

REBUTTAL TESTIMONY
OF
PAUL E. HAERING

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

1 Q. Are you the same Paul E. Haering who submitted prefiled direct testimony in
2 this proceeding?

3 A. Yes, I am.
4

5 Q. What is the purpose of your rebuttal testimony in this proceeding?

6 A. The purpose of my rebuttal testimony is to respond to certain portions of the
7 prepared testimony of the Electric Infrastructure Panel (“EIP”), the Gas
8 Safety Panel, the Accounting Panel, and Gas Rates Panel regarding the
9 following issues:

10 The Electric Infrastructure Panel’s Testimony

11 To address the proposal by the Staff Infrastructure Panel to hold the
12 Company “accountable” for its estimates through imposing a ratemaking
13 formula under which funding would be provided for the lesser of the existing
14 estimates or actual expenditures for specific projects and where
15 shareholders would absorb any exceedances above the current estimates.
16

17 Gas Safety Panel and Accounting Panel Testimony

18 To discuss the proposed leak backlog performance target.

19 To identify issues related to Staff’s revision of the Company’s forecasted
20 2010 year end leak backlog by establishing a target of 350 total leaks. To
21 provide updates of the Company’s leak management statistics to reflect the
22 number of leaks found, repaired, and in backlog through the end of

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1 November 2008.

2 To identify the basis for the proposed 5% inflation on leak repair costs and
3 the impact of reducing these costs on the number of leaks the Company will
4 be able to repair.

5 To discuss the performance target for mismarks and how it does not appear
6 to be reasonably set based on the Company's as well as Statewide historical
7 performance.

8 To discuss concerns regarding Staff's proposed establishment of a
9 performance metric regarding Company and Company contractor damages
10 which seems to have been unreasonably set at 0.3.

11 To discuss concerns regarding Staff's proposed penalty provision associated
12 with the Company's minimum spending level to replace or remove leak prone
13 pipe. Additionally the Company is proposing a methodology for how it feels
14 that these expenditures should be calculated.

15 Common Capital Budget and 2009 Budget

16 To provide the requested information regarding the approved expenditure
17 levels for the Kingston Building project and the Board approved 2009 Capital
18 Budget.

19 Electric Infrastructure Panel Testimony

20 Q. Did Central Hudson explain the fashion in which the Company's capital cost
21 estimates have been developed to Staff?

1 A. Yes, we did and in great detail. To illustrate the vast amounts of Central
2 Hudson resources that were required to respond to numerous rounds of
3 numerous Staff IRs, I have compiled them into an Exhibit _____(PEH-1R)
4 that clearly show the components of the costs in the Company's estimates
5 and that all of these costs are developed on a forecasted basis using the
6 best available information at that time. These estimates reflect what the
7 Company characterizes as reasonably estimated costs.

8 Q. Why is the extent of Staff discovery important in relation to the EIP proposal?

9 A. It should have been apparent to Staff that the Company's estimates were not
10 developed on the basis that those estimates would become binding bids for a
11 one-way maximum contract.

12 It is commercially unreasonable to know that a bidder bid on one basis but
13 then attempt to bind the bidder to a more stringent performance obligation,
14 knowing that the bidder did not price the risks of the more stringent
15 performance obligation into the pricing. As described by Mr. Mosher,
16 Central Hudson believes that the EIP proposal is not consistent with the
17 Commission's Policy Statement.

18 Q. Has the EIP also proposed to apply this concept to any individual projects?

19 A. Yes, it has. The EIP proposes to apply a one way maximum concept to the
20 Spackenkill Substation, as stated on page 24 of the EIP testimony:
21 "If the cost is less than \$6.73 million, we propose the deferral be
22 based on the actual cost of the substation. If the cost is greater than

1 \$6.73 million, we propose the deferral be based on the \$6.73 million
2 amount to hold the Company accountable for its electric plant in
3 service forecast.”

4 Q. Is the EIP aware of factors that can increase the actual costs of the
5 Spackenkill Substation but are beyond Central Hudson’s ability to control?

6 A. Page 23 of the EIP testimony refers to one, the delays in obtaining approvals
7 from the Town of Poughkeepsie. While the EIP apparently recognizes this
8 risk, the Staff response to Central Hudson IR 203(b & c) explicitly confirmed
9 its intention to make Central Hudson responsible for cost increases it cannot
10 control:

11 IR 203 (b) To the extent that the actual cost of the Spackenkill
12 Substation project is increased to greater than \$6.73 million as a result
13 of delays in approvals from the Town of Poughkeepsie, is it the
14 Panel’s intention to exclude the cost increases due to the delays from
15 the calculation of the deferrable amount?

16 Answer) The deferral authority applies to the lesser of the actual cost
17 or \$6.73 million. An increase in actual cost greater than \$6.73 million
18 as a result of delays would be excluded.

19 IR 203 (c) To the extent that the actual cost of the Spackenkill
20 Substation project is increased to greater than \$6.73 million as a result
21 of changes in the substation required to obtain approvals from the
22 Town of Poughkeepsie, is it the Panel’s intention to exclude the cost

1 increases due to the delays from the calculation of the deferrable
2 amount?

3 Answer) The deferral authority applies to the lesser of the actual cost
4 or \$6.73 million. An increase in actual cost greater than \$6.73 million
5 as a result of changes in the substation required to obtain approvals
6 would be excluded.

7

8 Other factors beyond Central Hudson's ability to control were also identified
9 to the EIP in Central Hudson responses to Staff IR 250. Central Hudson's
10 response to Staff IR 250 provided details on the assumptions that were used
11 for the development of the estimate for the Spackenkill Substation, and
12 stated that

13 "The cost estimate for the Spackenkill Substation was created consistent with
14 the methodology described in the response to IR 19. Assumptions used in
15 creating this estimate are detailed in DPS Q 250 Attachment B." The
16 Attachment DPS Q 250 Attachment B is a spreadsheet summarizing the line
17 items in the estimate, from which it should have been clear that the estimate
18 was developed on a reasonably estimated cost basis, and that the estimated
19 price was subject to variation as a result of changes in any or all of the line
20 items shown on the spreadsheet. Despite this clear meaning of Central
21 Hudson's responses to Staff's IR 250, Staff's response to Central Hudson IR
22 203 confirms that Staff intends to make Central Hudson responsible for any

1 and all such factors concerning the Spackenkill Substation. I have attached
2 Staff's response to Central Hudson IR 203 as Exhibit _____ (PEH-2R).

3 Q. Please describe the EIP proposal for the cost recovery mechanisms
4 associated with the Sag Mitigation Program.

5 A. This proposal is similar to those above, but has additional constraints. The
6 Sag Mitigation program as proposed by Central Hudson has an expense
7 (\$1.1 million) and a capital (\$6.2 million) component for the rate year. Staff
8 proposes to establish two one-way funding criteria for the expense, one for
9 re-tensioning costs and a separate one for access road costs. For each, the
10 EIP would allow for ratemaking purposes the lesser of the estimated costs or
11 actual costs. Cost overruns as compared to estimates for re-tensioning
12 could not be offset against cost under-runs for access roads, or vice versa,
13 as proposed by the EIP. For the capital portion, Central Hudson had
14 estimated the costs based on the costs of a typical two-pole structure
15 multiplied by an estimated number of structure replacements. The EIP
16 proposes to replace the Central Hudson basis of estimation with a new unit
17 pricing for each different type of pole/structures replaced multiplied by the
18 actual number of replacements for each type of pole/structure.

19

20 Q. Are there any questions or concerns regarding Staff's proposed treatment of
21 the capital component of the Sag Mitigation Program?

1 A. In referring to EIP panel testimony (pg 19 line 20 – pg 20 line 7) there is
2 confusion as to whether Staff is proposing a single criterion that
3 encompasses all structure replacements or three individual criteria, one for
4 each structure type. If each structure type represents an individual criterion,
5 because of the one way nature of the EIP proposal, it would not be possible
6 for Central Hudson to offset cost increase on one type of structure with cost
7 savings on another.

8 Q. Was the nature of Central Hudson's reasonably estimated costs for the Sag
9 Mitigation Program apparent to the EIP?

10 A. The reasonably estimated cost nature of all of our estimates should have
11 been apparent to Staff , and I have no reason to believe it was not apparent
12 to the EIP in relation to the Sag Mitigation Program.

13 Q. Please summarize the EIP proposals.

14 A. It is commercially unreasonable to take cost estimates developed on a
15 reasonably estimated cost basis and convert them into binding maximum
16 prices, and also demand any actual savings that may be achieved. The
17 Spackenkill Substation proposal employs the same basic concepts but goes
18 further by applying them to one project in the face of obvious facts showing
19 that the very risks Staff is seeking to immunize ratepayers from were
20 recognized by Staff to exist. The Sag Mitigation program EIP proposals go
21 still further, by separating that program into at least three and potentially five
22 separate proposals in which the lesser of estimates of actual costs for re-

1 tensioning, access roads and three basic types of replacement structures
2 would be tracked and the estimates replaced with lower actuals.

3 Mr. Mosher discusses the inconsistency of these EIP proposals with the
4 Commission's Policy Statement. I find them inconsistent with the obvious
5 facts concerning how Central Hudson's capital estimates were developed
6 that were clear, or should have been clear to the EIP, as representing
7 reasonably estimated costs. In my experience, it is commercially
8 unreasonable to attempt to take estimates developed on a reasonably
9 estimated cost basis and convert them into not-to-exceed estimates.

10

11 Gas Safety Panel Testimony

12 Q. How has Central Hudson performed in relation to the gas leak targets in the
13 current rate plan?

14 A. During the current rate plan, Central Hudson has a gas leak management
15 target of a year-end total backlog of 270 leaks by the end of 2007 and 250
16 leaks by the end of 2008. In recognition of the need for a link to the number
17 of leak repairs to the target, the backlog target was in effect unless the
18 Company repaired a minimum of 340 leaks (net of dig-ins) during each of
19 those years. During 2007, the Company did not achieve the backlog target
20 and would have paid a penalty of 6 basis points, but it repaired 363 leaks
21 (net of dig-ins), exceeding the 340-leak repair threshold and meeting the gas
22 leak management target. For 2008, it is projected that the Company will not

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1 achieve the backlog target and would have to pay a penalty of 8 basis points,
2 but it has repaired more than the 340 leak repair threshold, meeting the gas
3 leak management target. From the end of 2006 to the end of 2008, the leak
4 backlog has grown from 376 leaks to more than 500 leaks. The number of
5 leaks discovered each year is far greater than the expected 340 leaks
6 anticipated in the prior rate proceeding. The number of leak repairs and the
7 costs associated with those repairs are also much higher than those
8 anticipated during the rate proceeding. The Company petitioned the Public
9 Service Commission for additional rate relief for these leak repairs and for
10 funding to reduce the backlog but was denied.

11

12 Q. Has Central Hudson encountered increased numbers of leaks during the
13 current rate plan than were assumed in the rate allowances in the current
14 rate plan?

15 A. Yes. During 2007, we found 649 new leaks and Central Hudson repaired
16 544 leaks, 200 above the level provided for in rates, yet the backlog
17 continued to grow.

18 Q. Did Central Hudson inform the Commission of this situation?

19 A. Yes, we did. The Commission was informed formally through our request for
20 deferral of the additional costs incurred as a result of the additional number
21 of leaks we repaired above the rate allowance (among other issues, including
22 the fact that the rate allowance per repair was inadequate due to commodity

1 cost increases beyond Central Hudson's ability to control) and we also
2 informed members of the Gas Staff informally.

3 Q. What action did the Commission take?

4 A. The Commission denied our request to defer the additional costs, stating that
5 we should have had a higher funding level for leak repair in the rate plan
6 because we knew that new leaks might be discovered.

7 Q. Did Central Hudson respond to that determination?

8 A. Yes, we filed a petition for rehearing and, in that petition for rehearing
9 explained that there were two factors at work: the fact that Central Hudson
10 actually repaired more than the number of leaks assumed in the rate
11 allowance and the fact that there was also a higher number of leaks being
12 discovered. In addition, to address the higher number of leaks being
13 discovered, Central Hudson proposed interim funding that would provide for
14 reducing the backlog buildup that was occurring.

15 Q. Did the Commission agree to either of those requests?

16 A. No. For the rehearing related to our actual expenditures above the rate
17 allowance, the Commission said that we should have known that there could
18 be a build up in the backlog and therefore those costs were "foreseeable"
19 and Central Hudson's responsibility. As to the request for incremental
20 funding to address the buildup of the backlog (despite the increased leak
21 repairs actually done by Central Hudson), the Commission criticized us for
22 asking on procedural grounds.

1 Q. Regarding the Gas Leak Targets proposed by the Gas Safety Panel, do you
2 agree with the targets that have been proposed?

3 A. No, these targets are flawed in a number of ways. The first issue is that the
4 target does not account for the potential that the number of leaks discovered
5 over the course of 2009 and 2010 will be higher than what is built into the
6 forecast, it only reflects the existing backlog, but the backlog varies based on
7 not just the number of leaks repaired, which Central Hudson should be
8 expected to manage up to the level of funding provided for that purpose, but
9 also on the number of leaks discovered, which we cannot manage. The
10 second is that the proposed total leak backlog target does not accurately
11 relate to amount of funds which have been requested for the leak repair
12 program.

13 The concern with the total backlog target by the end of 2010 is that it
14 assumes that the projection of the leaks discovered is entirely exact and that
15 the numbers of repairs to reach that backlog are also exact. However, if the
16 number of leaks discovered between now and the end of 2010 increases
17 beyond the projection, the number of repairs necessary to reach to the
18 backlog target also increases and the costs required to make those repairs
19 increases. This required increase in leak repairs would be beyond the rate
20 allowance and the Gas Safety Panel does not address this situation. This is
21 particularly surprising because we have already had just this situation, as I
22 have described above.

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1 Q. What was the forecasted number of leaks that the Company anticipated
2 locating as well as leak backlog at the end of November 2008 and how does
3 that compare to the forecast that was provided in the rate case?

4 A. The forecasted number of leaks the Company anticipated discovering
5 through the end of November 2008 was 527 compared to an actual of 583.
6 The total repairs (net of dig-ins) during this period was forecasted to be 426
7 and the actual number repaired is 461. The Company continues to discover
8 more leaks than have been previously forecasted as spend well over its
9 current rate allowance to address this growing backlog despite the poor
10 earnings in our gas business.

11

12 Q. Do you have an alternative proposal to the total gas leak backlog target?

13 A. Yes, a more appropriate leak management target should be related to the
14 number of repairs made. The rate allowance for leaks defines the number of
15 leaks for which funding is provided. Therefore the Company recommends
16 that the target associated with leak backlog be tied to the number of repairs
17 completed and not to a leak backlog. The number of leak repairs for 2010
18 related to the capital and expense proposed by the Company in this filing are
19 627. The Company recommends that a target for leak management for
20 calendar year 2010 be established that the Company repair a minimum of
21 627 leaks. The Company has requested an increase in funding to address
22 the increasing leak backlog, however, it cannot be held accountable for the

1 number of accuracy of the forecasted number of leaks to be discovered.

2

3

4 Q. Do you have any concerns with the Accounting Panel's adjustment to the
5 projected growth rate for the costs of gas leak repairs of distribution main?

6 A. Yes, I do. The growth rate for the costs of gas leak repairs of distribution
7 main was established by Central Hudson using the actual growth rate in the
8 leak repair contract, plus the actual fuel cost adjustment also in the contract.

9 This, along with costs of restoration (primarily paving and transportation) has
10 direct ties to the cost of fuel and should grow at a rate higher than inflation.

11 These two factors were the basis for the 5% inflation factor that was used to
12 develop the Company's forecasted leak repair costs. By reducing the amount
13 by \$133,010, the Staff Accounting Panel has reduced the funding for the
14 number of leaks that can be repaired during the rate period by approximately
15 20 leaks. The Accounting Panel's reductions to rate year cost estimates are
16 inconsistent with the performance proposals made by the Gas Safety Panel
17 and insufficient to fund those proposed requirements.

18 Q. What has been the Company's performance with regard to mismarks?

19 A. The Company has over the past 5 years experienced mismark levels as
20 follows: 2003 - 0.60, 2004 - 0.72, 2005 - 0.74, 2006 - 0.99, 2007 – 0.80.

21 During 2003, 2004, and 2005, the Company has performed to better than the
22 statewide average. During 2006 and 2007, the Company's performance had

1 risen slightly to above the statewide average. During 2007 and 2008, the
2 Company made improvements to the mark-out program and the 2008 year-
3 to-date 3rd quarter results have shown a dramatic improvement with
4 performance at a level of 0.22 mismarks per 1000 tickets. This improved
5 performance is partially due to the improvements we have made in our
6 contractor performance incentives, mark-out methods, and mapping,
7 however this level of performance has not yet proven to be sustainable.

8 Q. With regard to the proposed target level for damages due to mismarks, do
9 you agree with the target level proposed by the Gas Safety Panel?

10 A. No, I do not. Central Hudson's recent performance has been above the
11 statewide average performance level of 0.73, where lower is better. Central
12 Hudson recognized that it should improve its performance in this area and
13 has instituted process improvements to achieve this result, but believes that
14 it should not be subject to a target below the statewide average. However,
15 the Gas Safety Panel proposes to set the mismatch target at 37% below the
16 statewide average.

17 Q. Do you have a proposed gas safety target for damages due to mismarks that
18 you would recommend?

19 A. Yes, I recommend that this target be set at the 2007 statewide average of
20 0.73 damages due to mismarks per 1000 one-call tickets, per Staff's stated
21 policy from page 5 of their testimony.

22

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1 Q. With regard to the proposed target level for damages due to Company or
2 Company Contractor Damages, do you agree with the target level and the
3 associated penalty proposed by the Gas Safety Panel?

4 A. No, I do not. The number of damages that occur in this category is
5 historically the smallest contributor to the overall damages and should not be
6 weighted so highly in the number of basis points that have been assigned to
7 it. The establishment of this target also needs to recognize the increased
8 exposure that the Company will experience as it significantly increases the
9 amount of gas infrastructure replacement and repair work it will complete.
10 The numbers of leak repairs are proposed to increase by 34% from 2008 to
11 2010. The amount of gas capital spent on gas safety infrastructure
12 enhancement is proposed to increase by 16% from 2008 to 2010. Both of
13 these efforts will increase our exposure to damages due to Company crews
14 or Company Contractor crews, increasing the likelihood that in 2010
15 reasonable performance in this area will not achieve this proposed target.

16
17 Q. Do you agree with Staff's assessment that damages in this category are not
18 related to increased capital spending or leak repairs?

19 A. No, I do not. Staff correctly noted that the damages in this category have
20 increased since 2005, but they incorrectly noted the timing of the increased
21 damages and the increased capital investment. The amount of capital spent
22 in 2005 on gas distribution main and service replacement was \$3.4 million,

1 increasing to \$5.1 million in 2006, and \$5.6 million in 2007. This more than
2 50% increase in gas main and service replacement work and resulting
3 increased exposure to damages has had a negative impact on the
4 Company's performance in this area.

5 Q. Do you have a proposed gas safety target for damages due to Company and
6 Company Contractors that you would recommend?

7 A. Yes, I recommend that this target be set closer to the Company's
8 performance through at a target of 0.4 damages per 1000 one-call tickets. A
9 target at this level will prevent backsliding of performance by the Company.

10 Q. What is the proposal of the Gas Safety Panel should Central Hudson not
11 expend \$6.1 million to replace or remove leak-prone pipe?

12 A. The Gas Safety Panel proposes that Central Hudson defer for ratepayer
13 benefit 150% of the difference between \$6.1 million and any lower, actual
14 expenditures. In the event that actual expenditures are higher than \$6.1
15 million, there would be no deferral. Like the EIP proposals I discussed
16 previously, this is another one way street that operates solely to ratepayer
17 advantage.

18 Q. Did Central Hudson seek any clarification as to this Gas Safety Panel
19 proposal?

20 A. Yes, we send IR [CH-104] because this proposal seemed extreme to us and
21 we thought that it might have been an inadvertent error. However, we found
22 that the Gas Safety Panel intended just what it said.

1

2 Q. Did the Gas Safety Panel provide any basis for its proposal?

3 A. No. While Staff has frequently said that it is not proper to point to the current
4 rate plan as a precedent, I believe that it is reasonable to point to it for a
5 frame of reference. The current rate plan provides that Central Hudson will
6 defer for ratepayer benefit the amount of the shortfall multiplied by 1.5 times
7 average authorized pre-tax rate of return, and that such deferral shall
8 represent the sole remedy against the Company for failure to make
9 expenditures at the total forecast level for replacement of cast iron and steel
10 mains and services. Under the current rate plan the target amount is
11 comprised of the costs of installation and removal of gas cast iron/steel pipe
12 replacement associated among: (1) the total category of New Business Gas
13 Service Replacements blanket work orders, (2) the total category of
14 Distribution Improvements Cast Iron Main Replacements blanket work
15 orders, (3) the total category of Distribution Improvements Main Replacement
16 blanket work orders, and (4) the summation of individual Distribution
17 Improvement specific projects involving the replacement of non-plastic gas
18 main.

19 In contrast, the present Gas Safety Panel proposed penalty would result in
20 approximately 10 times the impact as the prior rate treatment and the Gas
21 Safety Panel has not provided any support for this change.

22 In addition, the Gas Safety Panel has not sufficiently defined the \$6.1 million

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1 target, other than to state that it is the amount proposed by Central Hudson.
2 However, Central Hudson did not propose a penalty mechanism like the Gas
3 Safety Panel did, we simply made a capital forecast and we know what we
4 proposed, but we do not know what the Gas Safety Panel proposed. A
5 clarification on this point was requested in IR [CH-104], however the
6 response was not specific enough for Central Hudson to understand the
7 components included in the target.

8

9 Q. Regarding the Common Capital Expenditure Budget for 2009, has the Board
10 of Directors approved the budget and the expenditure levels for the Kingston
11 Building project?

12 A. Yes, this budget was approved by the Board of Directors on December 18,
13 2009. As indicated previously the Board does not approve individual projects,
14 however, the budget includes \$14.6 million for the Kingston Building Project.
15 The Board approved capital budget which was requested in DPS IR-627 is
16 included as Exhibit ___(PEH-R3).

17 Q. Does this conclude your rebuttal testimony?

18 A. Yes, it does.