retirement of RG&E's Russell generating station. Upon retirement of Russell, the company would remove $37.5 million of the fixed Russell cost components from the NBC (avoided O&M, depreciation, taxes, return on equity and income taxes) and also remove the variable component associated with the market value of its output. The Joint Proposal also addressed recovery through the non-bypassable charge (NBC) of the continuing costs associated with the Russell plant. These costs include property taxes, O&M expense, and decommissioning. The Electric Rate Joint Proposal also acknowledges that an amount for decommissioning funding associated with Russell may be required in the future. I will address this further in the Positive Benefit section of my testimony below.

Q. Did the Joint Proposals contain capital expenditure targets?

A. Yes. The Electric Joint Proposal set a target for transmission and distributions capital expenditures (CAPEX) of $280 million for the entire five year term of the agreement. If actual expenditures fail short or exceed the target by more than $25 million, the company will accrue interest on the balance (that has not accrued allowance for funds used during construction) beginning at the end of Year five. The Gas Joint Proposal contained a target of $32.5 million for government-mandated capital projects. The company would accrue interest on any overage of this target, beginning at the end of Year five. According to the ACFs, as of December 2006, RG&E has not currently reached the capital expenditures targets described. CAPEX is discussed further in the testimony of Staff Witness Dickens and the Gas Rate Panel.

RATE PLAN CONCERNS AND MODIFICATIONS

Q. Do you have any concerns or problems regarding the Joint Proposals and RG&E Annual Compliance Filings?

A. Yes. The company has tended to make interpretations of many of the items in the Joint Proposal that favor its own interests.

Q. Do you have any examples of such interpretations?

A. Yes. 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. In RG&E's 2005 Electric Annual Compliance Filing, the company deferred $354,605 for cost associated with "Heat Wave" storm costs.

Q. Does hot weather and humidity constitute a "storm"?

A. No. The company incurred record peak load during this "Heat Wave" storm, which may have stressed RG&E distribution system, but this is not a storm, rather it is a predictable, recurring event. The company also billed customers for their use of the increased consumption during the event. These increased revenues were not deferred.

Q. Did the actually company meet the $250,000 dollar threshold criteria for storm deferral mentioned above?

A. No. In order to reach the deferral threshold, the company included all costs associated with the restoration of service, not just incremental costs such as outside services and materials. The company included labor, benefits, and costs of its transportation equipment to calculate the heat "storm" costs; however these cost components were all separately forecast and recovered in the rate joint proposal. Removal of these non-incremental costs would decrease its costs below the $250,000 expense deferral threshold.

Q. Can you provide other examples of your concerns and problems with the current Rate Joint Proposals?

A. Yes. The company was allowed to establish a reserve of $2 million for Commission "required" outreach and education (O&E) associated with retail choices, which it was expected to spend over the entire five year term of the Electric Rate Joint Proposal. The company would defer the difference between actual costs and the $2 million in the reserve for recovery at the end of the term.

Q. Why did the Joint Proposal contain that O&E provision?

A. Staff was concerned that RG&E would not adequately educate and promote customer choice, i.e., not spend the money allowed in rates. As a result, we insisted upon a provision that ensured RG&E spent the funds allotted to O&E activities or return it to customers. RG&E was also concerned that the Commission would order or impose some significant new O&E programs beyond those contemplated in the Rate Plan.

Q. What level of spending has the company attained in regards to the "required" outreach and education in the first three years of the electric rate plan?

A. RG&E has spent $2.6 million in year one, $1.4 million in year two and $2.2 million in year three. The company has spent over $6.2 million and the deferral balance is presently over $4.2 million.

Q. Is amount of spending on customer outreach and education reasonable in light of the $2 million allowance the company was forecast to spend?

A. No. The $2 million was a guideline for expenditure for reasonable "required" outreach and education over the five year period of this agreement. The company has spent more than 300% of the amount envisioned for the entire five year plan by year three. Under RG&E's interpretation, the customers are now liable to pay back this deferred amount in the future. Staff does not believe this amount of discretionary spending was "required" by the Commission and should not be funded by customers.

Q. Did you encounter problems with the manner the company deferred costs associated with security expenditures?

A. Yes. The Joint Proposals set targets for the costs of obtaining security services from outside vendors. When the company reconciled the amount of its security expenditures to the targets, it used not only outside security costs, but also internal labor, benefits, and other cost elements. These other cost elements were forecasted separately elsewhere in the Joint Proposals and accordingly do not qualify for deferral treatment. The company has claimed during the first three years of the electric and gas joint proposals a security deferral of $550,000 to be recovered from ratepayers.

Q. What is the proper amount that should be deferred for security costs?

A. Based on targets for outside services costs, the proper amount should actually be an amount owed to the customers of approximately ($585,000) for Calendar Years 2004 through 2006. This difference between the Staff and the company amounts is over a $1.1 million.

Q. Can you give another example of the company's questionable interpretation of the Joint Proposal's language?

A. Yes. In the case of the major storm reserve, one of the clauses in the Joint Proposal to determine what constitutes a major storm was that it cost the company more than $250,000 per event. If the storm cost less the $250,000, the cost would be charged to expense.

Q. How did the company interpret this expense level?

A. For the first two years (Calendar Year 2004 and 2005) of the agreement, the company interpreted the threshold level correctly. For example, if a storm restoration total cost was $500,000, but $300,000 was for capital costs (i.e., poles, wire, cost of removal, etc.) and $200,000 was for expensed items, the company did not defer any costs, because the $300,000 was capitalized and would be recovered from ratepayers over time through depreciation and rate of return on invested capital. The remaining $200,000 did not exceed the $250,000 expense threshold stipulated in the joint proposal, and was not deferred.

Q. Did the company make a different interpretation in Calendar Year 2006 Annual Compliance Filing?

A. Yes. The company began to interpret the $250,000 threshold to include all costs, including capitalized costs. The company then went back to the preceding two years (Calendar 2004 and 2005) and retroactively applied its new interpretation of the threshold to include capitalized costs. By applying its new standard, the company was able to defer additional costs to the storm deferral that were not eligible for recovery.

Q. Is the company's new interpretation correct?

A. No. The $250,000 was designed to protect the company from incremental major storm expenses during the term of joint proposal. Capital costs associated with restoration would be recovered in the future from ratepayers from depreciation and return on its investment over the life of the asset.

Q. Has the company made any changes in allocating costs from what was anticipated in the Joint Proposals?

A. Yes. In the instance of site remediation costs, the Joint Proposals allocated costs 70% to Electric and 30% to Gas. However, in the company's Annual Compliance Filings, these costs were allocated 80% Electric and 20% to Gas.

Q. Has the company given any notification or reason for this change in allocation?

A. No, it has not given any reason for the change in allocations between the Gas and Electric Departments.

Q. Are the items you have discussed above concerning the Joint Proposals address all of your concerns and audit adjustments for company's Annual Compliance Filings?

A. No. As I have previously stated my testimony, the company's Filings are subject to revision and updates. Staff's audits are also ongoing, subject to new findings and changes.

Q. Please provide a general summary of RG&E commodity options available to customers under its Electric Joint Proposal.

A. All customers receive delivery service from RG&E. RG&E customers have the option to choose their commodity supply from either energy service companies (ESCOs) or RG&E. Customers choosing RG&E commodity can select from two price options: the variable price option (VPO) or a fixed price option (FPO). For the VPO customer, the price of commodity can fluctuate monthly, based on average market prices for the month. The non-bypassable wires charge (NBC) also fluctuates monthly. For the FPO, the commodity and NBC are set prior to the commodity option period based on forward looking prices for the commodity rate period and remains constant through the period. The referenced wholesale commodity price is then multiplied by 135% to determine the fixed commodity price component for the FPO rate by class.

Q. How are electric commodity earnings shared between shareholders and customers?

A. Commodity earnings are included in total electric earnings used for determining earnings sharing. Once the company's earnings exceed the 12% ROE ceiling, the calculated excess earnings are share equally (50%/50%) between shareholders and customers.

Q. Do you have any indication of the amount of commodity profits RG&E has earned?

A. Yes. According to Response IBER-0218 to DPS-137, RG&E achieved about $19 million of commodity profits in 2006.

Q. Is this the same earnings sharing mechanism used by RG&E's affiliated Energy East Company - New York State Electric and Gas (NYSEG)?

A. No. NYSEG has separate earnings sharing for commodity and delivery. The recent Joint Proposal adopted in Case 07-E-0479, modified the pricing methodology of NYSEG's FPO, as well as the earning sharing associated with it.

Q. How was the FPO calculated for NYSEG in this recent proceeding?

A. NYSEG now uses a conversion factor of a 6 mils per kWh adder and a 16.9% multiplier when it calculates the retail market supply price charged to FPO customers.

Q. Did the recent NYSEG Joint Proposal modify the earnings sharing between shareholders and customers?

A. Yes. Under NYSEG current sharing plan, NYSEG retains the first $10 million (pre-tax) of commodity earnings and shares any commodity earnings above the $10 million by allocating 85%

to ratepayers, while retaining 15%. The NYSEG Joint Proposal advances $5 million of the customer's share of commodity earnings, subject to offset from later customer's portion of commodity earnings. The customers are not at risk from any losses associated with FPO. The Joint Proposal also promotes numerous Commission policies such as: simplifying commodity price comparisons, continuation of the purchase of receivables available to ESCOs, simplification of the retail access program, true-up of the non-bypassable charges, and migration of large customers to mandatory hourly pricing.

Q. There seems to be a large difference between RG&E and NYSEG in the FPO price calculation and earnings sharing mechanisms. Should RG&E's future rate offerings and mechanisms be modified to incorporate the more current Commission orders on these commodity issues?

A. Yes. The Commission order in Case 05-E-1222 (see Order Adopting Recommended Decision with Modifications, issued August 23, 2006) adopted the ALJ's "finding that the current 35% mark-up was excessive" (page 25). As a result, should the Commission allow RG&E's FPO to continue beyond 2008 it should order RG&E to reduce the commodity markup to the level of markup provided to NYSEG. In addition, it should also require RG&E to modify the earnings sharing mechanism to be more in line with NYSEG's.

Q. How should RG&E's earnings sharing mechanism be modified?

A. First, commodity should be separated from delivery as NYSEG has done. Then, RG&E's commodity earnings should be shared in the same proportion as NYSEG's. This would result in 85%/15% sharing of commodity earnings with RG&E retaining the first $4.5 million pre-tax. This amount is equivalent in basis points to NYSEG's earnings sharing.

Q. Do you have any other proposed modifications?

A. Yes. RG&E's earnings sharing provisions need to be modified to reflect separation of commodity, the lower ROE and equity ratio, and the positive benefits adjustments (PBAs) discussed below.

REGULATORY ADJUSTMENTS

Q. You have presented the rates of return shown from the RG&E's Annual Compliance Filings earlier in your testimony; would this ROE be different if you were setting rates today?

A. Yes. The rates of return shown in the company's compliance filing would change. In a rate proceeding Staff would incorporate an updated rate of return and capital structure, updated interest rates, regulatory adjustments such as the removal of incentive compensation (per recent NYSEG Case 05-E-1222), expiration of cost to achieve amortization, removal of donations from regulated expense, removal of capitalized software in rate base, and the inclusion of the ASGA liability balance in rate base.

Q. Please explain the regulatory adjustment to remove capitalized software form rate base.

A. 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. I 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. Explain the regulatory adjustment to deduct the ASGA regulatory liability in rate base.

A. I have included the ASGA in rate base as the Joint Proposal excludes it until the term of the rate plan expires. The inclusion of the ASGA in rate base is the typical rate treatment of a regulatory liability.

Q. Explain the regulatory adjustment to reflect the expiration of cost to achieve amortization.

A. This adjustment is associated of the costs to achieve the Energy East and Rochester Gas merger. The costs associated with the merger were amortized over a period coinciding with the time period of the JP, which end in 2008. I have reflected the expiration of this amortization.

Q. How are Staff's adjustments presented in your exhibits?

A. These aforementioned adjustments, are presented in Exhibit ___(RPH-2)(Electric Income Statement and supporting schedules) and Exhibit __(RPH-3) (Gas Income Statement and supporting schedules), showing the company's Calendar Year 2006 (latest company annual compliance filing) as a starting point for Staff's presentation. The Company's 2006 Electric filing was modified to remove commodity revenues and expenses to show delivery amounts only. The commodity and delivery amounts were derived from the company response IBER-0218 to DPS-137.

POSITIVE BENEFITS 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 shown on Exhibit __ (RPH-4)?

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

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

A. The future earnings of RG&E, after positive benefit adjustments to regulatory assets and future funding of future reserves, would show increased rate of returns for both electric and gas, as shown on Exhibits ___(RPH-2) Electric and (RPH-3) Gas. Electric return on equity would be 35.91% and gas would be 15.98%. The forward looking statements employ an updated equity ratio of 38% as recommended by Staff witness Barry. This level is lower than the current 45% used by the company in its annual filing.

Q. Please explain the PBA Delivery Stranded Cost adjustments listed on Exhibit___ (RPH-4).

A. The Loss on Reacquired Debt is associated with losses due to early refunding of debt issues. These losses are amortized and included in the interest costs as part of the overall cost of capital. The 2003 Ice Storm deferral is associated with costs associated with storm restoration costs.

Q. Describe the Positive Benefit Adjustments shown in the ACF Deferral section of your schedule.

A. These amounts are associated with costs that were deferred under the Electric and Gas Joint Proposals (Cases 03-E-0765 and 03-G-0766).

Q. Describe the Positive Benefits proposal for Operating Reserve section of your exhibit?

A. I have increased the Storm Reserve by $10 million to pre-fund future storm costs based upon an estimated 5 years of storms expense at $2 million per year. I have also made an adjustment to Environmental Site Remediation regulated asset account for the latest known amount.

Q. Describe the amounts under the Fixed Supply related Regulatory Asset section.

A. These amounts are associated with RG&E losses associated with sales of generation plants (Nine Mile 2 and Oswego 6) and buyout of Non-Utility Generator purchased power contract (Allegheny).

Q. What do the amounts under the Decommissioning section correspond to?

A. The amounts shown are to fund future

decommissioning costs of retired RG&E generation plants. The amounts shown are estimates based on the latest available data.

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

A. These costs are related to the funding of reserves to offset future potential costs associated with events that are unpredictable or of an undetermined nature, such as storm costs, environmental site remediation, and decommissioning costs of retired generation plant (Beebee and Russell).

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

A. The electric return on equity increases from company compliance filing of 10.11 (delivery only) 10.11 to 35.91% resulting in an increase in annual over earnings of about $110.6 million when compared to the 9.0% fair ROE, as addressed by the Policy Panel. The gas return on equity increases from 9.88% to 15.98% resulting in an annual over earnings of about $16.8 million.

<u>ELECTRIC RATE PLAN CONCERNS AND MODIFICATIONS</u>

Q. What modifications should be made to the earnings sharing mechanism based upon Staff Policy Panel updated rate of return?

A. Based upon the updated rate of return and his recommended return on equity of 9.0%, the customer/company sharing should begin with a 50%/50% sharing of earning above a 9.35% ROE. The next tier of sharing would begin above a ROE of 10.0% ROE, with sharing 75% to the customers and 25% to the company. The sharing mechanism would continue with an upper limit of 11.0% ROE, above which 100% of excess earnings would be directed to the customers.

Q What additional rate provisions should be considered for the Electric Rate Plan if the Commission approves the acquisition?

A. The Commission has ordered that a revenue decoupling mechanism be implemented, as testified to by the Staff Gas Rates Panel. Besides the customer protection, rate levels, positive benefit adjustments, and earnings sharing, customer service mechanisms should also be a condition of approval. Consistent with the PBA proposals above, which minimize stranded costs, the potential for future stranded costs should be reduced. The threshold for deferral of Accounting, Regulatory, Legislative, and tax mandated should be increased from $250,000 to $500,000. The exogenous cost threshold should be increased to $2.5 million form the current $2 million, with individual items of less than $500,000 not eligible for inclusion in the aggregate threshold. Furthermore, the costs of Commodity Outreach and education, property tax and stray voltage costs would no longer be eligible for deferral treatment.

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 estimated surcharges were filed and these estimates were later reduced in May, 2007.

Q. Does Staff have concerns with the proposal to charge customers a surcharge for AMI?

A. Yes. These concerns and recommendations are addressed by Staff witness Benedict.

<u>RG&E Asset Sales Gain Account (ASGA)</u>

Q. The company's ASGA account was established from the proceeds of the sales of its Ginna Nuclear Power Plant. What have the balances been over the term of the Joint Proposal per the company's compliance filings?

A. The company's filings have shown the following balances (in million):

Beginning Balance 2004:	$389.6
Ending Balance 2004	$315.8
Ending Balance 2005	$266.8
Ending Balance 2006	$206.4

Q. What are the major causes of the change in the ASGA balances?

A. The company has refunded $110 million to customers, and deducted sales incentives, interest, and Purchased Power Agreement credits.

Q. Is RG&E currently using credits from its ASGA balance to moderate its electric rates?

A. Yes. According to the terms of its electric Joint Proposal, RG&E uses credits from its ASGA account to moderate its electric rates. These credits are deductions from RG&E's ASGA balance.

Q. Why is RG&E using ASGA credits to moderate its electric rates?

A. RG&E uses ASGA credits is to offset cost increases resulting from the increased costs of the Ginna Purchase Power Agreement (PPA) versus the costs of Ginna under RG&E ownership. The Ginna PPA was entered into as part of the transaction involving the sale of the Ginna nuclear plant. Bill increases result because the PPA contract prices paid by RG&E are higher than the amounts embedded in RG&E's rates for Ginna. These credits reduce RG&E's rates back to the amounts embedded for Ginna.

Q. What amounts has RG&E deducted for this PPA impact?

A. RG&E will have withdrawn $234.9 million from the ASGA to offset the Ginna PPA costs between 2004-2008. The annual amounts credited to customers resulting from the PPA have been as follows:

Year	ASGA Credit
2004	$28.0 million
2005	$30.5 million
2006	$55.4 million
2007	$63.8 million
2008	$57.0 million

Q. What will happen to RG&E's electric rates after the ASGA credits are fully utilized as a result of the PPA costs?

A. There is a looming structural deficit in RG&E's electric rates. All other things equal, RG&E's electric rates will have to increase by approximately $60 million, unless some other offsetting adjustments are made.

Q. Does RG&E's proposal to maintain the existing rate plans address this concern?

A. No. In fact, at best, if RG&E continues to use the approach from its Electric JP and deducts the increased costs of the PPA from the ASGA, this increase could come to bear in 2010.

Q. Does Staff's PBA proposal help to mitigate this future increase?

A. Yes. When the rates rise for the Ginna PPA, the PBA adjustments can mitigate this large increase.

Q. Do you have any other recommendations concerning the rate treatment of RG&E's ASGA?

A. Yes. The Commission should consider deducting the remaining ASGA balance (estimated to be $80.2 million) from RG&E's electric rate base beginning in 2009, upon the expiration of the current RG&E electric rate plan. Currently the

ASGA balance accrues interest at a rate of 10% per year.

Q. Why are you recommending this change?

A. The rate base reduction can contribute to the mitigation of the looming Ginna PPA related rate increase described above.

CONCERNS AND MODIFICATIONS TO THE GAS PLAN

Q. What modification should be made to the earning sharing mechanism based upon the Staff Policy Panel updated rate of return?

A. Based upon Mr. Barry's updated rate of return and his recommended return on equity of 9.0%, the customer/company sharing should begin with a 50%/50% sharing of earning above a 9.35% ROE. The next tier of sharing would begin above a ROE of 10.0% ROE, sharing 75% to customer and 25% to company. The sharing mechanism would continue with an upper limit of 11.0% ROE, above which the customers would retain 100% of excess earnings.

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 minimize RG&E's stranded costs, the potential for future stranded costs should be reduced if the Commission approves the proposed the acquisition. The threshold for deferral of Accounting, Regulatory, Legislative, and tax mandated should be increased from $100,000 to $200,000. The exogenous cost threshold should be increased to $1.0 million from the current $850,000, with individual items of less than $150,000 not eligible for consideration in the aggregate threshold. Furthermore, the costs of property taxes would no longer be deferrable.

CONCLUSION

Q. Please summarize your position.

A. RG&E's electric and gas rates are currently above the level that the Commission would allow in a rate proceeding. Consequently, the Commission could lower rates as a condition of approving the acquisition. In addition, the proposed elimination of regulatory assets and increased reserves would help to provide sustainable rates at lower rate levels or at the current rate levels for an extended period beyond 2008.

Q. Does this conclude your testimony?
A. Yes.