

REBUTTAL TESTIMONY
OF
MICHAEL L. MOSHER

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

1 Q. Are you the same Michael L. Mosher who filed direct testimony in these
2 cases?

3 A. Yes, I am.
4

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

6 A. The purpose of my rebuttal testimony is to respond to positions taken by the
7 Staff of the Department of Public Service in the testimony and exhibits filed on
8 November 25, 2008, and to explain a number of significant defects in those
9 positions. I will also provide a brief overview of the major issues addressed by
10 other rebuttal witnesses on behalf of Central Hudson Gas & Electric
11 Corporation ("Central Hudson" or the "Company").
12

13 Q. Please summarize your conclusions from a review of the Staff filing.

14 A. Although Staff's testimony and schedules show an electric "rate increase" of
15 \$17.6 million and a natural gas "rate increase" of \$6.1 million, totaling about
16 \$23.7 million, the delivery revenues allowed in the Staff filing are actually a
17 much smaller increase of only \$5.2 million, or 1.8% above the level of
18 revenues already authorized in Cases 05-E-0934 and 05-G-0935:
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Rate Year	Electric Delivery Revenues, (millions)	Natural Gas Delivery Revenues, (millions)	Total Allowed Delivery Revenues, (millions)
Commission Authorized: July 1, 2008 – June 30, 2009	\$231.1	\$59.0	\$290.1
Staff Filing: July 1, 2009 – June 30, 2010	\$235.2	\$60.1	\$295.3
Allowed Increase	\$4.1	\$1.1	\$5.2

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2 The large majority of the “rate increases” - approximately \$13.5 million, or
3 more than 75% of the electric “rate increase” and \$5.1 million, or nearly 85% of
4 the gas “rate increase” - are not “rate increases” at all. They are simply a
5 recalibration of the estimated \$18 million of sales shortfalls currently
6 experienced by the Company under the current rate plan to get back to the
7 level of revenues already authorized by the Commission as necessary to
8 support Central Hudson’s costs of service. The much smaller Staff
9 recommended increases of \$4.1 million and \$1.1 million for electric and natural
10 gas delivery service, respectively, are the true “rate increases” recommended
11 by Staff, and are inadequate for the Company to recover its cost of doing
12 business in the forecast rate year.

13

14 Q. Please summarize the significant reductions recommended by Staff to the
15 Company’s rate increase requests.

16 A. The Staff adjustments to the Company’s rate filing consist of both investment

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1 and expense reductions. The investment reductions relate to the equity ratio
2 and return on equity used in establishing rates and will be addressed by
3 witnesses Renner and Morin, respectively. The Staff expense reductions
4 relate to a number of specified elements of costs, most notably, the labor
5 allowance and variable pay, which imposes caps on the number of employees
6 needed to operate the business, and is categorically dismissive of a variable
7 pay element within a total market based compensation package. There are
8 also certain reductions, such as D&O insurance, which can only be
9 categorized as a flat-out disallowance from recovery of a legitimate and
10 reasonable expense, and if adopted by the Commission, will automatically
11 equate to an authorized return deduction. Staff also recommended significant
12 cash expense reductions for MGP site remediation and transmission sag
13 mitigation, proposing a non-cash funding source for these costs, which will
14 impose additional financing requirements on the Company. The Staff filing is
15 notably silent on the savings created by actions the Company has taken over
16 the last two years to streamline its operations and permanently reduce its cost
17 structure, particularly as it relates to fringe benefits, pensions, and other post
18 employment benefits (OPEBs).

19

20 In addition, the level of the rate increases proposed by Staff are somewhat
21 illusory because many of the recommendations made by Staff witnesses are
22 “lesser of” recommendations, which explicitly require expenditures, and at the

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1 same time seek to put a ceiling on the amount of certain item-by-item expense
2 allowances, thereby obtaining for customers reductions in costs below forecast
3 values that are achieved by Central Hudson (but insulating customers from
4 reasonable cost increases above Central Hudson's cost estimates), other
5 recommendations made by Staff witnesses include increased "incentives" or
6 automatic "rate adjustments," all of which are negative to Central Hudson and
7 would act to offset the revenues received, and still other Staff
8 recommendations for expense recovery operate in the reverse, by subjecting
9 the Company to the risk of cost increases that would not be adequately
10 provided for in rates.

11

12 As a result, while the Staff's position provides some level of revenue reliability
13 with the RDMs, the level of revenues in the Staff position is inadequate to
14 support Central Hudson's reasonable costs of operations, and (were it to be
15 adopted by the Commission, which it should not be) would result in both a
16 downgrade of Central Hudson's debt and at the same time require Central
17 Hudson to insure customers against reasonable cost increases in several
18 important areas, resulting in continued harsh regulatory treatment with actual
19 earnings performance well below the allowed rate of return.

20 Aspects of the Current Rate Plan:

21 Mandates, Incentives and Employee Count

22 Q. Are there any aspects of the current rate plan that you believe are important to

1 understand to evaluate Staff's proposed treatment of the present rate increase
2 applications filed by Central Hudson?

3 A. Yes, there are a few. First, I would like to invite attention to the expenditure
4 requirements of the current rate plan. Second, I would like to address the
5 "incentives" provisions of the current rate plan. I alluded to both of these
6 earlier in this testimony.

7

8 Q. First, please describe the mandates in the current rate plan for expenditures by
9 Central Hudson.

10 A. Under various sections of the Joint Proposal modified by the Commission in
11 the Order under the current rate plan, Central Hudson is required to make
12 electric, gas, and common plant capital expenditures totaling approximately
13 \$208 million (exclusive of AFUDC) by the end of June 2009. Separately, the
14 rate plan establishes a mandate to expend an additional \$15.75 million on gas
15 cast iron/steel pipe replacement by the end of calendar 2009.

16 In addition, Central Hudson is required to expend \$6.723 million for Electric
17 Transmission ROW Maintenance, and by virtue of a change to the parties'
18 Joint Proposal imposed by the Commission, Central Hudson is also required to
19 expend \$24.362 million for Distribution ROW Maintenance; both over the three
20 rate years of the current rate plan.

21 Despite the severe sales shortfalls and resulting revenue deficiencies under
22 the current rate plan, I can report that Central Hudson is on track to meet all of

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1 these mandates, and our earned return continues to suffer as a result.

2

3 Q. Please describe the "incentives" in the current rate plan.

4 A. The current plan has several "incentives". There are comprehensive sets of

5 multi-part Customer Services Quality, Electric Reliability, and Gas Safety

6 performance targets and "incentives". Central Hudson was required to meet

7 these "incentives" (or suffer the consequences) independent of the level of

8 revenues or earnings. In addition, there is a property tax incentive included,

9 which provides for a shared deferral on the differences (positive or negative)

10 between the rate allowances and actual property taxes to be shared 90/10

11 between customers and the Company, respectively.

12

13 Q. Does the Staff filing include similar mandates and "incentives"?

14 A. The subjects are similar but the present Staff filing proposes largely to move

15 the fences, making the "incentives" more stringent, more costly to the

16 Company, or both. The Staff filing includes plant-in-service and capital

17 expenditure targets, with one-way deferral provisions which include

18 depreciation expense, on under-spending in any category compared to what is

19 provided for in rates. In addition there is a punitive gas infrastructure

20 enhancement expenditure provision, which requires the Company to spend

21 \$6.1 million in 2010 to replace leak-prone pipe, or defer 150% of any shortfall

22 (as opposed to the revenue requirement equivalent of any shortfall for the

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1 benefit of ratepayers.) The Staff position also requires the Company to
2 expend the recommended rate allowance for distribution ROW maintenance.
3 The electric reliability "incentives" continue with the same metrics for frequency
4 and duration of electric interruptions. However, there are increased, more
5 stringent targets proposed for Customer Service quality "incentives" with
6 additional equity dollars at risk, as well as stricter targets and new gas safety
7 "incentives" proposed, also with additional performance exposures. In
8 addition, while the State government is now facing a revenue crisis, which is
9 likely to produce increased state, county, and town property taxes as more
10 fully addressed in the rebuttal testimony of the Revenue Requirements Panel,
11 the Staff filing excludes the existing deferral mechanism for property taxes,
12 which through November 2008 resulted in more than \$3.2 million in benefits to
13 customers (and much smaller benefits to Central Hudson).

14

15 Q. Mr. Mosher, does Central Hudson agree with Staff's proposal to impose a hard
16 ceiling on the number of employees recognized for ratemaking purposes at the
17 historic period ending value of 830?

18 A. No, we do not. Mr. Brocks describes the defects in the "analyses" presented
19 by Staff that attempts to justify that position. However, I will address the
20 inconsistency of Staff's proposal with the Test Year Policy Statement.

21

22 Q. You have stated that Staff proposes to limit the number of employees to the

1 historic year-ending value of 830. Is setting rates on the basis of unadjusted
2 historic information consistent with the Commission's Policy Statement?

3 A. I do not believe so. The Policy Statement calls for rates to be set on the basis
4 of forecasts of future costs during the rate year period. Those forecasts are
5 supposed to be based on a "verifiable link" between the historic period results
6 and the future rate year. Staff has not attempted to show that its position is
7 consistent with the Policy Statement.

8

9 Q. Are there other Staff proposals that you believe violate the Policy Statement?

10 A. Yes. I believe that the group of proposals made by the Staff Electric
11 Infrastructure Panel ("EIP") violates the Policy Statement.

12

13 Q. Why?

14 A. The Policy Statement calls for the establishment of rates for the future based
15 on a forward-looking rate year that contains reasonable estimates of elements
16 of cost. The EIP does not propose to set rates on that basis. Instead they
17 propose to set rates on the basis of the lesser of estimates or actual costs with
18 the evident intention of using the estimates as a mere placeholder and
19 replacing the estimates with every lower actual cost level. The EIP does not
20 address the inconsistency of its proposals with the Policy Statement and, as
21 explained by Company witness Haering, the EIP proposals change the nature
22 of Central Hudson's current cost estimates, as Mr. Haering has described,

1 from the estimates of time and materials basis that was actually used into a
2 guaranteed maximum cost after the estimates were developed, but the EIP
3 does not recognize that change, nor does the Staff Rate of Return Panel
4 address the necessary compensation for increased risks that would be
5 required in relation to Staff's proposals.

6
7 Asymmetrical Treatments in Staff's Position

8 Preclude Potential Upside Gain and Institutionalize Potential Downside Loss

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10 Q. Please explain what you mean by "asymmetrical treatments" in Staff's
11 position?

12 A. Staff has made several proposals that would expressly limit the Company to
13 the lesser of a specified rate allowance or actual expenditures. These
14 mechanisms include the capital expenditures "net plant" mechanism I
15 mentioned earlier, cost ceilings on specific projects or improvements, and a
16 number of operating expense items that, while not explicitly asymmetrical, will
17 operate in an asymmetrical fashion to produce built-in earnings erosion.
18 Collectively, these items have the effect of shifting to Central Hudson the risk
19 that the actual costs exceed the rate allowance. In this category, I would
20 include the following:

Expense Item Description	Estimated Value (\$)	Negative Earnings Basis Point Effect
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Variable pay disallowance	\$2,500,000	40
Bad debt/uncollectibles	\$1,000,000	17 per \$1M
Property tax	\$1,000,000	17 per \$1M
Fringe benefits	\$643,000	11
Regulatory Commission expense	\$212,000	3.5
Directors & Officers insurance	\$604,000	10
Gas leak repair	\$133,000	2
Gas mains and services cost of removal	\$500,000	8
Legal services	\$645,000	10
Stray voltage testing	\$750,000	15
Interruptible gas sales	\$200,000	15
Injuries & damages	\$165,000	3
Environmental	\$127,000	2
Miscellaneous other	\$300,000	5
Total		~158 Total

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In addition, Staff has proposed a multitude of one-way penalty-only performance mechanism “incentives”. The table below summarizes the “incentives” proposed by Staff.

Performance Mechanisms Items	Penalty Value (\$)	Basis Points
Electric Reliability - electric bp=~ \$50,000		30 Total
Interruption - duration (CAIDI)	\$500,000	10
Interruption – frequency (SAIFI)	\$500,000	10
Substation completion	\$250,000	5
Enhanced trimming completion	\$250,000	5
Gas Safety – gas bp = ~\$13,000		30 Total
Gas Leak Management		
- total year-end leak backlog	\$65,000	5
- total leaks pending repair	\$117,000	9
Damage Prevention		
- Overall damages	\$26,000	2
- Mismarks damages	\$52,000	4
- Company/contractor damages	\$52,000	4

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Emergency Response		
- 30 minute response	\$52,000	4
- 45 minute response	\$26,000	2
Customer Service Quality – total bp =~\$60,000		30 Total
Customer Satisfaction Index	\$237,500 to \$950,000	4 to 15
PSC Complaint Rate	\$475,000 to \$950,000	7.5 to 15
Total		90 Total

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3 As previously mentioned, Staff’s proposed “lesser of actual or cost cap”
 4 proposals applicable to specific substation expenditures and elements of the
 5 transmission sag mitigation program in all probability represent another
 6 potential earnings drag item, but cannot explicitly be quantified at this time.

7

8 Yet another kind of risk reflected in the Staff position on MGP remediation and
 9 transmission sag mitigation recovery are the Staff proposals to make available
 10 new “rate moderators” created by inflating the theoretical depreciation reserve
 11 and calling for the creation of regulatory liabilities related to the differences
 12 between the book and newly created theoretical depreciation reserves. These
 13 proposals increase Central Hudson’s risks by increasing its financing
 14 requirements through preventing the Company from having the current cash
 15 flow required to fund to its operations.

16

17 Q. Mr. Mosher, has the Staff Rate of Return Panel considered these additional

1 risks?

2 A. I have not found any explicit statement in the Staff Rate of Return Panel
3 testimony that shows that the Panel evaluated or considered or was even
4 aware of these risks to Central Hudson in developing their recommendations.

5

6 To facilitate Commission consideration of these concerns, the Company has
7 asked Steven Fetter, a former Chairman of the Michigan Commission, one of
8 Central Hudson's independent directors and a recognized expert, to offer for
9 the Commission's consideration alternative policy approaches to achieve
10 regulatory objectives and concerning the necessity for Commission support for
11 ratepayer funding for sufficient levels of Directors and Officers (D&O)
12 insurance to permit utilities to attract and maintain qualified officers and
13 directors.

14

15 Revenue Decoupling Mechanisms

16 Q. Please describe generally the revenue decoupling mechanisms (RDM)
17 proposed by Staff.

18 A. There are two RDMs proposed by Staff. Staff witness Twergo and the Staff
19 Gas Rates Panel have proposed different revenue decoupling mechanisms for
20 electric and gas delivery service, respectively. The proposed electric RDM is a
21 revenue per class model with class revenue variances measured monthly, but
22 trued up annually, unless cumulative deferred balances exceed an arbitrary \$4

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1 million threshold. The proposed gas RDM is actually a revenue per customer
2 disguised as a unit per customer model, subject to implementation with a zero
3 deadband weather normalization adjustment for heating classes, but with
4 targets that disregard heat/non-heat classifications, with revenue variances
5 measured and trued up annually, and with no trigger for recovery or refund on
6 deferred balances. These deferred balances, measured monthly for the
7 electric RDM and measured annually for the gas RDM, are proposed by Staff
8 to accrue carrying charges at the other customer capital rate, disclosing, in my
9 opinion, another asymmetrical risk to Central Hudson through being required
10 to carry debit balances at an obviously economically inadequate carrying
11 charge rate.

12

13 Q. How do the Staff RDM's differ from the Company's proposed RDMs?

14 A. The Company proposed consistent unit per customer RDM models to true-up
15 both electric and gas delivery service revenues, applicable to specific service
16 classes, or sub-classes, with use variances measured and trued-up monthly
17 via new monthly RDM factors, with a reconciliation that mirrors the Company's
18 purchased electric and gas supply recovery mechanisms. The Company has
19 proposed that any monthly deferred balances accrue carrying charges at the
20 pre-tax weighted average cost of capital, consistent with all other deferrals we
21 proposed.

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1 The RDMs as proposed by the Company's Electric and Gas Forecasting
2 Panel's are not only consistent with the Commission's RDM Order, but are
3 consistent and balanced in their design methodology, operation, and
4 refund/recovery mechanisms. The Staff RDM's have many shortcomings.
5 They are not only strikingly different in their design and operation, but they are
6 unnecessarily complex, and even leaving the normal weather issue aside, will
7 result in the build-up of deferred balances that will not provide proper price
8 signals which will further disconnect customers from the true costs of providing
9 delivery service, resulting in unnecessary customer confusion, especially for
10 combination customers. In addition, it has not been demonstrated that the
11 Staff models will be less volatile than what has been proposed by the
12 Company IR's. The Company's Electric and Gas Forecasting Panels will
13 address other deficiencies and issues with the RDMs as proposed by Staff.

14

15 Q. With regard to the Staff proposal to disallow funding for D&O insurance above
16 a primary coverage layer, what will be the consequence to Central Hudson if
17 the Commission were to agree with Staff's proposal?

18 A. The alternatives available to Central Hudson will be either not to fund the
19 additional insurance and risk the loss of qualified directors and officers, or for
20 shareholders to provide the funding. Staff's position ignored these
21 consequences. In my opinion, these consequences are plainly undesirable
22 and demonstrate the improper nature of Staff's position. All stakeholders –

1 customers, shareholders, and regulators - benefit from good corporate
2 governance and the Commission should recognize D&O insurance as a
3 legitimate and reasonable cost of doing business.

4

5 Regulatory Commission Assessment and Property Taxes

6 Q. Is there any new information concerning Regulatory Commission Assessment
7 expense and property taxes?

8 A. Yes. After receipt of the Staff Accounting Panel testimony, the Company
9 submitted several IR's (including CH IR-35 and CH IR 140,) to gain a better
10 understanding of the Staff proposal to eliminate the property tax deferral and to
11 address property tax and Regulatory Commission expense in light of the
12 State's financial crisis. As discussed by the Revenue Requirement Panel, the
13 State's needs for revenues will drive tax increases and Regulatory
14 Commission expense.

15 Since the time of those responses, Governor Paterson has put forth proposals
16 to respond to the State budget deficits, which as more fully quantified and
17 discussed by the Revenue Requirement Panel, represents a \$12.4 million rate
18 increase that is not related to Central Hudson's costs, but the State's revenue
19 needs.

20

21 Pension/OPEBs Update

22 Q. Did the Staff testimony propose any update concerning pension and OPEB

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1 costs?

2 A. Not explicitly, however the Staff Accounting Panel agreed with the specific
3 items that the Company proposed as subject to update, which included
4 pension and OPEBs.

5

6 Q. Do you believe that the Commission should have a fully updated record
7 concerning pensions and OPEBs?

8 A. Yes, I do. These costs are a significant portion of the costs of doing business.
9 It is obvious to all, I believe, that the recent changes in the equity markets and
10 financial markets have major implications for the cash requirements that may
11 be imposed on Central Hudson. At this time, market values of plan assets
12 have plummeted. Full updates are warranted to determine whether this has
13 continued, worsened, or improved as of the time of the decision

14

15 Q. Has the Company provided any information recently to Staff concerning the
16 current status of its pension and OPEBs funding?

17 A. Yes, we have. On December 2, 1008 I received an information request from
18 Staff (outside the rate case) and I responded to it on December 8, 2008. I
19 have attached as Rebuttal Exhibit _____ (MLM-1R) a copy of the response
20 that was provided on December 8, 2008 to Staff's requests. I note that the
21 December 2nd request was issued just a week after the date of Staff's
22 testimony in these cases, yet Staff's testimony is silent on the subject.

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2 Q. Please describe the importance of the information that you provided to Staff.

3 A. Among other things, the information shows a significant drop in the value of

4 Central Hudson's plan assets, informs Staff that the Company expects to

5 receive from its actuary an estimate of the potential consequences in

6 December 2008 and an updated formal study in mid-January 2009, and that

7 the provisions of the 2006 Pension Protection Act may impose additional

8 funding requirements.

9

10 Q. Has Central Hudson received any updated or revised expense projections of
11 its pension and OPEB expense?

12 A. Yes. On December 18, 2008, the Company's actuary, Mercer, provided

13 Central Hudson with updated projections of FAS 87 (pension) and FAS 106

14 (OPEB) expense for the period 2009 – 2014, reflecting plan asset balances as

15 of November 30, 2008.

16

17 Q. What are the updated pension and OPEB expense projections?

18 A. For the forecast rate year, the FAS 87 expense is projected to be \$35.8 million,

19 an increase of approximately \$22.6 million from the June 2008 actuarial

20 estimate used by the Company in the development of its filing. The FAS 106

21 expense is projected to be \$9.25 million for the forecast rate year, an increase

22 of approximately \$2.9 million from the June 2008 actuarial estimate. It is

1 Central Hudson's intent to submit the final actuarial information in January for
2 the record of these cases as soon it becomes available and to update this item
3 later in the proceeding should there be any significant changes.

4
5 Sales Forecasts

6 Q. Mr. Mosher, did Central Hudson provide Staff with updated economic
7 information received from the NYISO?

8 A. Yes. We received Economy.com updated economic information on November
9 18, 2008 and forwarded it to Staff on November 19, 2008. I believe that this
10 new information was not received by Staff in time for Staff to consider it as part
11 of Staff's Sales Forecasting Panel. However, Central Hudson has updated the
12 models it previously submitted in these cases to show the effects of the new
13 Economy.com information.

14 Although we had intended to also update the Staff models to incorporate the
15 new information, the use of EViews models by Staff, which are new to Central
16 Hudson, have prevented us from doing so to date given the press of other
17 work requirements to analyze Staff's filing. Central Hudson's Forecasting
18 Panel's rebuttal testimony addresses the electric and gas sales forecasts in
19 more detail.

20

1 Q. Are there any other issues you would like to address in your rebuttal
2 testimony?

3 A. Yes. Today, Central Hudson will be filing a petition under separate cover
4 seeking Section 70 approval to transfer a small parcel of property, currently a
5 utility asset classified as Plant Held for Future Use, to non-Utility property. The
6 filing details the reasons and proposed accounting, which includes deferral of
7 the difference between the appraised market value and the original book cost.
8 The Company proposes that the deferred amount be added to the offset list in
9 the current proceeding.

10

11 Q. Does this conclude your rebuttal testimony?

12 A. Yes, it does.