

REBUTTAL TESTIMONY
OF
STEVEN M. FETTER

CASES 08-E-0887 & 08-G-0888

1 I. INTRODUCTION AND BACKGROUND

2

3 Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

4 A. My name is Steven M. Fetter. I am President of Regulation UnFettered.

5 My business address is 1489 W. Warm Springs Rd., Suite 110,

6 Henderson, Nevada 89014.

7

8 Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

9 A. I am testifying on behalf of Central Hudson Gas & Electric Corp. ("Central

10 Hudson" or the "Company").

11

12 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

13 A. I am President of Regulation UnFettered, a utility advisory firm I started in

14 April 2002. Prior to that, I was employed by Fitch, Inc. ("Fitch"), a credit

15 rating agency based in New York and London. Prior to that, I served as

16 Chairman of the Michigan Public Service Commission ("Michigan PSC").

17 Earlier I served as Majority General Counsel to the Michigan Senate and

18 Assistant Legal Counsel to Michigan Governor William Milliken.

19

20 Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

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1 A. I graduated with high honors from the University of Michigan with an A.B.
2 in Communications in 1974. I graduated from the University of Michigan
3 Law School with a J.D. in 1979.

4

5 Q. PLEASE BRIEFLY DESCRIBE YOUR ROLE AS PRESIDENT OF
6 REGULATION UNFETTERED.

7 A. I formed a utility advisory firm to use my financial, regulatory, legislative,
8 and legal expertise to aid the deliberations of regulators, legislative
9 bodies, and the courts, and to assist them in evaluating regulatory issues.
10 My clients include investor-owned and municipal electric, natural gas and
11 water utilities, state public utility commissions and consumer advocates,
12 non-utility energy suppliers, international financial services and consulting
13 firms, and investors.

14

15 Q. WHAT WAS YOUR ROLE DURING YOUR EMPLOYMENT WITH FITCH?

16 A. I was Group Head and Managing Director of the Global Power Group
17 within Fitch. In that role, I served as group manager of the combined
18 18-person New York and Chicago utility team. I was originally hired to
19 interpret the impact of regulatory and legislative developments on utility
20 credit ratings, a responsibility I continued to have throughout my tenure at
21 the rating agency. In April 2002, I left Fitch to start Regulation UnFettered.

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2 Q. HOW LONG WERE YOU EMPLOYED BY FITCH?

3 A. I was employed by Fitch from October 1993 until April 2002. In addition,
4 Fitch retained me as a consultant for a period of approximately six months
5 shortly after I resigned.

6

7 Q. DO YOU ALSO HAVE A FORMAL ROLE RELATED TO CENTRAL
8 HUDSON?

9 A. Yes. Since 2002, I have been an independent director on the Board of CH
10 Energy Group, Inc. ("CHG"), the parent holding company of Central
11 Hudson. I currently serve as Lead Independent Director and Chairman of
12 the Board's Governance & Nominating Committee. I view my rebuttal
13 testimony here as less advocacy for the Company and more the sharing of
14 thoughts I have about the striking of a fair balance that I endeavored to
15 achieve when I served as a state regulator. I have informed Central
16 Hudson that I believe it is appropriate under these circumstances for me
17 NOT to receive any compensation for this testimony, other than travel
18 expense reimbursement.

19

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1 Q. HOW DOES YOUR EXPERIENCE RELATE TO YOUR TESTIMONY IN
2 THIS PROCEEDING?

3 A. My experience as a Commissioner on the Michigan PSC and my
4 subsequent professional experience analyzing the U.S. electric and
5 natural gas sectors – in jurisdictions involved in restructuring activity as
6 well as those still following a traditional regulated path – have given me
7 solid insight into the importance of a regulator’s role in setting rates and
8 also in determining appropriate terms and conditions of service for
9 regulated utilities. In this rebuttal testimony, I will focus on the tone and
10 direction expressed within the Staff testimony that I believe is inconsistent
11 with fair and balanced regulatory policymaking.

12

13 Q. HAVE YOU PREVIOUSLY GIVEN TESTIMONY BEFORE REGULATORY
14 AND LEGISLATIVE BODIES?

15 A. Since 1990, I have testified on numerous occasions before the U.S.
16 Senate, the U.S. House of Representatives, the Federal Energy
17 Regulatory Commission, and various state legislative and regulatory
18 bodies on the subjects of credit risk within the utility sector, electric and
19 natural gas utility restructuring, fuel and other energy cost adjustment
20 mechanisms, construction work in progress and other interim rate
21 recovery structures, utility securitization bonds, nuclear energy, and other

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1 miscellaneous matters related to utility regulatory policy. While at Fitch, I
2 testified at this Commission's Competitive Opportunities Proceeding
3 related to the electric utilities within the state.

4

5 My full educational and professional background is presented in
6 Exhibit_(SMF-1R).

7

8

II. EXECUTIVE SUMMARY

9

10 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

11 A. I have reviewed a summary of the Staff of the Department of Public
12 Service (Staff) testimony, specifically with respect to the performance
13 mechanisms proposed by Staff witnesses Roenick and Silverstein and the
14 Staff Gas Safety Panel, as well as the Staff Accounting Panel, and have
15 serious concerns about positions those individuals have taken that I
16 believe are inconsistent with the balance that should be struck by
17 regulatory decision-makers. I have consulted with Company witness
18 Michael Mosher on the points of difference with Staff that he has identified
19 in this proceeding – he has fully explained the issues upon which he
20 disagrees within his rebuttal testimony. My comments address the
21 negative direction that those Staff positions would take Central Hudson.

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2 Q. FIRST, WITH YOUR INVOLVEMENT ON THE CHG BOARD, CAN YOU
3 COMMENT UPON STAFF'S RECOMMENDED DISALLOWANCE FROM
4 RECOVERY OF ALL BUT \$15 MILLION OF DIRECTORS AND
5 OFFICERS LIABILITY INSURANCE COVERAGE?

6 A. Yes. CHG has made a concerted effort over the past decade to attract
7 directors whose professional experience can provide helpful guidance to
8 Company executives as they manage the day-to-day affairs of both
9 Central Hudson and CHG. I delineate the two entities because I firmly
10 believe that the diverse career backgrounds of the current Board accrue to
11 the benefit of both customers and shareholders. For example, I do not
12 believe there is a regulated utility near Central Hudson's size that has a
13 board of directors with such wide and relevant experience: regulatory,
14 governmental policymaking and senior management, legal, finance and
15 banking, and corporate strategy and management.

16

17 Q. WHAT ARE THE CONCERNS OF DIRECTORS WITH SUCH
18 SUBSTANTIAL EXPERIENCE AND PROFESSIONAL
19 RESPONSIBILITIES?

20 A. I think I speak for all of the directors when I say that, while we view our
21 service on the CHG Board as substantial, challenging, and rewarding, we

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1 would not want to carry on that role if it meant that a lawsuit, whether with
2 some degree of merit or none at all, could place the financial future of
3 ourselves and our families at risk. Staff has proposed allowing ratepayer
4 funding for \$15 million of liability insurance for a total of 24 directors and
5 officers. This equates to approximately \$625,000 of coverage per
6 individual, which is clearly inadequate under the economic and litigious
7 situation that exists within the U.S. business culture today. The additional
8 \$604,000 in the Company's rate request would provide the Board with an
9 additional \$85 million of coverage, a level that is clearly justifiable under
10 current business circumstances.

11
12 Q. COMPANY WITNESS MOSHER DELINEATES A LONG LIST OF
13 ISSUES THAT APPEAR TO PROVIDE POTENTIAL DOWNSIDE
14 EFFECTS WITH LIMITED OR NO UPSIDE POSSIBILITIES. HOW DO
15 YOU VIEW THAT SITUATION?

16 A. During my tenure as a state regulator, my fellow commissioners and I
17 attempted to incentivize constructive behavior by Michigan's regulated
18 utilities with positive financial benefits, while striking a fair balance on the
19 downside by providing for negative penalties for poor performance. As
20 Mr. Mosher explains in his rebuttal testimony, such balance does not exist
21 here. The expense items that Staff has proposed be disallowed – from

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1 bad debt loss to property taxes to legal expense to variable pay that is
2 common within the utility industry – would reduce Central Hudson’s ability
3 to earn its authorized ROE, likely by 100 basis points. Such a drag on
4 earnings from funds that are reasonable for the Company to expend
5 makes illusory the ability of the Company to earn its authorized ROE at
6 whatever level it is set.

7 Similarly, “penalty only” performance mechanisms related to
8 electric reliability, gas safety, and customer service quality – as proposed
9 by Staff -- hold out the potential for a lower ROE still, with no upside
10 incentive. As a director for the past seven years, I know that Central
11 Hudson management strives mightily to achieve appropriate levels within
12 these key operational areas. But that said, given the numerous penalty
13 provisions, some of which are new,, there is a reasonable probability that
14 the Company will incur some of these penalties. Thus, earned ROE will
15 move further from the authorized level.

16 Taken together, these negative financial impacts could lead to
17 pressure on Central Hudson’s strong credit ratings. A downgrade serves
18 no stakeholders’ purpose: investors take a financial hit and potentially
19 could show decreasing interest in providing funds, and higher financing
20 costs that result from lower credit ratings translate into higher rates for
21 customers.

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2 Q. DO YOU HAVE CONCLUDING THOUGHTS?

3 A. Yes. I believe that a strong "A" rating – Central Hudson's level -- is more
4 important today than in the past to ensure access to capital at reasonable
5 cost. The financial crisis makes maintaining the Company's current
6 ratings even more important to ensure that ratepayers receive highly
7 reliable utility service at reasonable prices. I encourage the Commission
8 to show a sensitivity to Central Hudson's specific circumstances in a way
9 that allows reasonable expenditures made for the benefit of customers to
10 be recovered through the rates set in this proceeding. To do otherwise is
11 to place into jeopardy the Company's current positive financial standing, to
12 the potential detriment of both customers and investors.

13

14 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

15 A. Yes it does.