

REBUTTAL TESTIMONY OF
STACEY A. RENNER
CASES 09-E-0588 & 09-G-0589

1 Q. Please state your name, business address, and position with Central Hudson
2 Gas & Electric Corporation.

3 A. My name is Stacey A. Renner and my business address is Central Hudson
4 Gas & Electric Corporation (“Central Hudson” or the “Company”), 284 South
5 Avenue, Poughkeepsie, NY 12601. My position with the Company is
6 Treasurer.

7

8 Q. Are you the same Stacey A. Renner who filed direct testimony in these
9 cases?

10 A. Yes, I am.

11

12 Q. What is the purpose of your rebuttal testimony?

13 A. I will respond to the recommended applicable cost of long-term debt and
14 customer deposits, for the rate year ending June 30, 2011, contained in the
15 direct testimony of the Staff Rate of Return Panel (the “Panel”) on behalf of
16 the New York State Department of Public Service (“Staff”).

17

18 Q. What is your reaction to the embedded cost of long-term debt recommended
19 by the Panel for the rate year?

20 A. First, I note that both the Panel and the Company have proposed deferral
21 treatment for long-term debt costs and I will discuss that in more detail later
22 in this testimony. Deferral treatment helps to neutralize the rate year impact

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1 on customers and shareholders from variations in long-term debt costs. It is
2 still important, however, to utilize an estimate of such costs that is reasonably
3 likely to occur in order to set delivery rates at a level that is representative of
4 the true cost of service. Setting long-term debt costs too high or too low
5 results in a mismatch in cash expended for interest expense and that
6 collected from customers, as well as the corresponding build-up of a
7 regulatory asset or liability that will be reconciled in a future rate case. I
8 believe that the Panel's recommended embedded cost of long-term debt
9 underestimates the reasonably expected cost of issuing new debt and will
10 result in the build-up of a regulatory asset during the rate year.

11

12 Q. What is the basis for your position that the Panel underestimates the cost of
13 long-term debt?

14 A. There are three reasons that lead me to this position: (1) the Panel
15 incorrectly estimated the cost of new debt, relying on erroneous data, (2) the
16 Panel's methodologies rely on only very recent periods, which fails to
17 recognize the volatility over the past year that is the basis for the Panel's
18 recommendation for deferral treatment, and (3) Central Hudson issued long-
19 term debt as recently as September 30, 2009, at a cost that significantly
20 exceeds the Panel's recommended cost of new long-term debt.

21

22 Q. Please describe the error reflected in the Panel's cost of long-term debt.

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1 A. In response to a Company information request, which is denoted as CH-88
2 and shown in Exhibit___(SAR-1R), the Panel acknowledges that it
3 erroneously used data from a promotional page of the BondsOnline website.
4 The promotional page showed extremely low credit spreads that contributed
5 toward a low recommended cost of long-term debt for the rate year. I also
6 note that CH-88, part d), is incorrect. In both CH-18 (also included in
7 Exhibit___(SAR-1R)) and CH-88, the Panel responded that billions of dollars
8 of 10-year and 30-year utility bonds were issued in 2009 at credit spreads
9 better (lower) than the erroneous data used in the Panel's testimony. The
10 Panel's Exhibit___(RRP-18), IR Response 6 of 11, shows no utility bonds
11 issued on such favorable terms.

12
13 Q. Do you have any additional concerns about the Panel's response in CH-88?

14 A. Yes. The Panel provided a correction to the recommended cost of debt in
15 that response. Rather than using the correct data from BondsOnline
16 (Reuters) to recalculate the credit spread, the Panel used an alternative
17 source of data. The Company obtained the correct BondsOnline data, which
18 was available at the time the Panel prepared its testimony. That data is
19 shown in Exhibit___(SAR-2R). For September 2009, the average of 10-year
20 and 30-year utility credit spreads was 181 basis points. The alternative
21 source introduced by the Panel in CH-88 reflects a credit spread of 153 basis
22 points for September 2009. While the Panel's response to CH-88

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1 acknowledges that it does not have a subscription to BondsOnline, its
2 response to CH-18 presents BondsOnline as a “reliable resource.” It is
3 unclear why the Panel would select BondsOnline as its source initially and
4 then change the source rather than obtain the correct data from the same
5 source, but the impact is a lower credit spread than would result from using
6 their originally intended source.

7
8 A final comment on the Mergent Bond Record, which the Panel employs as
9 its alternative source of credit spreads in CH-88. I have avoided using this
10 source as an indicator of debt costs for Central Hudson because the
11 underlying data for the utility indices is comprised of very large issuers and
12 the data is gathered from secondary trading of utility bonds (as opposed to
13 new bond offerings, which we are trying to estimate for the rate year). As a
14 small issuer, Central Hudson’s bonds are ineligible for such an index and, to
15 the best of my knowledge, the Company’s bonds seldom trade in the
16 secondary market. Staff acknowledged as much in its May 15, 2009 Brief
17 Opposing Exceptions in Central Hudson’s recently completed Rate Case (08-
18 E-0887 and 08-G-0888), adding 100 basis points to the Mergent data (p. 39
19 of the Brief is included as Exhibit___(SAR-3R)). The Commission concurred
20 in its Order in that Case. Applying the same methodology today, using the
21 Mergent data from the Panel’s Exhibit___(RRP-4), yields a cost of debt for
22 the rate year of 6.67% (5.67% average for July 2009 through September

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1 2009, plus 100 basis points).

2 Q. Please discuss in more detail your concerns about the time periods that the
3 Panel based its analysis on?

4 A. While the Panel acknowledges the recent volatility in financial markets and
5 “that market conditions continue to be somewhat uncertain” (p. 16, lines 3-4),
6 they use only very recent data in their recommendation. Furthermore, they
7 use these time periods inconsistently in the development of their
8 recommended cost of long-term debt in the rate year.

9 o Treasury rates are based on the average during the month of October
10 2009 (p. 13, lines 13-15)

11 o The first methodology for estimating the credit spread uses data that is
12 indicated in Exhibit___(RRP-16) as representing September 2009, but
13 also shown as representing either November 2, 2009 or November 3,
14 2009 in Exhibit___(RRP-17), Document 10 of 14. In the update
15 provided in CH-88, the data represents September 2009.

16 o The second methodology used the average of utility credit spreads for
17 July 2009 through September 2009, as shown in Exhibit___(RRP-18),
18 IR Response 6 of 11. As shown in the Exhibit, credit spreads
19 improved significantly in those 3 months compared to the prior 6
20 months.

21 o The third methodology is the average of four debt offerings spanning
22 June through September of 2009. I note that the average included

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1 one offering that was only a 5-year maturity, which is outside the 10 to
2 30-year maturity range considered in the other methodologies (it is
3 shown in Exhibit____(RRP-18), IR Response 6 of 11, “9/21 Niagara
4 Mohawk Power Corp.”). Excluding those 5-year bonds, the third
5 methodology’s result increases from 157.5 basis points to 173.3 basis
6 points.

7 I disagree with the Panel that today’s treasury rates are a better forecast of
8 treasury rates in the rate year than the composite forecast of leading
9 consultants and financial institutions available in the Blue Chip Financial
10 Forecast. For utility credit spreads, where I am not aware of a specific
11 forecast, I believe it is more reasonable to base the estimates on a broader
12 range of data that captures the volatility we have experienced over the past
13 year. I agree with the Panel that an update is warranted later in the case,
14 and recommend using up to 12 months of utility spread data (and no less
15 than 6 months). The use of a single month’s data serves only to select
16 whatever volatility is represented in that month and lock it in for the rate year.
17 I also note that under the positions of the Staff Policy Panel and Staff Rate of
18 Return Panel, that spread would be locked in for up to a three-year period.

19

20 Q. How did Central Hudson’s recent bond offering compare to the Panel’s
21 assumptions?

22 A. The Panel refers to the data employed in my testimony, the most current

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1 available at the time the testimony was prepared, as “stale” (p. 14, line 20).
2 The Panel then employed three methodologies, with data spanning June
3 through September of 2009 and including debt issued by Central Hudson on
4 September 30, 2009, to arrive at an estimated cost of long-term debt for the
5 rate year of 5.10%. In response to CH-16, shown in Exhibit____(SAR-4R),
6 the Panel states “we consider the current interest rates as the best indicator
7 of future interest rates.” By extension, Central Hudson’s September 30, 2009
8 bond offering would be a good indicator of rate year debt costs, yet the
9 Panel’s recommendation of 5.1% is significantly lower than the actual cost of
10 5.8% realized with that bond offering.

11

12 Q. Do you agree with the Panel’s recommendation that “the Commission re-
13 authorize the true-up of all new debt issuances and existing auction rate
14 debt” (p. 16, lines 5-7)?

15 A. Yes, with some clarification. The data certainly shows extreme volatility in
16 credit spreads. This is illustrated by the 9 months of spreads listed in
17 Exhibit____(RRP-18), IR response 6 of 11. The uncertainty in any forecast of
18 credit spreads based on such history warrants a true-up of the cost of new
19 debt issuance during the rate year (including refinancing of auction rate
20 debt). Regarding auction rate debt, the Company has longstanding deferral
21 treatment for variable interest on long-term debt that applies to its auction
22 rate debt and dates to the issuance of such debt. That deferral should

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1 remain as long as the auction rate debt remains in a variable rate mode.

2

3 I also note that the rate for customer deposits is set by the PSC, effective
4 January 1 of each year, and the Panel has reflected such rate in their cost of
5 capital (see p. 16, line 22 through p. 17, line 3). It appears to me that the
6 recently established rate is driven by the Federal Reserve's current "zero
7 federal funds rate" policy, which is distorting the yield curve with very low
8 short-term interest rates. It also seems clear that the short-term interest
9 rates can only go up from here. Using the new customer deposit rate,
10 effective January 1, 2010, in the rate year that begins July 1, 2010, provides
11 certainty on the rate for only 6 months. As a factor that is not within the
12 Company's control, but for which a variation from the rate allowance is likely
13 from January 1, 2011 through the end of the rate year on June 30, 2011, I
14 believe a true-up akin to the interest rate true-up is warranted.

15

16 Q. Does this conclude your rebuttal testimony?

17 A. Yes.