Case 06-G-1332 – Proceeding on Motion of the Commission as to the Rates, Charges, Rules, and Regulations of Consolidated Edison Company of New York, Inc. for Gas Service

REPORT OF CON EDISON OF NEW YORK ON THE REVENUE DECOUPLING COLLABORATIVE

August 4, 2008

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BEFORE THE STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Gas Service

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REPORT OF
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Pursuant to the New York State Public Service Commission's ("Commission") September 25, 2007 order in Case No. 06-G-1332,[1] Consolidated Edison Company of New York, Inc. ("Con Edison" or "Company") hereby submits its report on the collaborative efforts to develop recommendations for Commission approval regarding the Revenue Decoupling Mechanism ("RDM") to be used for rate years two and three of the Company's current gas rate plan ("2007 Gas Rate Plan")(the "Report").[2]

Despite the diligent efforts detailed in this Report, the parties participating in the Collaborative were unable to reach a consensus on a revenue decoupling mechanism for the last two years of the current rate plan. Accordingly, this Report details the nature and extent of those

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[1] Case No. 06-G-1332, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Gas Service*, Order Adopting in Part the Terms and Conditions of the Parties' Joint Proposal (September 25, 2007) ("Gas Rates Order").

[2] Con Edison initially filed its Report with the Commission on June 19, 2008. In light of information that first came to the Company's attention on July 10, 2008 (discussed in detail below), and since the Report had not yet been issued for comment by the Commission, the Company is filing this updated Report to reflect that additional information, to summarize an additional meeting of the Collaborative held on July 24, 2008 to discuss that information, and to reflect input from the parties on this updated Report.

collaborative efforts and Con Edison's recommendation for the continuation of revenue decoupling for its Gas service.[3]

Con Edison recommends that either the currently effective Revenue Per Customer ("RPC") mechanism continue in effect without change for the second and third years of the 2007 Gas Rate Plan or that the current mechanism be modified to use the customer counts from the Company's Customer Reports to measure customer growth instead of measuring the growth in 30-Day equivalent bills, as is currently the case.

For the reasons explained in this Report, these two alternatives are the only alternatives presented to and considered by the Collaborative that are both viable and consistent with the parameters established by the Gas Rates Order for the consideration of a revenue decoupling mechanism for the second and third years of the 2007 Gas Rate Plan.

BACKGROUND

The Gas Rates Order adopts the June 1, 2007 Joint Proposal in the above-captioned proceeding and incorporates the Joint Proposal as an attachment (referred to herein as "Gas Rates Order, Attachment 1"). The Joint Proposal delineates a comprehensive set of terms and conditions describing how the RDM would operate in the first year of the three-year rate plan for Con Edison's gas business, commencing October 1, 2007 and continuing through September 30, 2008.[4]

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[3] As discussed infra, some parties, including Staff, are still evaluating their positions based upon new information discovered and presented to the parties in July.

[4] For the purposes of this Report, "Rate Year 1" ("RY1") means the 12-month period starting October 1, 2007 and ending September 30, 2008; "Rate Year 2" ("RY2") means the 12-month period starting October 1, 2008 and ending September 30, 2009; and "Rate Year 3" ("RY3") means the 12-month period starting October 1, 2009 and ending September 30, 2010.

The Joint Proposal provides that a collaborative to be chaired by Con Edison ("Collaborative") be formed, no later than November 1, 2007, to evaluate an RDM for RY2 and RY3. Specifically, the Joint Proposal provides for the parties to evaluate

> whether a RAM [Revenue Adjustment Mechanism] that relies upon rate year billing determinants is reasonable and workable, without precluding the evaluation of other alternatives, including the continuation of the mechanism implemented for rate year one, with or without modifications. Each of the alternatives will be premised upon continuation of the WNA [Weather Normalization Adjustment] with no dead band and the Company's opportunity to retain new business.[5]

Con Edison sent a Notice of the Collaborative to all active parties in Case No. 06-G-1332 on October 12, 2007. The notice advised the parties that the Company would be convening the Collaborative and that the first meeting would be held on or about November 9, 2007, at the Company's offices; asked parties to advise the Company whether they were interested in participating in the Collaborative; and advised the parties that we would establish a date and time for the initial meeting.

In addition to the Department of Public Service Staff ("Staff"), the following parties notified the Company that they wanted to participate in the Collaborative:

1. City of New York ("City")
2. New York Energy Consumers Council ("NYECC")
3. Natural Resources Defense Council ("NRDC")
4. Consumer Power Advocates ("CPA")
5. County of Westchester ("Westchester")
6. Intelligent Energy
7. New York State Consumer Protection Board ("CPB")
8. Pace Energy Project ("PACE")
9. Public Utility Law Project ("PULP")
10. National Grid USA Service Co. ("Grid")
11. New York State Electric & Gas/Rochester Gas & Electric Corporation ("NYSEG")

The first meeting of the Collaborative took place on November 8, 2007. Thereafter, parties met at least monthly, in addition to communications among various parties to exchange

[5] Gas Rates Order, Attachment 1, p. 11.

information in an effort to better understand the RPC Mechanism established for Rate Year 1 and alternatives available for Rate Years 2 and 3. Meetings were held at Con Edison headquarters, 4 Irving Place, New York, NY, on the following dates, except for the meeting on April 22, 2008, which was held at the New York State Department of Public Service's Manhattan office at 90 Church St., New York, NY:

- Thursday, November 8, 2007
- Monday, December 17, 2007
- Thursday, January 24, 2008
- Wednesday, February 6, 2008
- Monday, February 25, 2008
- Friday, March 7, 2008
- Friday, April 4, 2008
- Tuesday, April 22, 2008
- Monday, May 19, 2008
- Thursday, July 24, 2008

A teleconference bridge was also made available at all of the meetings to facilitate participation by phone. Advance notice for each of these meetings was provided to all parties on the Commission's Active Party List for Case No. 06-G-1332.

The Gas Rates Order required the Company to submit a report on or about April 15, 2008, to include recommendations for Commission approval regarding the RDM to be implemented for Con Edison's gas business for Rate Years 2 and 3 and, to the extent the Company would incur incremental costs for information resource system changes required to implement a new modified revenue adjustment mechanism, a description of such changes and the projected costs.[6]

[6] The Gas Rates Order directs the Company to file a report with the Commission "on or about" April 15, 2008, unless the Company provides before that date a reasonable cause for delay. Gas Rates Order, p.5, note 11. On April 11, 2008, the Company submitted a letter to the Commission advising that the report would not be filed by April 15, 2008, because the parties were still assessing proposals in an attempt to achieve a consensus regarding an RDM for Rate Years 2 and 3. On May 22, 2008, the Company submitted a follow-up letter to the Commission advising that discussions were nearing conclusion and that the Company was in the process of finalizing its report for submission

This document constitutes that report.

THE RY1 REVENUE PER CUSTOMER MECHANISM

During the first year of the Gas Rate Plan, Pure Base Revenues (defined below) from gas service provided to certain Con Edison firm full service and retail choice customers is subject to reconciliation pursuant to an RPC mechanism. That is, at the conclusion of Rate Year 1, the Company will surcharge or refund certain customers the difference between actual Pure Base Revenues from the customer groups subject to the RPC mechanism as measured against pre-established per customer target revenue levels for such groups. Specifically, the RPC mechanism applies to the following groupings of customers:

- SC No. 2 - Rate I;
- SC No. 2 - Rate II;
- SC No. 3 customers with 1-4 dwelling units; and
- SC No. 3 customers with more than 4 dwelling units.

Each grouping includes all customers taking service under SC No. 9 that would otherwise take service under such grouping. The groupings exclude customers taking service in economic development zones (Rider G), under a manufacturing incentive rate (Rider I), or under the low-income program, and customers receiving service at a firm-bypass rate. Distributed Generation customers being served under Riders H and J are also excluded from the groupings.[7]

The 2007 Gas Rate Plan (Attachment 1, pp. 10-11) provides that:

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to the Commission. As indicated above, the Company filed an earlier version of this Report with the Commission on June 19, 2008.

[7] Gas Rates Order, Attachment 1, pp. 9-10.

RPC factors (defined as dollars and cents amount per customer) for each of the four RPC groupings defined above will be calculated as follows:

- The Rate Year Pure Base Revenue target for each grouping, which was, in part, the basis for establishing the revenue requirement in this proceeding, divided by the monthly average of equivalent 30 day bills forecast for that grouping for the rate year. Appendix L [to the Joint Proposal] shows the RPC factors at proposed rates for RY1, RY2 and RY3.[8]

- Pure Base Revenues are revenues from delivery rates and charges, excluding Gross Receipts Taxes, MFC, Billing and Payment Processing Charges, and all other applicable credits or surcharges other than WNA credits or surcharges.

The Company will retain Pure Base Revenues for each grouping equal to the RPC factor for each grouping times the actual number of customers in the rate year in each grouping ("Allowed Pure Base Revenue Retention")(the actual number of customers by grouping will be determined by dividing the number of days of service covered by bills issued during RY1 by 360). For each grouping, the retained Pure Base Revenues will be referred to as the Allowed Pure Base Revenues.

At the end of RY1, for each grouping, the Company is required to reconcile the actual Pure Base Revenues to the Allowed Pure Base Revenues and refund customers if the actual Pure Base Revenues are more than the Allowed Pure Base Revenues and surcharge customers if the actual Pure Base Revenues are less than the Allowed Pure Base Revenues. Any shortfall or excess will be surcharged or refunded to customers in each grouping on a volumetric basis over the next 12 months; provided, however, that if the Company's projected reconciliation for the combined RPC groupings at the end of RY1 equals or exceeds $10 million, the Company will implement interim RPC refunds or surcharges, by grouping. Any interim refunds or surcharges would be credited towards the final RY1 reconciliation.[9]

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[8] Adjusted RPC factors for RY 1 that reflect the Commission's decision to adopt a levelized rate increase are reflected in the Company's September 28, 2007 compliance filing.

[9] On May 28, 2008, the Company filed with the Commission to implement, effective June 1, 2008, interim surcharges for applicable firm sales and firm transportation customers in three groupings (i.e., SC No. 2 - Rate I, SC No. 2 - Rate II, and SC No. 3 customers with 1-4 dwelling units) and a refund (also applicable to firm sales and firm transportation customers) for SC No. 3 customers with more than 4 dwelling units. The net interim surcharge/credit reflected in the Company's May 28th filing is $22.4 million. As explained below, new information has come to the

OVERVIEW OF COLLABORATIVE DISCUSSIONS

Discussions during the first months of the Collaborative were focused on the implementation of the RPC mechanism in RY1. In particular, the Company explained how it was calculating accrual or deferral estimates from monthly actual Pure Base Revenues versus Allowed Pure Base Revenues for the purpose of determining whether an interim surcharge/credit should be instituted.

The Company explained that for each month and RPC grouping, the Company calculated a monthly accrual or deferral estimate based on the number of 30-Day equivalent bills generated from the Company's billing system, monthly RPC factors described below, and the actual Pure Base Revenues collected.

The number of 30-Day equivalent bills was calculated by dividing the total number of days of service covered by bills issued in the month by 30. The number of 30-Day equivalent bills was then multiplied by a distribution of the annual RPC factors into monthly RPC factors. For each RPC grouping, the monthly RPC factor was derived from average customer gas usage patterns by month. Thus, higher monthly RPC factors were assigned to months where average customer gas usage is high, and comparatively lower RPC factors assigned to months in which the average customer gas usage is low. The sum of all monthly RPC factors equals the annual RPC factor for the rate year by grouping.

The Company explained that it then calculated the monthly Allowed Pure Base Revenue for each RPC grouping as the product of the 30-Day equivalent bills and the monthly RPC factor

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Company's attention since the May 28th filing that indicates that the net interim surcharge/credit should be designed to recover $13.2 million. After consultation with Staff, the Company is not planning to file to amend the interim surcharge but instead continue to recover the surcharge pursuant to the May 28th filing. It is projected that the Company will recover less than $4 million through the end of October 2008. As provided in the Joint Proposal, the interim surcharge will be reconciled at the end of RY1 and adjusted prospectively to prevent any overrecovery or underrecovery.

for the grouping, and that the last step in the monthly accrual/deferral calculation is taking the difference between the monthly Allowed Pure Base Revenue and the actual Pure Base Revenue.

To assist the Collaborative in developing a RY2 and RY3 recommendation, the Company provided the accrual or deferral calculations on a monthly basis, as well as supporting data, while also explaining that the final determination of any rate year refund or surcharge will be based on the monthly average of 30-Day equivalent bills in the rate year, the annual RPC targets and annual actual Pure Base Revenues, and not on the monthly targets developed for accrual or deferral purposes.

The Company's original net monthly calculations through December 2007 indicated the possibility of a net cumulative surcharge in excess of $10 million by the end of RY1. Based upon the Company's limited historical experience with monthly 30-Day equivalent bills, the Company, in consultation with Staff and other parties active in the Collaborative, refrained from implementing an interim surcharge on the basis of this initial experience with this RPC mechanism. Instead, the Company first endeavored to more fully evaluate the accruals.

The Company, with on-site Staff participation, performed verifications and checks of the Company's Information Resources system to validate proper calculations of 30-Day equivalent bills by RPC groupings. These initial efforts verified the calculation of the monthly accruals (subject to the adjustments noted below to correct for the inadvertent inclusion of fuel-related revenues associated with certain voucher bills as well as revenue from one RPC exclusionary customer).[10]

[10] As discussed infra, in light of the concerns expressed by parties during the Collaborative, the Company continued to endeavor to identify any issues with the manner in which it was calculating 30-Day equivalent bills, including after the initial version of this Report was filed with the Commission on June 19, 2008. As a result of these efforts and as described in more detail below, the Company discovered an issue with the calculation of 30-Day equivalent bills that caused the monthly accruals to be overstated.

In the following months, the Company continued to evaluate, with the parties to the Collaborative, whether other circumstances, including circumstances in future months, may indicate that the year-end surcharge would be less than $10 million. As indicated above, in May 2008, the parties collectively concluded that there were no anticipated circumstances that would indicate a year-end surcharge of less than $10 million.[11]

Because continuing the currently effective RPC in RYs 2 and 3 in its present form was one alternative for the Collaborative to consider, the parties spent a considerable amount of time discussing the results of RY1. A number of parties expressed concern as to the amount of the projected net surcharge. In response, Staff expressed the view that any refunds or surcharges in any RPC mechanism, including the current method, would inevitably capture several different drivers of customer gas usage. Examples of these drivers include economic conditions, abnormal weather patterns that the Weather Normalization Clause can not account for, and conservation practices outside of gas efficiency programs.

Staff also noted that any refunds or surcharges in any RPC mechanism would depend on the forecast of customer usage. That is, historically, aggressive (higher) customer usage forecasts have lowered delivery rates and the cost to each customer and the forecasts for customer usage determine where the customer costs are recovered, i.e., in the delivery rates during the rate year or the RDM charges the following year. Aggressive customer usage forecasts shift the revenue recovery from the delivery rates to the RDM surcharges.

As mentioned earlier in this Report, although the Collaborative began meeting in early November 2007, the first four months were focused almost exclusively on understanding the

[11] As shown in Appendix A, as of April 2008, the Company's initial cumulative net accrual was $22.4 million. As discussed below, the accrual as of April 2008 has since been revised downward to approximately $13.2 million. While lower than the initial estimate, the revised accrual is still projected to exceed $10 million at the end of RY1 and therefore, under the terms of the Gas Rates Order, an interim surcharge is required.

implementation of the RPC in RY1 and in evaluating the results it was producing. It was not until March and April that most proposals for RY2 and RY3 began emerging. The proposals are addressed as part of the chronology of the Collaborative's meetings and other interactions. As indicated above, since some of these proposals were made just before (and some after) the original target date for this Report (i.e., April 15, 2008), the Company notified the Commission that this Report would be submitted at a later date in order to provide additional time for the parties to fairly evaluate and consider these proposals and attempt to achieve a consensus position.

Although these additional efforts did not result in a consensus, they did provide an opportunity for a fuller evaluation of alternative mechanisms for Rate Years 2 and 3 and an airing of the participants' views as to the pros and cons of these alternatives and whether or not such proposals were appropriate for implementation in the context of the Company's existing gas rate plan.

REVISED MONTHLY ACCRUAL DATA

During the course of the Collaborative, the Company endeavored to identify any issues with the manner in which it was calculating 30 Day equivalent bills and the Company continued these efforts, even after the initial version of this Report had been filed. Although the Company did not identify any significant issues with the 30 Day equivalent bill calculation during the course of the Collaborative, on July 10, 2008, the Company first became aware of a calculation anomaly that caused an overstatement in the number of 30 Day equivalent bills. This anomaly resulted in an accrual balance of approximately $22.4 million as of April 2008, when the actual accrual balance as of April 2008 should have been approximately $13.2 million.

The source of this discrepancy was customers on Levelized Payment Plans ("LLP"). The following is a summary of the anomaly the Company identified:

- Customers that are on the LPP are billed monthly for their calculated monthly installment amount, rather than their recorded and billed usage, regardless of whether or not a commodity bill (actual or estimated) is generated.
- When a bill record is generated and there is no commodity charge (i.e., installment bill only), it does not carry a "from" date since it is not a bill for usage; it is an invoice to remind the customer to pay the monthly installment amount.
- When calculating the period of the bill for RDM reporting, this zero "from" date caused the calculation of an excessive number of days, which converted into an excessive number of relative 30-Day equivalent bills.

The number of levelized billing records between October 2007 and April 2008 with no associated bills was 264. While the number of records is relatively small, the number of actual 30-Day equivalent bills produced by the process described above was overstated by approximately 82,000. Once this discrepancy is corrected, the $22.4 million accrual balance as of April 2008 is reduced to an accrual balance (as of April 2008) of $13.2 million.

Programming has been adjusted to identify these conditions and bypass them for RDM purposes until the commodity bill is generated.

In Appendix BB are tables listing the original and revised accrual data. For purposes of evaluating the proposals for RY2 and RY3 (described below), the revised accrual data in Appendix BB should be used.

SUMMARY OF COLLABORATIVE MEETINGS AND DISTRIBUTIONS OF PROPOSALS AND DATA

The collaborative meetings encompassed various RDM discussions, the topics of which are summarized in Appendix AA on a meeting-by-meeting basis. Also identified are several dates on which information or a proposal(s) was circulated among the parties between collaborative meetings.

POSITIONS OF THE PARTIES

During the course of this Collaborative, participating parties made various comments and asked many questions about the operation of the RY1 RPC mechanism and the alternative mechanisms for Rate Years 2 and 3 presented for discussion at the Collaborative meetings. As indicated in the chronology of meetings, the April 22nd meeting was a forum at which some parties expressed their positions as of that date.

The following is a summary of the positions that active participants in the Collaborative requested be included in the Report. Each of these parties, as well as the Company and other active parties to this case, reserve the right to provide additional comments to the Commission pursuant to any process for public comment established by the Commission.[12]

City of New York - The City contends that new business revenue should only be recovered by the Company to the extent that the Company is truly serving new business that would normally be expected to require infrastructure improvement, incremental billing and service expenditures, or both. The City is concerned that under the RY1 RPC mechanism, the Company could retain revenue attributable to customers who convert from one service class to

[12] Although this Report contains the Company's recommendation for an RDM for Rate Years 2 and 3, and the reasons for that recommendation, any process for public comment should provide for both initial and reply comments, in order to provide the Company (and others) a fair opportunity to respond to proposals for alternative mechanisms and/or disagreements with the Company's recommendation.

another. The City believes that in several cases such conversions do not represent a direct infrastructure improvement or an increased operating cost, and would not have materially increased Company revenues in the pre-RDM world. The City concludes the Company's ability to recover revenue from service class conversions should be limited to allowances for additional metering and billing costs for increased total customer counts (not just customers in the RDM categories) and for increased loads on the system.

The City is also concerned that RY1 out-of-period billing adjustments would result in reducing revenues in RY1 when bills are adjusted for overcharges prior to the implementation of the RDM (or increasing revenues when bills are adjusted for undercharges). The City contends that prior to RDM, the Company may overbill (or underbill) some customers in one period and charge/credit them for the overbilling (or underbilling) in subsequent periods. For overbillings that occur during the RDM period, the RDM deferral or accrual would be reduced when the overbilling occurs and increased when the Company corrects the bill. The City claims that in both cases the overbilling benefits and the cost of the correction is borne by the same party: the Company before RDM and the ratepayers afterwards. The City's concern is that for overbillings prior to RDM that are corrected under RDM, the benefits flow to the Company and the costs flow to the ratepayers, and that this "windfall" for the Company will not be reversed until the RDM is terminated, which is not likely to occur for many years, if at all.[13]

NYECC - NYECC is concerned with the monthly volatility seen thus far in the 30-Day equivalent bills data. NYECC is also concerned that the end-of-year customer surcharge estimates have not been in line with their expectations and have been out of character with what

[13] The City requested data that would allow the parties to estimate the magnitude of this effect. In response to data requests from the City (attached as Appendix K and Appendix S), the Company explained that the data the City requested is not available and that the Company would not be able to provide this data in all cases without implementing major programming changes to its data retrieval systems.

they believe to be real customer growth. NYECC indicates they will not support a RY2 mechanism that continues to use 30-Day equivalent bills as the measurement of customers. NYECC is, however, supportive of revisiting an RPC mechanism based on 30-Day equivalent bills if the volatility observed in the monthly data is proven to be mitigated on an annual basis.

NRDC - NRDC supports using a revenue per customer approach to implement the RDM in order to make the Company whole for additional costs from a growing customer base. However, NRDC is concerned that the methods discussed during the collaborative period to arrive at customer counts may not be dependable or may allow for gaming of the numbers. NRDC is encouraged that a revenue per customer method that satisfies the Company's and Staff's needs can be designed and the new information from the Company in July seems to move the parties closer towards refining the methodology. NRDC remains concerned with the seemingly obscure calculations that go into the customer counts, which NRDC believes can potentially and significantly skew surcharges or refunds under the RDM. Going forward, NRDC urges more transparency in order to ease its concerns.

Westchester -Westchester reserved its right to take a position during the anticipated comment period of this proceeding.

Staff – Staff's position prior to the discovery of the approximately $11 million overstatement of the calculation of 30 Day equivalent bills was that the dollar adjustment circulated on April 3, 2008 and discussed at the April 4, 2008 RDM meeting be applied to the RY1 RDM and that the preferred proposal circulated on May 16, 2008 and discussed at the May 19, 2008 meeting be implemented for RY2 and RY3. Staff believed that the RY1 adjustment reflects the understatement in the Company's rate design's 30-Day equivalent bills, which Staff alleges was caused by a lack of data on actual 30-Day equivalent bills, and that the preferred proposal for RY2 and RY3 is consistent with the Company's opportunity to retain new business as stated in the Joint Proposal.

Staff's position was based on the following principles and views:

- Any RPC mechanism should be predicated on the use of 30-Day equivalent bills as a surrogate for the number of customers.

- The Company uses 30-Day equivalent bills in its rate design based only upon forecasted 30-Day bills.

- 30-Day equivalent bills (and not the customer count from the Company's Customer Report) is the only direct measure of a customer's opportunity to use the Company's delivery system and is the best linkage to actual revenue received by the Company.

- The monthly volatility seen in the 30-Day equivalent bills is due to the fact that the 365/366 day billing year divides into 12 bills unevenly.

- 30-Day equivalent bills are no more volatile than the Customer count data when looked on a 12 month rolling average.

- Customer count is not accurate as it reflects only a point in time and does not capture where in the billing cycle new customers enter the Company's system or old customers exit the system (day 1 to day 33 after the scheduled meter read).

- Staff's study of the 12 months ended December 2007 backcasted to the 12 months ended December 2005 results in an "apples to apples" adjustment of the Rate Plan's forecast of customers, and is necessary.

In light of the discovery of the overstatement, the need for further analysis of the new calculations, and in recognition of the time sensitivity related to the issue of crafting and implementing an RDM mechanism for Con Edison for Rate Year 2, Staff will address the issue of the overstatement, its impact and Staff's proposal for a Rate Year 2 and 3 RDM mechanism during the comment and reply comment period expected to be established in a future procedural schedule Order.

CON EDISON RECOMMENDED RDM FOR RATE YEARS 2 AND 3

It is Con Edison's position that the Collaborative identified only two viable revenue decoupling mechanisms for implementation during Rate Years 2 and 3 of the Company's gas rate plan that are within the parameters established by the Joint Proposal adopted by the Commission: (1) continuation of the RY1 RPC mechanism; and (2) continuation of the RY1 RPC mechanism modified to use customer growth based upon the Company's Customer Report instead of 30-Day equivalent bills. For the reasons explained below, either of these two alternatives is acceptable to the Company.

Staff presented for consideration by the Collaborative various revenue decoupling alternative mechanisms, and the City presented one alternative mechanism; other Collaborative participants commented on and discussed these alternative mechanisms but no other party presented an alternative mechanism for consideration. However, none of the alternatives presented by Staff or the City can be reasonably considered by the Commission in the context of this proceeding because they violate the Gas Rates Order and the Joint Proposal and undermine the foundation of multi-year ratemaking.

These alternatives would deny the Company the opportunity to retain new business, in contravention of the express terms of the Gas Rates Order, by either: (i) capping the Company's opportunity to retain revenues from new business, by limiting the Company's retention of new business revenues to marginal costs or otherwise establishing a revenue cap or first establishing a dollar adjustment to the Allowed Pure Base Revenue; (ii) resetting customer growth forecasts for the outer years of the rate plan based upon data not available to the parties at the time rates were set; or (iii) applying an unduly narrow definition of "new business." A fundamental underpinning of multi-year rate plans is that utilities retain the incentives they earn through their efforts until the end of the term of the rate plan, at which time customers reap the long-term benefit of those efforts. The Commission should preserve the integrity of multi-year rate plans by rejecting proposals in this proceeding that would frustrate or change the incentives inherent in the 2007 Gas Rate Plan mid-stream.

In addition, going against the clear directives of the Gas Rates Order, Staff also improperly sought to make adjustments to the RY1 mechanism. This recommendation should also be rejected.

Opportunity to Retain New Business

The right to retain revenues from new business was critical to the Company's acceptance of the overall terms of the Joint Proposal adopted by the Commission, which reflected a comprehensive balancing of interests on numerous issues. The purpose of the Collaborative, as set forth in the Gas Rates Order, was to recommend an RDM for RY2 and RY3, not to revisit the customer and usage forecasts that formed the basis of the Signatory Parties' agreement to the Joint Proposal or the Commission's adoption of the Joint Proposal. Over the course of the three-year rate plan, certain differences between actual and forecasted levels will benefit the Company and others may work to the Company's disadvantage. The ability for the Company to retain the agreed-upon benefits over the course of the three-year rate plan provided a critical incentive for the Company to sign the Joint Proposal. Re-benchmarking the RY2 RPC factors based on the results of RY1 30-Day equivalent bills, or otherwise capping revenue opportunities because actual results may not be as some parties anticipated, selectively and improperly singles out this one element of the overall rate agreement for "updating." Implementing a Commission mandate to evaluate an appropriate revenue decoupling mechanism for Rate Years 2 and 3 must not serve to vitiate this provision of the Rate Plan. Moreover, it bears mention that the higher-than-anticipated customer growth will redound to the benefit of customers the next time rates are reset.

Proposed Adjustments to Rate Year 1

The Commission should reject any proposal to modify the RY1 RPC mechanism as it applies to Rate Year 1, which is also clearly outside the mandate for this Collaborative.[14] Additionally, Staff's proposed adjustment to the starting point of the Rate Plan's forecast of customers should be rejected. The forecast included in the Joint Proposal was based on the information available at the time the parties were negotiating the Joint Proposal. Staff's attempt to retroactively adjust the starting point by applying an analysis of the 12 months ended December 2007 backcasted to the 12 months ended December 2005 inappropriately re-visits (with the benefit of hindsight) a crucial element of the JP that the Signatory Parties agreed to and that the Commission adopted in the Gas Rates Order.[15]

Notwithstanding Staff's claims, Staff's comparison is not "apples to apples" since it compares data from the Company's Customer Service System, which is continuously updated, to a database that reflects data extracted at a point in time and not updated for later re-billings and cancellations. Moreover, Staff does not dispute that the dollar adjustments it proposes might be different depending on the time period used for comparison. Additionally, it should be noted that comparing actual 30-Day equivalent bills for the period ending September 2007 to the 30-Day equivalent bills assumed in Staff's forecast for the same period shows that the actual 30-Day equivalent bills were less than those forecast for some classes (Appendix V), indicating that there was no issue with the starting point. It also demonstrates that the determination of the need for

[14] Gas Rates Order, Attachment 1, pp. 11-12.

[15] Staff's analysis makes no mention of the fact that customer growth between the end of 2005 and 2007 as reflected in the Customer Reports was significantly greater than the Joint Proposal's forecast.

an "adjustment" is dependent upon the period selected and should not be based upon information that was not available at the time that the Joint Proposal was signed. Finally, it is important to note that the growth reflected in the Joint Proposal was based on a review of the Company's Customer Report data.

In addition, the new information correcting an initial overstatement in the number of 30-Day equivalent bills provides further support for rejecting Staff's proposed adjustment to the starting point of the Rate Plan's forecast of customers. That is, assuming for purposes of argument the validity of Staff's backcast, based on the revised 30-Day equivalent bill data, the data for the 12 months ended December 2007 backcasted to the 12 months ended December 2005, would not support Staff's proposed starting point adjustment.

Verifying New Business

The City argues that the increases in the RDM target revenue for new customers should only reflect truly new business and the portion of the class RPC revenues associated with the new part of the business: metering and billing for re-metered buildings, system costs for heating conversions, and the entire RPC for truly new loads. The City applies a definition of "new business" that is inconsistent with the spirit, intent and express terms of the Joint Proposal. That is, the criterion that any RDM mechanism for Rate Years 2 and 3 provide the Company the opportunity to retain new business was intended to provide the Company an incentive to grow its firm gas business. An RDM that attempts to calculate the Company's incremental costs associated with new heating load and then limit the Company's revenue retention to such costs vitiates that incentive, thereby denying the Company a fundamental element of this Gas Rate Plan. And as explained below, not only does the City understate the costs incurred by the Company in generating new business, there is no basis for treating the Company's efforts to successfully convert an interruptible oil heat customer or a cooking-only customer to firm gas heating service differently from other "new business." In fact, the Joint Proposal expressly provides for the Company to retain all revenue from its oil-to-gas conversion program.[16] Accordingly, the City's proposal is in direct contravention to another express term of the Gas Rate Plan adopted by the Commission.

The new business provisions included in the Joint Proposal and adopted in the Gas Rates Order were incorporated precisely to give the Company an incentive to undertake the types of efforts that would attract new business. Adopting the City's position would undermine the incentives built into the Gas Rates Order and there would be limited or no benefit to the Company in growing new load. Additionally, the City ignores the fact that all customers will directly benefit from growth on the system as costs are spread among a larger pool of customers. Other than conclusory statements, the City offers no evidence or data to explain or support its assertion that conversions from one customer service class to another (or from one RPC group to another) will lead to higher revenues that the Company would not otherwise realize in the absence of an RDM.

In addition, the City's position is based on unsubstantiated assumptions about certain service classes/RPC groups, and a failure to fully recognize costs the Company incurs and benefits that accrue to customers. The City assumes that the only costs associated with "truly" new business are metering and billing costs for re-metered buildings and system costs for heating conversions. However, the City does not take into account other costs -- such as business development-related costs and additional facilities maintenance costs -- the Company incurs through its efforts to attract new business.

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[16] Gas Rates Order, Attachment 1, pp. 26-27.

Finally, the City's argument here fails to give due recognition that, while on an individual basis all customers with added load may not require a new or additional service or meter, collectively the added load from these customers may result in additional infrastructure costs, such as mains reinforcement.

Out-of-Period Billing Adjustments

As to the City's concerns regarding pre-RDM gas service being accounted for on an RDM basis, as indicated above, the Company explained that the impact of such slippage is minimal and that what the Company gains at the beginning of a rate year, it loses at the end, essentially resulting in a wash. Moreover, the City's concern would be rendered moot if the Commission adopts a mechanism that uses the Company's Customer Reports because the allowed revenues would not be dependent upon the 30-day bill count.

Continuation of Rate Year 1 Mechanism vs. The Customer Report Approach

Once proposals that go beyond the scope of the Collaborative's mandate are eliminated, only the mechanism in effect for RY1 and the Customer Count RPC mechanism remain for Commission consideration.

As to the current mechanism, as discussed earlier in this Report, the Company, with on-site Staff participation, performed verifications of the Company's Information Resources system to validate the calculations of 30-Day equivalent bills by RPC groupings. After this Report was initially filed on June 19, 2008, an anomaly in the calculation was discovered.

As discussed above, the anomaly was associated with transactions not directly related to actual bills. Once this anomaly was addressed, the difference between 30-Day equivalent bills and the data from the Customer Reports (for which some difference is to be expected) was more in line with expectations. Hence, the current mechanism remains a valid alternative for implementation during Rate Year 2 and Rate Year 3. Although the Company intends to continue to monitor its calculation of 30-day equivalent bills, the Company has no reasonable expectation of finding another anomaly that would have any material impact on the current calculation.

Notwithstanding, the Company is sensitive to the concerns expressed by customer group representatives that participated in the Collaborative, in terms of the complexity associated with using 30-Day equivalent bills as a basis for measuring customer growth and the monthly volatility of 30-Day equivalent bills as compared with the use of customer counts from the Company's Customer Reports. Indeed, such monthly volatility poses risks for the Company as well as customers. All of Staff's proposals utilize 30-Day equivalent bills as a direct measure of customers and do not address these concerns. Staff's proposals would continue a process that, in the Company's view, maintains an unnecessary complexity in tracking changes in numbers of customers for purposes of a revenue-per-customer mechanism.

There are several significant benefits to measuring customers based on the Customer Report. The Customer Report is a snapshot of all active customers at a given point in time and, unlike 30-Day equivalent bills, is unaffected by any operational or billing cycle effects. This generates a much more stable customer count when compared to 30-Day equivalent bills. Appendix Z graphically compares the monthly changes of 30-Day equivalent bills and customers measured from the Customer Reports over the past year, by RPC group. Appendix Z clearly shows that the 30-Day equivalent bills are a much more volatile measure than customer counts from the Customer Reports. The absence of any billing cycle effects on the Customer Report also allows for a simpler identification of actual system growth or reduction that is not skewed by unavoidable billing related issues (e.g., the length of the billing month, holiday schedules, out of period billing adjustments, cancellations, and re-renderings).

Staff's claim that customer count is not accurate (because it reflects only a point in time and does not capture where in the billing cycle new customers enter the Company's system or existing customers exit the system) is without merit. The net effect of new customers coming on to the system for part of a month (and included in the Customer Report customer count) and existing customers leaving the system after being a customer for part of a month (and not included in the Customer Report customer count) is immaterial in any particular month. These minor month-to-month variations result in a de minimis impact over the course of a 12-month rate year. In addition, Staff's "point-in-time" concern is equally applicable to 30-Day equivalent bills (which only reflect information for a particular month). Moreover, Staff itself relies on the data in the Customer Reports to assess the level of customer growth. Therefore, for purposes of comparing the Customer Report to 30-Day equivalent bills, Staff's "point-in-time" argument should be rejected.

Most importantly, measuring customers by the Customer Report would be fully consistent with the data source used to forecast customer growth. The customer, sales and revenue forecasts used, in part, for determining the revenue requirement and rates in the 2007 Gas Rate Plan reflected customer growth forecasts based on analysis of the Company's Customer Report. Moreover, as previously noted, adjusting the starting point of the forecast using the Customer Report number of customers and then measuring actual numbers of customers on a forward looking basis would bring consistency between how the forecast was developed and how it should be measured.

As to NRDC's concern regarding gaming of the number of customers in the Customer Reports, there is no information or evidence that supports this assertion. As discussed above, the Customer Reports were used as the basis for forecasting the incremental growth reflected in the forecast of sales used in the Joint Proposal. As demonstrated by the voluminous appendices to this Report, the Company responded to all data requests and there was a robust exchange of information among the parties in this Collaborative. There is nothing in any of that data that would support or even suggest that gaming is a valid concern.

Should the Commission decide to adopt the proposed Customer Count proposal, the RPC factors for Rate Years 2 and 3 would be those shown in Appendix V. If the Commission decides to continue the existing mechanism, the Company would make another compliance filing to adjust the RPC factors in Appendix L to reflect the Commission's adoption of levelized rates.[17] In summary, the Company's proposal for use of the Customer Report for the Allowed Pure Base Revenue calculation would reduce the monthly volatility seen by the use of 30-Day equivalent bills data, be simpler and more transparent in reporting, and be consistent with the source data used to develop the growth rates of the forecast.

As a final point, the Company notes that the Joint Proposal provides for the Company to identify in the Report the extent to which "the Company would incur incremental costs for information resource system changes required to implement a new or modified revenue adjustment mechanism (e.g., carrying charges, including depreciation, on capital expenditures)."[18] The Company does not anticipate any such charges for either continuing the RY1 RPC mechanism or implementing the Customer Count method. However, should the Commission order the implementation of a different mechanism, the Company reserves the right

[17] As noted in footnote 6, above, adjusted RPC factors for RY1 that reflect the Commission's decision to adopt a levelized rate increase are reflected in the Company's September 28, 2007 compliance filing.
[18] Gas Rates Order, Attachment 1, p. 12.

to identify such costs and defer such costs for future recovery, as provided in the Gas Rates Order.[19]

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Respectfully submitted,

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[19] Id.