STATE OF CONNECTICUT

BEFORE THE DEPARTMENT OF PUBLIC UTILITY CONTROL

DPUC Review of Southern Connecticut	**)**	
Gas Rates and Charges	**)**	**Docket 99-04-18 Phase 3**
DPUC Review of Connecticut Natural	**)**	**Docket 99-09-03 Phase 2**
Gas Rates and Charges	**)**	

DIRECT TESTIMONY OF

PAUL L. CHERNICK

ON BEHALF OF

THE OFFICE OF CONSUMER COUNSEL

Resource Insight, Inc.

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I. Identification and Qualifications

Q: State your name, occupation and business address.

A: I am Paul L. Chernick. I am President of Resource Insight, Inc., 347 Broadway, Cambridge, Massachusetts.

Q: Summarize your professional education and experience.

A: I received an SB degree from the Massachusetts Institute of Technology in June, 1974, from the Civil Engineering Department, and an SM degree from the Massachusetts Institute of Technology in February, 1978, in technology and policy. I have been elected to membership in the civil engineering honorary society Chi Epsilon, and the engineering honor society Tau Beta Pi, and to associate membership in the research honorary society Sigma Xi.

I was a utility analyst for the Massachusetts Attorney General for more than three years, and was involved in numerous aspects of utility rate design, costing, load forecasting, and the evaluation of power supply options. Since 1981, I have been a consultant in utility regulation and planning, first as a research associate at Analysis and Inference, after 1986 as president of PLC, Inc., and in my current position at Resource Insight. In these capacities, I have advised a variety of clients on utility matters.

My work has considered, among other things, the cost-effectiveness of prospective new generation plants and transmission lines, retrospective review of generation-planning decisions, ratemaking for plant under construction, ratemaking for excess and/or uneconomical plant entering service, conservation program design, cost recovery for utility efficiency programs, the valuation of environmental externalities from energy production and use, allocation of costs of service between rate classes and jurisdictions, design of retail and wholesale rates, and performance-based ratemaking (PBR) and cost recovery in restructured gas and electric industries.

Q: Have you testified previously in utility proceedings?

A: Yes. I have testified approximately one hundred and sixty times on utility issues before various regulatory, legislative, and judicial bodies, including the Arizona Commerce Commission, Connecticut Department of Public Utility Control, District of Columbia Public Service Commission, Florida Public Service Commission, Maryland Public Service Commission, Massachusetts Department of Public Utilities, Massachusetts Energy Facilities Siting Council, Michigan Public Service Commission, Minnesota Public Utilities Commission, Mississippi Public Service Commission, New Mexico Public Service Commission, New Orleans City Council, New York Public Service Commission, North Carolina Utilities Commission, Public Utilities Commission of Ohio, Pennsylvania Public Utilities Commission, Rhode Island Public Utilities Commission, South Carolina Public Service Commission, Texas Public Utilities Commission, Utah Public Service Commission, Vermont Public Service Board, Washington Utilities and Transportation Commission, West Virginia Public Service Commission, Federal Energy Regulatory Commission, and the Atomic Safety and Licensing Board of the U.S. Nuclear Regulatory Commission.

Q: Have you testified previously before the Connecticut Department of Public Utility Control (the Department)?

A: Yes. I testified in

- Docket No. 83-03-01, a United Illuminating (UI) rate case, on behalf of the Office of Consumer Counsel, on Seabrook costs.
- Docket No. 83-07-15, a Connecticut Light and Power (CL&P) rate case, on behalf of Alloy Foundry, on industrial rate design.
- Docket No. 99-02-05, the CL&P stranded-cost docket.
- Docket No. 99-03-04, the UI stranded-cost docket.
- Docket No. 99-03-35, the UI standard-offer docket.
- The initial phase of this Docket No. 99-03-36, the CL&P standard-offer docket.
- Docket No. 99-08-01, investigation into electric capacity and distribution.
- Docket No. 99-09-12, the nuclear-divestiture plan for CL&P and UI.
- Docket No. 99-09-03, on the performance-based ratemaking proposal of Connecticut Natural Gas.
- Docket No. 99-09-12 RE01, on the Millstone auction.
- Docket No. 99-03-36 RE03, on CL&P's Generation Services Charge.

Q: Are you the author of any publications on utility planning and rate-making issues?

A: Yes. I am the author of a number of publications on rate design, cost allocation, cost recovery, cost-benefit analysis, and other ratemaking issues. Several of my recent papers and report deal with issues in electric and gas industry restructuring, including integrated resource planning and performance-based ratemaking.

II. Introduction

Q: On whose behalf are you testifying?

A: I am testifying on behalf of the Connecticut Office of Consumer Counsel.

Q: What is the purpose of your testimony?

A: I was asked to prepare a preliminary review of the proposal of Southern Connecticut Natural Gas (SCG) and Connecticut Natural Gas (CNG) (collectively, the Companies) on the inclusion of gas costs in the earnings sharing mechanisms (ESMs) previously approved by the Department.

Q: Please summarize your testimony.

A: The Companies' proposals have numerous flaws, any one of which would be sufficient reason to reject the proposals or defer their review. Most of problems are in the areas of the timing of the proposals, their incompleteness, their biases, and their asymmetry.

III. Preliminary Review of the Proposal

Q: What are the problems with the timing of the proposals?

A: The Companies' request is premature. The Department's Orders in Docket No. 99-04-18 Phase III and in Docket 99-09-03 Phase II require an approved Gas Cost Reduction Plan before a sharing of gas-supply savings can be implemented. Merger-related savings must be identified in the context of the Gas Cost Reduction Plan. According to its responses to Information Requests OCC-42 and OCC-45, SCG has not yet completed its Plan and does not even have a draft available.

At this point, pursuant to the Orders, the Companies should be filing explanations of how they will identify and track the specific merger-related savings that will be developed in greater detail in the Gas Cost Reduction Plan. They should not be requesting approval of the ESMs until they have fulfilled the requirements in the Department's orders.

Q: What are the problems with the completeness of the proposals?

A: The Companies' filing does not fulfill the Department's requirements of a "detailed methodology" for identifying merger-related savings. Indeed, the filing does not make any serious attempt to differentiate merger-related from other savings. Since the Department has limited the inclusion of gas savings in the ESM to those that can be demonstrated to be merger-related, this deficiency must be corrected before shareholders share in any gas-cost savings.

The proposal is extraordinarily vague. The Companies have suggested adjustments that they have not defined, including adjustments to commodity cost for changes in "level." The Companies have also noted that commodity-cost differentials vary with weather, but have not proposed any specific adjustment for weather.

The Companies have also presented inconsistent descriptions of the allocation of savings from inter-affiliate transactions, between the CNG, SCG, and their affiliates New York State Electric and Gas (NYSEG) and Berkshire Gas, all of which are subsidiaries of Energy East. In some places, the Companies suggest that the savings will be allocated between affiliates in proportion to the affiliates' retail sales, while in other places, they assert that the transactions will be priced at market prices, rather than allocated. The first approach favors NYSEG and (since NYSEG has no cost-of-gas adjustment clause) Energy East shareholders over CNG and SCG ratepayers. If the second approach is to be applied, it is not clear that there are any merger-related savings, since the utilities could by and sell at market prices without the merger. In the latter case, all savings from inter-affiliate transactions would have to be removed from the ESM.

The general drift of the proposal is to claim all savings as merger-related, even if they are clearly achievable by free-standing utilities. In the BP Energy Alliance, for example, the utilities retain savings from trading activities up to the First Gate, which represents an estimate of what the utilities could do on their own and is based (at least for CNG and SCG) on CNG's pre-merger trading practices. Clearly, these savings are not merger-related and should not be included in the ESM.

Q: How are the proposals biased?

A: The Companies have not justified the selection of 2000 as the base year for the computations. In many ways, it seems a poor choice of base year:

- It is the only year in the last three in which SCG's commodity cost was higher than the NYMEX index.
- Due to high summer commodity prices, storage levels were unusually low going into the winter of 2000-01.
- The pattern of NYMEX and other producing-area prices over the year was highly atypical, with prices rising through the year and reaching unprecedented levels by the end of the year. This pattern skews the computation of average differences.
- In 2000, SCG was operating under an asset-management agreement, which does not appear to have produced adequate results.

The use of 2000, rather than 1998, 1999, or an average of the three years, will produce arbitrarily higher ESM payments to shareholders.

Q: What are the problems with asymmetry in the proposals?

A: The proposal leaves too much discretion to the Companies in determining whether changes in costs are "merger-related," resulting in asymmetric cost recovery: the Companies can claim that cost increases are non-merger-related, while retaining a share of all cost reductions for shareholders, regardless of the origin.

Indeed, the Companies have refused to accept sharing of negative savings in the ESM for any of the three gas-cost categories (capacity, commodity, or unaccounted-for gas). The Companies also leave open the possibility that they will apply *ad hoc* non-merger-related adjustments to allow them to claim positive merger-related savings even when costs are increasing. Their position seems to be that anything that goes right should be treated as merger-related, and credited to shareholders, while anything that goes wrong should be ignored.

The proposal does not coordinate demand and commodity charges, and could result in the Companies receiving a reward for actions that shift costs between demand and commodity. For example, if a Company traded capacity with a high demand charge and low retained-gas and commodity charges for capacity with a low demand charge and high retained-gas and commodity charges, it could claim an ESM saving for the reduced demand charge, while excluding the increase in commodity costs from the computations. Overall gas prices might not change at all, but the shareholders would get an ESM share of the demand-charge savings, resulting in higher costs for ratepayers. Shareholders would receive a reward for achieving nothing.

Q: Would you like to comment on any other aspects of the Companies' proposals?

A: Yes. The Companies' proposal for the treatment of unaccounted-for (UAF) gas is particularly problematic. In addition to the general problems discussed above, the proposals for UAF would:

- Charge incentives for measures that increase charges to existing customers for the current level of service. One source of UAF is the under-reporting by volumetric meters of cold, dense gas in the coldest parts of the winter, when demand is highest and the gas is coldest. Improving metering reduces reported UAF, not by reducing real leaks or losses, but by increasing billings for gas and delivery service to customers. Reduction in UAF by these means would not represent a benefit to ratepayers, who would pay more for both delivery service and gas, with the difference going to shareholders.
- Include non-merger-related UAF reductions, including SCG's main-replacement program.
- Ignore the sensitivity of UAF to weather and other non-merger-related fluctuations. A year with a cold December will tend to have high sendout and low sales (since most of the sales will not be recorded until the next January), resulting in an high reported UAF. This effect is exacerbated if the previous year had a warm December. Conversely, a year with a warm December, following one with a cold December, will tend to have a low reported UAF. Similarly, since much of real losses are not related to sendout, UAF will tend to be lower in years with high sendout. UAF varies with sales mix; industrial gas meters tend to be temperature-compensated, while residential meters are not. A single external circumstances can drive UAF through several of these effects. For example, a year with high oil prices and low gas prices will tend

to produce high interruptible gas sendout, reducing UAF in three ways: spreading fixed losses over a higher sendout, increasing the percentage of sales that is metered with temperature-compensated meters, and sending out more gas at times when the gas is relatively warm. The Companies' proposals would leave them free to correct UAF downward for non-merger-related factors when UAF is high (or even for selected non-merger-related factors when UAF is low), but not require upward adjustments for factors that reduce UAF.

Q: Does this conclude your testimony?

A: Yes, at this time. As I noted above, this testimony represents only a preliminary review of the Companies' proposals. There has not been sufficient time in these dockets for me to review and evaluate the Companies' responses to discovery (especially for CNG, whose responses were delivered on Saturday June 23, with additional discovery to be delivered on June 26), or complete my description of the problems in the proposals. I will supplement this testimony as soon as feasible.