

REBUTTAL TESTIMONY
OF
STACEY A. RENNER

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

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 capital structure and supporting
14 statements contained in the direct testimony of the Staff Rate of Return
15 Panel (the “Panel”) on behalf of the New York State Department of Public
16 Service (“Staff”).

17

18 Q. What is your reaction to the Panel’s recommended capital structure?

19 A. I disagree that Staff’s recommended capital structure, which reflects 45%
20 equity, is the appropriate capital structure for Central Hudson for the rate
21 year. A higher equity ratio is warranted. Central Hudson’s capital
22 expenditures have nearly doubled over the last five years and its cash flow

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 from operations is insufficient to meet its needs, resulting in an increasing
2 reliance on new capital. In 2009, Central Hudson will likely engage in its
3 highest level of financing activity since before the divestiture of its generating
4 plants. This financing activity comes at a time of crisis in financial markets
5 and recessionary economic conditions.

6
7 My direct testimony in this case proposed that Central Hudson's parent
8 company would increase its investment in the utility operations, raising the
9 equity ratio to 48%. That proposal would provide the support necessary to
10 maintain the utility's credit ratings, which are not adequately supported under
11 the Company's current delivery rates. The proposal also reflects an
12 appropriate return on the incremental equity. The additional equity would
13 offset the need for long-term debt that is very likely to reflect higher interest
14 rates than any of Central Hudson's current outstanding debt.

15
16 The Panel's recommendation reflects a methodology that was applied
17 mechanically to achieve a result that maintains the status quo. The Panel's
18 tests of reasonableness and expected consequences ignore the evidence
19 published by the rating agencies about their assessment of Central Hudson's
20 ratings as well as the advantages provided by those credit ratings in today's
21 challenging capital markets.

22
23 Q. What is the basis for your disagreement with the Panel's methods used in the

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 development of the 45% equity ratio?

2 A. In testimony and responses to information requests, the Panel cited several
3 cases to support the methodology they employed. In those cases, the
4 Commission generally considered the capital structure of the consolidated
5 operations of the parent company, adjusted for non-utility operations, to
6 ensure that utility ratepayers are paying only the capital costs incurred to
7 support utility operations, with no support for non-utility operations. In
8 making such adjustments, consideration is given to the relative risk of utility
9 and non-utility operations in the consolidated parent. In other words, the
10 Commission's approach assumes that the parent company has structured its
11 non-utility operations, which are assumed to have higher financial risk, with a
12 relatively more aggressive capital structure than the parent's utility
13 operations, which are assumed to have lower financial risk. The Commission
14 views these differing allocations of capital by the parent companies as
15 reflecting an inversion of the appropriate allocation of capital in relation to
16 financial risk, and it therefore adjusts the equity ratios of the utility operations
17 to reflect a more appropriate allocation of capital in relation to the financial
18 risks perceived by the Commission. An additional premise for the
19 Commission's approach is the absence of "ring-fencing" that effectively
20 isolates the finances of utility operations from the non-utility operations when
21 both are part of a larger parent company.

22

23 In Central Hudson's case, there is no such inversion in the allocation of

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 capital. There is currently no long-term debt in the non-utility capital
2 structure. The presumptively more risky non-utility operations have a higher
3 equity ratio (100%) than the presumptively less financially risky utility
4 operations. From the perspective of the principles that underlie the
5 Commission's approach to the consolidated capital structure of the parent
6 companies, the adjustments procedures employed for other utility companies
7 in New York are not relevant.

8
9 The Panel, however, without addressing the underlying differences in
10 circumstances between Central Hudson and other New York utility
11 companies, mechanically applied the typical approach to determine its
12 recommended capital structure in a manner that resulted in restricting the
13 equity ratio to the present stand-alone financials of the utility. The Panel also
14 employed its reliance on the typical approach to support its conclusion that
15 the equity ratio in Central Hudson's capital structure should not be increased,
16 even though, as explained above, the entire method is not relevant to Central
17 Hudson's circumstances. In addition, no consideration appears to have been
18 given to the benefit that the utility may derive from the conservative capital
19 structure of the non-utility operations and the consolidated parent, as that
20 structure existed in the December 31, 2007 data used by the Panel in their
21 calculations. The Panel's approach, removing non-utility capital at 100%
22 equity, and the corresponding recommendation, maintains the low equity
23 ratio upon which Central Hudson's current delivery rates are based. The

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 Panel's support provided for that recommendation is then based on several
2 inaccurate applications of the guidelines published by the rating agencies.

3

4 Q. Please summarize the Panel's testimony on the subject of capital structure.

5 A. The Panel's testimony on capital structure includes (i) the development of a
6 recommended capital structure, employing a methodology that the Panel
7 supports with "Commission precedent," (ii) a discussion of the
8 reasonableness of the recommendation based primarily on the Panel's
9 interpretation of rating agency guidelines, (iii) a summary of the
10 recommendation, supported by the assertion that it "is consistent with that of
11 other New York utilities and within the guidelines for an A-rated utility with
12 Central Hudson's business and financial ratings," and (iv) an assessment of
13 the possible consequences of the recommendation on Central Hudson.

14

15 Q. What is your understanding of the methodology that the Panel used to
16 determine its recommended capital structure?

17 A. The Panel's methodology starts with the consolidated capital structure of the
18 parent of a utility subsidiary and then removes non-utility operations,
19 assuming "reasonable" levels of debt and equity for those operations, based
20 on the premise that the parent company has mis-allocated capital between
21 non-utility operations and utility operations in relation to financial risk as I
22 have explained above. Two examples of the use of this methodology in
23 other cases were included in the Panel's testimony: Case 06-E-1443 for

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 Orange & Rockland Utilities, Inc. (“O&R”) and Case 05-E-1222 for New York
2 State Electric and Gas (“NYSEG”). Further details were provided in
3 subsequent responses to information requests, which I have shown in
4 Exhibit___(SAR-1R) through Exhibit___(SAR-4R).

5
6 These examples show that the outcome is heavily dependent on the
7 judgment used in making adjustments to the actual reported capital
8 structures of the utility operating company and its non-utility affiliates. In the
9 O&R case, shown in Exhibit___(SAR-3), the non-utility affiliates had an
10 equity ratio of 34.8% on December 31, 2006. That ratio was adjusted to
11 50%, effectively imputing debt to the utility operations. O&R reported only
12 43.3% equity for that period, but the recommendation adopted in the case
13 reflected an adjusted equity ratio of 47.5% for purposes of setting rates,
14 more than 400 basis points higher than the reported equity.

15
16 In the NYSEG case, the adopted equity ratio was lower than the actual 46%
17 equity NYSEG was reporting. The consolidated parent company’s equity
18 ratio of 40% was adopted for purposes of setting rates in that case, again
19 imputing debt on the utility. In both cases, the judgment used in the cases
20 had the effect of more closely aligning the utility’s equity ratio to levels more
21 consistent with the parent company’s non-utility operations.

22
23 Q. Was the methodology employed in Central Hudson’s case consistent with

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 cases referenced by the Panel?

2 A. In Central Hudson’s case, the parent’s non-utility operations, which include
3 cash held at the holding company, were removed at an equity ratio of 100%,
4 which reflects the non-utility capitalization at December 31, 2007. After
5 removing this equity, the Panel was left with Central Hudson’s capital
6 structure at December 31, 2007, which matches what Central Hudson
7 actually reported for that period in the Company’s Securities and Exchange
8 Commission (“SEC”) filing on form 10-K. That stand-alone capital structure
9 was applied for the rate year. Removing the non-utility operations at 100%
10 equity is not consistent with the O&R case, in which the reported non-utility
11 equity ratio was adjusted to 50%, or with the NYSEG case, in which the
12 consolidated parent company’s equity ratio was adopted. Upon request for
13 additional information to support their recommendation, the Panel cited the
14 Commission in Case 07-G-0141, shown in Exhibit___(SAR-1R) (the quote
15 was incorrect in the response and has been corrected here), stating “We
16 typically develop the capital structure for utility subsidiaries of holding
17 company parents by first developing the consolidated capital structure of the
18 parent, and then removing any capital associated with more risky competitive
19 operations at an equity ratio consistent with our view that regulated
20 transmission and distribution utilities are less risky than competitive
21 ventures.” Just beneath the Panel’s reference to that case on page 33, I
22 noted “In this case, neither party employed our traditional approach,” which
23 indicated to me that Staff has not consistently employed this approach and

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 the Panel was indeed free to consider alternatives. On page 34 of that case,
2 the Commission continues “Barring evidence to the contrary, removal of
3 competitive subsidiaries from the consolidated parent capital structure at a
4 60% equity ratio would be our normal approach.”

5

6 Q. Should the Panel have considered other alternatives?

7 A. Yes, there can be a range of possible outcomes from using the methodology
8 employed by the Panel, depending on the “reasonable” level of debt and
9 equity applied during the adjustment for non-utility capital. They could have
10 determined Central Hudson’s equity ratio using the Commission’s normal
11 approach (60% equity), as suggested in Case 07-G-0141. Exhibit___(SAR-
12 5R), Schedule 1, shows the calculation the Panel discussed in their
13 testimony and included in their Exhibit___(RRP-2). In Exhibit___(SAR-5R),
14 Schedule 2, we have applied a 60% equity ratio for the removal of non-utility
15 capital from the consolidated parent company. No change has been made to
16 the total capital of the consolidated parent, the non-utility capital, or Central
17 Hudson. This approach results in a common equity of 53.5% for purposes of
18 setting delivery rates.

19

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 Similarly, a 50% equity ratio could have been applied to the non-utility
2 capital, consistent with the adjustment made in the O&R case.

3 Exhibit___(SAR-5R), Schedule 3, shows that this adjustment results in a
4 recommended equity ratio of 55.8%.

5

6 Q. Are there other alternatives that should also have been considered?

7 A. For more than five years prior to December 31, 2007, Central Hudson has
8 been the only subsidiary of the parent company with long-term debt in its
9 capital structure and the consolidated equity ratio has been significantly
10 higher than that of Central Hudson. Central Hudson has benefited from this
11 situation, retaining significant earnings as a source of capital to finance the
12 growing capital investments in its electric and natural gas systems, without
13 the burden of seeking external equity financing. In fact, the parent had
14 available equity capital during those five years held as liquid short-term
15 investments, and had it chosen to do so, could have infused additional equity
16 into Central Hudson, displacing long-term debt and increasing Central
17 Hudson's equity ratio, while maintaining an equity ratio that exceeded 60%
18 for its non-utility operations. Since July 1, 2006, Central Hudson has
19 operated under the terms of Case 05-E-0934 and Case 05-G-0935. Those
20 cases allowed Central Hudson to increase its equity ratio up to 47% for
21 purposes of calculating shared earnings, should the Company's earnings be
22 above the 10.6% threshold established for sharing. Due primarily to
23 significant actual sales shortfalls compared to those reflected in delivery

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 rates, Central Hudson has been earning well below its 9.6% allowed return
2 on equity and, acting in the economic interest of shareholders, the utility
3 capital structure has been maintained very near the level used in setting its
4 delivery rates. Exhibit____(SAR-5R), Schedule 4, shows a hypothetical
5 example where \$50 million of equity is infused into Central Hudson from the
6 parent at December 31, 2007, without issuing additional CH Energy Group
7 equity. The exhibit shows non-utility capital with \$50 million of long-term debt
8 (an equity ratio of 71.6%). When the consolidated capital structure is
9 adjusted to remove the non-utility capital, the result is an equity ratio
10 recommendation for Central Hudson of 47.8%. This compares to the
11 consolidated parent's equity ratio of 55.2%.

12
13 Q. What is Central Hudson's proposed capital structure in this case?

14 A. Central Hudson has proposed increasing its equity ratio to 48% by retaining
15 all of its net income and making just such an equity infusion from the parent
16 company. In each of 2006 and 2007, Central Hudson retained approximately
17 75% of its earnings to reinvest into utility operations and maintain its capital
18 structure. In 2008, Central Hudson has retained 100% of its earnings. In
19 Exhibit____(SAR-5R), Schedule 5, we show the Panel's capital structure
20 methodology applied to actual September 30, 2008 balances for the parent
21 company, the non-utility capital, and Central Hudson. The approach results in
22 a Central Hudson equity ratio of 46% for rate setting purposes,
23 demonstrating progress in the improvement of Central Hudson's equity ratio.

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 Central Hudson has proposed an equity infusion from the parent to further
2 increase the equity ratio to 48%. This is demonstrated in Exhibit____(SAR-
3 5R), Schedule 6, where the non-utility capital reflects an equity ratio of 82%
4 and Central Hudson reflects an equity ratio of 48%. The non-utility capital far
5 exceeds the 60% equity ratio reflected in the Commission's normal approach
6 or the 50% equity ratio applied on the O&R case. Subsequent to such an
7 equity infusion, the Panel's methodology for determining capital structure
8 would support the 48% equity ratio.

9
10 Q. What support did the Panel offer for its recommendation to use 45% equity
11 for setting delivery rates in this case?

12 A. After determining the 45% equity ratio and citing Commission precedent as
13 the basis for the methodology, the Panel evaluated the result for
14 reasonableness and considered possible consequences.

15
16 Q. Did you find any shortcomings in the basis for the Panel's assertion that 45%
17 equity is reasonable for Central Hudson?

18 A. The framework for the Panel's evaluation of the reasonableness of their
19 recommended equity ratio is based on rating agency credit analysis, primarily
20 the guidelines published by Standard & Poor's ("S&P"). My review of the
21 Panel's testimony and exhibits indicates that the S&P guidelines are not
22 utilized appropriately. Before getting into the details of the Panel's
23 application of those guidelines, there is an important assumption used in the

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 Panel's testimony that I would like to address. One of the key financial ratios
2 used by the rating agencies is "total debt to total capitalization", or "debt/debt
3 plus equity," expressed in percent. It is not accurate to assume, as the Panel
4 does in its testimony, that 100% less the total debt to total capitalization ratio
5 published in rating agency reports is comparable to the equity ratio used for
6 setting delivery rates. When the rating agencies calculate total debt, they
7 include short-term debt with long-term debt, as well as imputing debt for
8 other multi-year commitments, e.g., unfunded pension and other post-
9 employment benefit plan liabilities, purchased power agreements, and
10 leases. That total debt, with adjustments, is also part of the ratio's
11 denominator, total capitalization, along with common equity. There may be
12 other differences from the capital structure used in the rate setting process
13 as well, e.g. customer deposits, which are not part of the rating agency
14 ratios. I grant that total debt to total capital is the most directly relevant ratio
15 used in the evaluation of the rate setting equity ratio's impact on
16 creditworthiness and bond ratings. But it can be confusing and
17 unintentionally misleading to switch between the two ratios while citing rating
18 agency guidelines. Those guidelines exist for total debt to total capitalization
19 but do not exist for the equity ratio used in setting rates in this case. For
20 purposes of evaluating capital structure and its impact on credit ratings, the
21 rating agency ratios should be used exactly as they are published and
22 applied consistently.

23

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 Q. Do you agree with the Panel's assertion that its recommendation is within
2 S&P's guidelines and is thereby reasonable?

3 A. The Panel does not appropriately apply the S&P guidelines in support of its
4 recommendation. First, on page 10 of its testimony, the Panel incorrectly
5 cites a November 30, 2007 report as support that their recommendation is
6 within S&P guidelines for an A-rated company. Upon request for the report,
7 included as Exhibit____(SAR-6R), the reference was corrected to a 2004
8 report. The statement in testimony that "S&P indicates that A-rated
9 companies with excellent business profile ratings, like Central Hudson, can
10 maintain an A-rating with debt to total capital ratios of 60%," is not supported
11 by the 2004 report. The 2004 report precedes S&P's business risk profile
12 framework that assigns "excellent" or other labels to business risk. In 2004,
13 S&P used a numerical scale of 1 (best) to 10 (worst) for the business risk of
14 utility companies. On page 11 of the 2004 report, Central Hudson is shown
15 to have a business profile score of "3". In Table 1, on page 4 of that report,
16 the range for A-rated companies with Central Hudson's business profile is
17 shown to be 50% to 55% debt.

18
19 Q. What does S&P report as Central Hudson's total debt to total capitalization
20 ratio?

21 A. The Panel provided S&P's August 28, 2008 Credit Stats for Electric Utilities
22 as Exhibit____(RRP-18), which showed the four-year ratings history and the
23 five-year history of key financial ratios. One of the financial ratios shown is

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 “debt/debt plus equity,” which is the same as total debt to total capitalization
2 ratio used in the Panel’s testimony. That report shows Central Hudson’s total
3 debt to total capitalization as follows:

4	Year	Debt/Debt plus equity
5	2007	57.5
6	2006	57.6
7	2005	70.7
8	2004	73.0
9	2003	73.0

10 Recall that Central Hudson’s equity ratio for 2007, calculated by the Panel in
11 their Exhibit____(RRP-2) as 44.49% (with data that corresponds to Central
12 Hudson’s stand-alone capital structure in 2007), is the basis for their
13 recommended capital structure. That recommendation corresponds to S&P’s
14 calculated total debt to total capital ratio of 57.5% for 2007. It is clear from
15 the S&P material, all of which was provided by the Panel in support of their
16 testimony, that the values S&P has calculated for Central Hudson’s total debt
17 to total capitalization (57.5% in 2007) are outside of the range (50% to 55%)
18 for A-rated companies with Central Hudson’s business risk profile. The
19 Panel’s recommendation is not supportive of an A-rating for a utility
20 company.

21
22 Q. Does the Panel provide other information that contradicts their assertion that
23 their recommendation is within S&P guidelines for an A-rated company and

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 is therefore reasonable?

2 A. Yes. The Panel provides S&P's new methodology for portraying the
3 business risk and financial risk profiles of utility companies in a November
4 30, 2007 report shown in their Exhibit____(RRP-20). In Table 2, on page 3,
5 that report identifies total debt to total capital as one of three indicative ratios
6 for financial risk. Applying the values of that ratio for Central Hudson over
7 the past 5 years, Central Hudson measures in the "Aggressive" and "Highly
8 Leveraged" ranges. In the matrix for business risk and financial risk shown in
9 Table 1, on page 2 of that report, the highest rating for financial risk levels of
10 "Aggressive" and "Highly Leveraged" is BBB. The Panel's recommendation
11 is not consistent with the S&P guidelines they provided in support of that
12 recommendation.

13
14 Q. Does S&P itself offer any direct assessment of Central Hudson's capital
15 structure and its impact on the Company's rating?

16 A. Yes. As further support that Central Hudson's total debt to capitalization is
17 high for an A-rated company, I refer to Exhibit____(SAR-6) from my direct
18 testimony, which shows S&P's June 6, 2008 ratings report for the Company.
19 Table 2, on page 5 of that report, shows the same values for total debt to
20 total capitalization as I listed earlier. In its rationale for Central Hudson's
21 rating, S&P states "The ratios are somewhat weak for the current rating, for
22 which we would expect FFO to debt in the mid-20% area and debt to capital
23 in the upper-40% area. However, the ratings incorporate an expectation of

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 improved credit measures over the term of the current rate agreement.”

2 Incidentally, it should be noted that the current rate agreement has not

3 produced the improvements in credit measures anticipated by S&P, rather

4 the reverse has occurred.

5

6 Q. Where else does the Panel rely on S&P guidelines to support their
7 recommended capital structure?

8 A. The Panel incorrectly cites data from another S&P report in lines 1 through
9 10 on page 11 of their testimony, where they state “the average debt ratio of
10 95% of the 51 utility companies with an “A-rating” was in the range of 58.2%
11 to 45.0%...” In the Panel’s response to Central Hudson’s request for
12 workpapers supporting that statement, which I have included as
13 Exhibit___(SAR-7R), the Panel corrected the statement to read “the average
14 debt ratio of “approximately 68%” of the 51 utility companies with an “A-
15 rating” was in the range 59.2% to 46.4%.” The Panel’s correction refers to
16 the average of the three years ended 2007. Again I refer to Central
17 Hudson’s values for that ratio, which are provided earlier in this rebuttal
18 testimony and average 61.9% for those three years. Central Hudson’s
19 average ratio is actually outside the high end of the range. The Panel’s
20 corrected statement is not supportive of the next sentence in its testimony
21 (page 11, lines 10-12, which states “Our recommended common equity ratio
22 for Central Hudson falls within these ranges and is reasonable.”

23

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 Q. Does the Panel offer support for its assertion, on page 14, lines 1-4, that
2 “Our recommendation is consistent with that of other New York State utilities
3 and is within the guidelines for an A-rated utility with Central Hudson’s
4 business and financial ratings?”

5 A. As I have shown earlier, the Panel’s methodology for developing the 45%
6 equity ratio recommendation does not appear to be consistent with the
7 Commission’s principles or the methodology used in the cases referenced for
8 other New York State utilities. The recommendation itself also does not
9 appear to be consistent. The Panel states on page 12 (lines 4-8) of their
10 testimony that “Central Hudson’s credit rating at A (S&P)/A2 (Moody’s) is
11 stronger than the other S&P and Moody’s-rated electric utility companies in
12 New York because it has lower business and financial risks.” The Panel
13 provides Exhibit___(RRP-4) as support. A corrected version of that exhibit is
14 included here as Exhibit___(SAR-8R). To fully understand the S&P business
15 and financial risk profiles shown in the exhibit, I refer to the background
16 information on S&P’s ratings provided by the Panel in Exhibit___(RRP-20).
17 The S&P report in that exhibit defines business risks to include:

- 18 1. regulation
- 19 2. markets
- 20 3. operations
- 21 4. competitiveness
- 22 5. management

23 The report goes on to define financial risks as “Financial risk is analyzed both

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 qualitatively and quantitatively, mainly with financial ratios and other metrics
2 that are calculated after various analytical adjustments are performed on
3 financial statements prepared under GAAP. Financial risk is assessed for
4 utilities using, in part, the indicative ranges in table 2.” Table 2 shows three
5 ratios:

- 6 1. Cash flow: (FFO/debt)(%)
- 7 2. Cash flow: (FFO/interest)(x)
- 8 3. Debt leverage: (Total debt/capital)(%)

9 In their testimony, the Panel lists examples of business risks that make the
10 other utilities more risky than Central Hudson. In fact, the Panel’s
11 Exhibit___(RRP-4) (see Exhibit___(SAR-8R)) shows that all ten of the New
12 York utility operating companies listed have a business risk of “excellent,”
13 S&P’s highest rating. Exhibit___(RRP-4) (see Exhibit___(SAR-8R)) also
14 shows that seven of the ten operating companies listed have a financial risk
15 rating of “intermediate.” The other three companies are the next level down.
16 Central Hudson is one of the seven and thus has the median score for the
17 New York utility ratings of financial risk. The Panel has shown in its exhibit
18 that Central Hudson has the exact same business and risk profile as seven
19 of the ten New York operating companies listed. The data that the Panel
20 provided as support is not consistent with the Panel’s statement on page 12.

21
22 Q. Does the Panel make other errors in asserting that their recommendation is
23 consistent with other New York utilities?

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 A. Yes, the Panel's references to S&P's guidelines are applied incorrectly to
2 support that assertion. The Panel argues on page 12 of its testimony that the
3 New York State Electric & Gas, Rochester Gas & Electric, Niagara Mohawk,
4 and Consolidated Edison operating companies have higher business risks
5 than Central Hudson. As I mentioned above, S&P makes no distinction
6 between the business risk for Central Hudson and the other New York State
7 utility operating companies: they are all rated the same. At the request of
8 Central Hudson for justification for how the Panel's examples of higher risk at
9 other companies warrants a higher equity ratio in the determination of the
10 cost of capital reflected in delivery rates, the Panel applied the S&P
11 guidelines. I have included the Panel's response as Exhibit___(SAR-9R)
12 and note that it makes reference to a report included in Exhibit___(SAR-6R).

13 The Panel's responses to both parts of the question read "The Panel
14 referred to such...as an example of the additional risks faced by these
15 companies as reflected in their lower credit ratings, which in turn are
16 supported by higher equity ratio guidelines. This is shown in the S&P report
17 provided in response to CH-82a, page 4." The Panel is incorrectly applying
18 the guidelines it references. S&P's guidelines on page 4 of that report are
19 provided for total debt to total capital (the third matrix in Table 1), not equity
20 ratio. For all levels of business risk shown in that matrix, the range for debt
21 leverage (total debt to total capital) increases as credit ratings decrease.
22 Conceptually, if we apply this relationship to the equity ratio, equity ratios
23 should decrease as credit ratings decrease. This makes sense because

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 these ratios are indications of creditworthiness. A lower equity ratio, or
2 higher debt ratio, indicates higher financial risk and warrants a lower credit
3 rating per S&P's guidelines for credit analysis. This is by no means support
4 for authorizing lower equity ratios for rate setting purposes to utility operating
5 companies with A-level credit ratings as the Panel concludes, unless the
6 objective is to align the financial ratios to a lower credit rating: granting
7 comparably lower equity ratios to A-rated utilities would result in weaker
8 financial ratios and ultimately a downgrade of credit ratings for those utilities.

9 In turn, higher financial risk requires a corresponding higher return from
10 equity investors, which should culminate in higher allowed returns on equity
11 in the rate setting process.

12

13 Q. Do you agree with the Panel's assessment of the consequences of their
14 recommendation?

15 A. No, I do not. The Panel bases their assessment on the reduced risk resulting
16 from the implementation of a revenue decoupling mechanism ("RDM") for
17 electric and natural gas service and a weather normalization clause ("WNC")
18 for natural gas service. The Panel cites an October 2008 S&P report for a
19 general reference to the industry, stating "electric and gas utility companies
20 are well positioned to endure the potential hardship that can impact other
21 industries because of their solid cash flows and limited refinancing needs in
22 the short run." The report is not specific to Central Hudson's situation, in
23 which the Company's cash flow is not sufficient to fund its system

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 infrastructure investments and its need to access the public debt markets is
2 significant. The Panel's recommendation reflects \$57 million of long-term
3 debt to be issued in 2009 (the Panel's Exhibit__(RRP-5)). Additionally, the
4 Company faces the challenge of remarketing or refinancing its \$116 million of
5 auction rate bonds in the near future, as I discussed in my direct testimony.
6 In aggregate, Central Hudson will likely issue debt amounting to 37% of its
7 total outstanding debt per the Panel's recommended capital structure in
8 Exhibit__(RRP-2).

9
10 Furthermore, the Panel does not properly appreciate the concerns that the
11 rating agencies have expressed in their evaluation of Central Hudson's
12 creditworthiness. The Panel cites Moody's September 22, 2008 credit report
13 as support for its recommendation, stating "Moody's indicated that it would
14 favorably view regulatory approval of a revenue decoupling mechanism
15 because such an approach typically helps mitigate the negative financial
16 consequence of lost revenues associated with conservation and other
17 efficiency programs, as well as price elasticity. Given the above, we expect
18 no decline in Central Hudson's credit strength upon adoption of our
19 capitalization recommendation." In that report, Moody's changed the rating
20 outlook on Central Hudson's debt to negative, from stable, stating "CHG&E's
21 negative rating outlook takes into account our view that the utility's historical
22 financial metrics have been weak relative to its A2 senior unsecured rating
23 and that we have a less favorable view of the regulatory environment in New

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 York, especially as it relates to the level of allowed returns on equity, when
2 compared to prior periods.” In its rationale for the rating, Moody’s states
3 “CHG&E’s ratings reflect its overall business and regulatory risk profile that is
4 more typical of the Baa category, which is less favorable today and
5 prospectively compared to our historical view that these two factors were
6 more typical of what we would expect to see for the A rating category.”

7

8 Q. How does the Company’s own proposed capital structure address the
9 concerns of S&P and Moody’s?

10 A. S&P and Moody’s have both emphasized Central Hudson’s comparably
11 weak financial ratios in their ratings reports. Those ratios reflect the capital
12 structure upon which Central Hudson’s current rates are based. The Panel’s
13 recommendation of 45% equity, the same as in Central Hudson’s current
14 rates, matches the historical capital structure and offers no improvement that
15 would address the concerns of the rating agencies. Central Hudson has
16 proposed increasing the equity ratio by 300 basis points, which is expected
17 to improve its total debt to total capital ratio by a like amount. That change
18 would also improve its cash flow ratios, particularly cash coverage of its
19 interest payments and cash flow relative to its outstanding debt, by lowering
20 its total debt and interest expense on that debt (compared to the current
21 capital structure recommended by the Panel). Combined with the
22 Company’s proposal for allowed return on equity of 10.25%, which would
23 improve cash flow through higher returns, Central Hudson could address

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 concerns about its debt ratings and improve its financial integrity consistent
2 with the objectives outlined in my direct testimony.

3

4 Q. Do you have any final comments or concerns about the capital structure
5 recommendations in this case?

6 A. Yes. First, I would like to comment on current financial markets. It has been
7 widely reported in the media that we are operating in extraordinary financial
8 and economic conditions. Those conditions can have a significant impact on
9 Central Hudson's debt costs. The Panel has proposed a true-up on the cost
10 of all long-term debt at the end of the rate year. Exhibit___(SAR-10R) shows
11 an example that was prepared by the Panel in response to a question about
12 that proposal, illustrating how the true-up would be calculated. The Panel
13 acknowledges the variability in long-term debt cost that could occur as a
14 result of expected high levels of financing activity and uncertain financial
15 conditions over the course of the rate year. The Panel's proposal expands
16 my proposal for a true-up on the refinancing of Central Hudson's auction rate
17 bonds. I agree that a true-up that holds customers and shareholders neutral
18 for the cost of all long-term debt during the rate year is appropriate under
19 current and expected conditions.

20

21 A true-up on debt costs does not, however, address the importance of capital
22 structure and financial management during times of adverse external
23 conditions. The macroeconomic environment clearly has an impact on

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 Central Hudson's access to the debt markets and the cost of that debt, as
2 the true-up acknowledges. To illustrate that impact, I have included
3 Exhibit___(SAR-11R), which lists the 2008 utility industry debt issuances I
4 am aware of through the agents in Central Hudson's medium-term notes
5 program. The exhibit shows the significant increase in credit spreads and
6 coupons on new issuances of investment grade long-term debt starting in
7 September 2008. Each week brings unwelcome news about macroeconomic
8 conditions, and I do not expect a significant improvement in the near term. If
9 ever there was a time to bolster a company's financial situation against an
10 uncertain outlook, now is that time. It is my responsibility to position Central
11 Hudson for access to capital at all times, and to assure adequate liquidity
12 under a wide range of conditions. We face challenging conditions at a time
13 of relatively high capital expenditures that will exceed Central Hudson's
14 operating cash flow over the next several years and require equity and debt
15 financing. Additionally, contributions to the Company's post-employment
16 benefit plans, while not yet quantified, are expected to increase significantly
17 from the levels included in our direct testimony and exhibits to offset falling
18 asset values. The re-pricing of risk in financial markets over the past 12 to
19 18 months has spared no asset class (other than U.S. government debt
20 securities). Central Hudson starts to face these challenges from a position of
21 strength, with A-level ratings on its senior unsecured debt, which facilitates
22 access to the public debt markets on reasonable terms. Improving the
23 Company's cash flow and capital structure are prudent and important steps

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 to take now to address the weaknesses cited by the rating agencies that
2 assign Central Hudson's debt ratings. In this case, Central Hudson is
3 seeking the rate support required to make those improvements and maintain
4 the cost and access advantages of its A-ratings.

5
6 As a protection for ratepayers, in the event that Central Hudson's parent is
7 unexpectedly unable to fund the 48% equity that we are recommending, the
8 true-up mechanism for the cost of long-term debt could be expanded to
9 recognize the weighting of the various components of the capital structure.
10 Such a true-up, on both the cost of long-term debt and the weighting of all
11 components of capital, up to a 48% weighting for equity, would result in a
12 refund to customers if the Company does not achieve its recommended
13 equity ratio.

14
15 My final comment is about consistency in the rate treatment given to Central
16 Hudson in this case. I have shown that the Panel's recommended capital
17 structure is not consistent with the rating agency guidelines for an A-rated
18 utility company and I have recommended a structure more supportive of the
19 current A-ratings. If the Panel's recommendation is adopted, however, it
20 should be acknowledged that the recommendation aligns more closely to a
21 BBB/Baa rating, as indicated by the rating agencies in their reports for
22 Central Hudson. As such, consistent treatment should be applied throughout
23 this case, most notably the determination of allowed return on equity. While

STACEY A. RENNER
CASES 08-E-0887 & 08-G-0888

1 Company witness Dr. Morin will address the cost of equity thoroughly in his
2 rebuttal testimony, I note that the Panel's recommended cost of equity
3 reflects an A-rating for Central Hudson. That assumption of an A-rating,
4 which is not supported by the capital structure recommendation, results in a
5 direct downward adjustment to the cost of equity that is unwarranted and
6 inconsistent.

7

8 Q. Does this conclude your rebuttal testimony?

9 A. Yes.