

STATE OF NEW YORK
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of Consolidated Edison)
Company of New York, Inc.'s Plans for)
Electric Rate Restructuring With Respect to)
Service Provided in Westchester County)

Docket No. 00-E-1208

REBUTTAL TESTIMONY OF
PAUL CHERNICK
ON BEHALF OF
THE CITY OF NEW YORK

Resource Insight, Inc.

NOVEMBER 7, 2001

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1 **I. Introduction**

2 **Q: Are you the same Paul Chernick who pre-filed direct testimony in this**
3 **proceeding?**

4 A: Yes.

5 **Q: What is the purpose of the rebuttal testimony?**

6 A: In this testimony, I respond to the direct testimony of the Staff witnesses,
7 primarily that of Mr. Harvey Arnett, and of the Westchester County Panel of
8 Messrs. Berry and Radigan.

9 **II. Staff Testimony**

10 **Q: Please summarize the Staff's position on the recovery of stranded costs in**
11 **the two Con Edison zones.**

12 A: Mr. Arnett testifies that "Con Edison's delivery rates, rather than the full service
13 rates, should be equalized" (Arnett Direct, p. 3). Since he considers the stranded
14 costs to be part of delivery rates, his position is that Con Edison should charge
15 the same stranded costs in both zones. Mr. Arnett asserts, "Equalizing delivery
16 rates best satisfies" two goals: "best promoting efficient consumption decisions"
17 and fairness (ibid.).

18 **A. Staff's Efficiency Argument**

19 **Q: What does Mr. Arnett mean by "best promoting efficient consumption**
20 **decisions"?**

1 A: Mr. Arnett recognizes that New York City consumers pay higher market supply
2 charges than consumers in Westchester.¹ He then asserts, “This differential
3 should be reflected in the price paid by consumers so that they can make
4 appropriate decisions on where they locate and how much electricity they
5 consume” (Arnett Direct, pp.3–4). In effect, Mr. Arnett argues that electric rates
6 should be increased in New York City to encourage customers to relocate out
7 of the City.

8 **Q: Is Mr. Arnett’s position reasonable?**

9 A: No. To the contrary, his position is unsupportable, for a number of reasons.

- 10 • Mr. Arnett strongly argues that the PSC should redesign Con Edison’s rates
11 to encourage residents and businesses to leave New York City and relocate
12 to Westchester.² It is incredible that Mr. Arnett did not consider the effects
13 of the World Trade Center tragedy before formulating his recommendation
14 that the Commission promote this exodus from New York City (IR NYC-S
15 6b).
- 16 • In responding to discovery Mr. Arnett was unable to identify any PSC
17 order that established the policy objective of using rate design to encourage
18 customers to relocate between areas within a utility’s service territory (IR
19 NYC-S 5a). Similarly, Mr. Arnett cannot identify the amount of load that
20 *should* leave New York City for Westchester, or the amount that *would*

¹Mr. Arnett refers to all the services covered by the MSC (generation energy and capacity, some transmission services and ancillary services) as “commodity,” a term that would generally be applied only to energy.

²Given the tendency for businesses that have left the City to leave New York State entirely, this policy would be bad for both the City and the State, which earns substantial tax revenues from businesses located in New York City.

1 leave if his proposal were adopted (IR NYC-S 6). Yet he is sure that prices
2 in the City should be increased to drive some customers out.

3 **Q: What about Mr. Arnett’s assertion that locational marginal prices should**
4 **be used to influence “how much electricity [customers] consume?”**

5 A: As with relocation, Mr. Arnett states that some electric uses should be curtailed
6 in New York City and increased in Westchester, but cannot identify those uses
7 (IR NYC-S 5d). On discovery, Mr. Arnett claimed that the Commission
8 supported his position that locational price differentials should provide
9 consumers with different incentives to use electricity in different portions of a
10 single utility’s service territory:

11 The PSC, in Opinion 89-30, which established guidelines for Con Edison’s
12 supply and demand side bidding program, adopted a scoring system that
13 added points for bidders with in-City locations. A Westchester bidder
14 would not have received these points in the evaluation process. (IR NYC-S
15 5b)

16 Mr. Arnett’s reliance on this ruling is misplaced. It does not support the
17 notion that locational marginal pricing (“LMP,” also called location-based
18 marginal pricing, or LBMP) should be used to encourage different levels of
19 customer usage in different parts of a service territory. The supply and demand
20 procurement that Mr. Arnett cites has to do with the siting of generation and
21 load control, and the administrative review of energy efficiency projects.

22 So far as I am aware, LMP has been proposed and used to give appropriate
23 price signals to

- 24 • generation owners, regarding the dispatch of power plants,
- 25 • generation developers, regarding the citing of future generation,
- 26 • transmission developers (utilities or otherwise), regarding the increase in
27 transmission capability across constrained interfaces,

- 1 • dispatchable loads, regarding the timing of load curtailments in response
2 to very high energy prices.

3 The current, equitable method for allocating stranded costs across zones
4 of the Con Edison service territory (or the related methods used in the NYSEG
5 and NiMo territories) does not interfere with any of these mechanisms. I am not
6 aware of any case in which a regulatory agency suggested that LMP is a useful
7 guide for customer relocation, or to give consumers incentives for the general
8 reduction of energy use in one portion of a utility's territory and increase in
9 another portion.

10 **Q: Does Mr. Arnett hedge his recommendation?**

11 A: Yes. Mr. Arnett acknowledges that the current method for setting the MAC
12 “would lead to efficient consumption decisions...if the incremental costs to
13 deliver power [by which he means both distribution and stranded costs] to New
14 York City are lower than they are in Westchester by an amount that is equal to
15 the commodity [by which he means market-supply] cost differential” (Arnett
16 Direct, p. 4).

17 **Q: Does Mr. Arnett demonstrate that lower distribution and stranded costs
18 for New York City do not offset the difference in market supply costs
19 between New York City and Westchester?**

20 A: No. He simply assumes that there are no offsetting cost differences. Mr. Arnett
21 admits that he has not “done a study of the incremental delivery [i.e.,
22 distribution and stranded] costs for Westchester and for New York City” (Arnett
23 Direct, p. 7) and simply asserts that “a reasonable assumption, which parties are
24 free to rebut, is that they are equal” (Arnett Direct, p. 5). Contrary to the
25 Commission's desire that this proceeding determine “Whether a cost basis exists
26 for different delivery rates in the two areas” (Case 96-E-0897 and Case 00-E-

1 1208, Order Instituting Proceeding, July 20, 2000), Mr. Arnett simply assumes
2 the lack of a cost basis, without any analysis and contrary to all available
3 evidence.

4 **Q: Is Mr. Arnett's assumption reasonable?**

5 A: No. To begin with, casually assuming the absence of offsetting cost differences
6 would be unreasonable in any determination of this magnitude. In this case,
7 furthermore, there are two specific reasons for believing that Mr. Arnett's
8 assumption is wrong and that costs are lower for New York City than for
9 Westchester.

- 10 • New York City customers contribute much more per kWh of sales to the
11 reduction of stranded costs, so their allocation of stranded costs per kWh
12 should be lower than Westchester's.
- 13 • Mr. Arnett's own 1982 study, the most recent attempt to assign distribution
14 costs between Westchester and New York City, found that distribution
15 costs per unit of sales were lower in New York City, due to the lower load
16 factor and higher distribution investment and O&M costs in Westchester.
17 Thus, Mr. Arnett's basic assumption, that incremental distribution costs in
18 Westchester and New York City are equal, is not reasonable.

19 **Q: What is the practical effect of Mr. Arnett's disclaimer on his**
20 **recommendation?**

21 A: Given the magnitude of the impact of Mr. Arnett's recommendation, as well as
22 its departure from precedent, the Commission should order Con Edison to
23 perform a cost-of-service study for distribution services, and determine the
24 effect of load in each zone on stranded costs, prior to adopting Mr. Arnett's
25 recommendation.

1 **Q: How do events since September 11 affect the reasonableness of Mr. Arnett's**
2 **assumption that incremental distribution costs are equal across the zones**
3 **of Con Edison's service territory?**

4 A: Since the destruction of the World Trade Center, a large amount of commercial
5 load has left New York City, leaving office space empty and distribution
6 equipment underutilized. The incremental distribution cost of serving that load,
7 should it return to Manhattan, would likely be very small. The distribution
8 savings of further reducing load in New York City, and especially in lower
9 Manhattan, are likely to be very small, until the loss of load resulting from the
10 recession and the September 11 attacks has been reversed.

11 If additional load leaves New York City for Westchester, the additional
12 load would require reinforcements of the Westchester distribution system, at
13 much higher costs than the cost of keeping the load in New York City.

14 **Q: Did Mr. Arnett prepare an estimate of the savings in distribution costs from**
15 **further reducing loads in New York City and moving those loads to**
16 **Westchester?**

17 A: No. As I noted earlier, Mr. Arnett entirely ignored the effects of September 11
18 (IR NYC-S 6b). Moreover, he has no estimate of the effect of his proposal on

- 19 • load decreases from New York City (IR NYC-S 6)
- 20 • load increase in Westchester (IR NYC-S 7)
- 21 • distribution-cost savings (if any) in New York City (IR NYC-S)
- 22 • distribution-cost increases in Westchester (IR NYC-S 7a).

23 **Q: You demonstrated in your direct testimony how much more New York City**
24 **customers contribute to the reduction of stranded costs. Does anything in**
25 **Mr. Arnett's testimony contradict that analysis?**

1 A: No. Mr. Arnett does not attempt to demonstrate that New York City and West-
2 chester customers contribute equally to reducing stranded costs. He implicitly
3 assumes that “they are equal,” just as he assumes all other costs (other than the
4 market-supply costs) are equal.

5 Mr. Arnett’s failure to address this issue is curious, since he clearly
6 understands its importance. He acknowledges that “before it can be concluded
7 that equalized delivery rates are fair to ratepayers, it must be shown that these
8 costs are best recovered from customers without regard to their geographic
9 location” (Arnett Direct, p. 10). Despite testifying that the equality of delivery
10 costs “must be shown” before his recommendation can be adopted, he does not
11 even attempt to make any such showing.

12 **Q: Then what is Mr. Arnett’s justification for charging stranded costs equally**
13 **across geographic locations?**

14 A: His entire argument is contained in two sentences:

15 Stranded generation costs that now exist were caused by result of changes
16 in technology (efficient combined cycle plants compared to steam or
17 nuclear units) and legislative and regulatory initiatives (encouraging IPP
18 contracts using electricity price forecasts that have proven to be too high).
19 These are the types of costs that should be shared by all ratepayers. (Arnett
20 Direct, p. 10)

21 This limited explanation of the origin of stranded costs provides no basis
22 for equalized recovery of stranded costs across generation market zones. Indeed,
23 it ignores completely the definition of stranded costs, which is the difference
24 between the utility’s costs of generation *and the market price*. Mr. Arnett’s
25 support of equalized recovery of stranded costs thus ignores both the nature of
26 stranded costs and the following considerations:

27 • *The greater role of New York City customers in reducing the stranded*
28 *costs.* Mr. Arnett apparently understands that New York City customers

1 contribute more to reducing stranded costs than do Westchester customers.
2 His testimony recognizes that other parties would “argue that using
3 stranded costs to offset the MSC commodity cost differential is justified
4 by...the fact that New York City customers currently pay a higher
5 commodity costs,...are paying more towards supporting generation and,
6 therefore,...should pay less of the stranded costs” (Arnett Direct, p. 11).
7 Yet his testimony fails to address this differential in stranded costs, and
8 simply asserts that equal delivery costs are fair.

- 9 • *Differences in stranded costs are due more to locational differences in*
10 *market prices for energy and capacity, and less to the technological and*
11 *regulatory considerations Mr. Arnett invokes.* Mr. Arnett attributes the
12 stranded costs to steam plants (by which I assume he means the plants Con
13 Edison describes as “reheat”), but Con Edison’s divested plants in the City
14 had significant negative stranded costs, while its plants upstate had
15 roughly zero stranded costs. The IPP contracts in the City have zero or
16 negative stranded costs, while the upstate IPP contracts, negotiated under
17 the same regulatory initiatives, have large positive stranded costs. In each
18 case, it is the location of the plants, rather than their technology or
19 regulation, that determines stranded costs.
- 20 • *Con Edison would have little or no stranded costs if market prices were as*
21 *high upstate as in the City.* The stranded generation costs that now exist
22 were caused, in large part, by the low market prices that Westchester
23 enjoys but that are denied to New York City.
- 24 • *“Costs that should be shared by all ratepayers” need not necessarily be*
25 *equally shared by all ratepayers.* The PSC appears to have a consistent
26 policy of allocating stranded costs to equalize rates among classes for Con

1 Edison and the other utilities. The Staff agreed to such an allocation in the
2 recent NiMo-NGrid merger settlement.

3 • *The Staff and the PSC have not required that stranded costs actually “be*
4 *shared by all ratepayers.”* Some customer classes of various utilities are
5 allocated zero stranded costs. That provision is also included in the recent
6 NiMo-NGrid merger settlement.

7 In short, Mr. Arnett’s assertions regarding the origin of stranded costs do
8 not support his conclusion, and his conclusion does not support his recom-
9 mendation in this case. The Commission should reject Mr. Arnett’s recommend-
10 ation to discard the existing MAC methodology, since that proposal is based on
11 the unsupportable assumption that there are no delivery-cost differentials.

12 **Q: Does Mr. Arnett express any interest in estimating zonal differences in**
13 **stranded costs and distribution costs?**

14 A: No. Mr. Arnett indicates no such interest, and suggests that all other differences
15 between New York City costs and Westchester costs can be ignored if that
16 difference does not *exactly* match the NYC-Westchester difference in the MSC,
17 perhaps even on a monthly basis. He dismisses the relevance of any differences
18 in stranded costs and distribution costs: “since the differential in commodity
19 costs changes with diverse factors, such as fuel prices, the balance between
20 supply and demand, changes in transmission configurations, it would simply be
21 unbelievable that the differential in delivery costs would track the differential
22 in commodity costs over any length of time” (Arnett Direct, pp. 4–5).

23 **Q: Is Mr. Arnett’s difficulty in believing that “differential in delivery costs**
24 **would track the differential in commodity costs over any length of time”**
25 **reasonable?**

1 A: No. The tracking Mr. Arnett describes is not only believable, it is inevitable. As
2 I demonstrated in my direct testimony, New York City's share of stranded costs
3 goes down when New York City market prices (Mr. Arnett's "commodity"
4 costs) rise. Since stranded costs are part of Mr. Arnett's "delivery" costs, the
5 "delivery" differential would tend to move in the same direction as the
6 differential in market prices.³

7 As my direct testimony demonstrated, the reductions in stranded costs due
8 to the higher market prices in the City, as well as the additional benefits of the
9 upstate generation to Westchester customers, can both be tracked and updated
10 over time. If the Staff would prefer a more complicated MAC computation than
11 currently exists to "track" the "differential in delivery costs," the City is willing
12 to work with the Staff and Con Edison to develop such a tracking mechanism.
13 Such a mechanism might be appropriate once the inequities resulting from the
14 legacy of regulation (i.e., the lack of sufficient generation and transmission in
15 the City) are eliminated. The simpler method currently used is preferable on
16 simplicity and equity grounds, and currently produces about the same result as
17 a cost-based allocation. In any case, the Staff's lack of interest in developing a
18 method to track the effects of higher in-City market prices and excess upstate
19 generation on stranded costs justifies neither ignoring those effects nor
20 abandoning the current allocation of stranded costs through the MAC.

21 **Q: Your direct testimony also quoted the 1982 Staff study of the relative distri-**
22 **bution costs in the two zones. Does Mr. Arnett properly describe the results**
23 **of this study?**

³Similarly, the added benefit to Westchester of the excess upstate generation (and hence the share of the stranded costs for those plants appropriately allocated to Westchester) is greatest when the differential in market prices is greatest.

1 A: No. Mr. Arnett states that, in the 1982 study, “subtransmission, distribution and
2 customer costs were allocated to the geographic location they served. The study
3 showed no geographic cost differential because these elements showed none”
4 (Arnett Direct, p. 8). This is simply incorrect. In fact, the 1982 study found:

5 A significant reason for the differences in the indicated rate of return
6 between New York City and Westchester is the cost of the distribution
7 system per unit of electricity sold. Direct assignment of distribution plant
8 and expenses on the basis of the records kept by geographic location was
9 possible and resulted in approximately 86 percent of distribution costs
10 being charged to New York City and 14 percent to Westchester. Although
11 the underground system in New York City is expensive, the number of
12 kWhs delivered per dollar of investment is very high. This means that
13 expenses (relative to revenues) are less, thus indicating a higher rate of
14 return. Westchester, which is more suburban and rural in nature, has a low
15 population density. This increases the unit costs, and results in a lower
16 indicated rate of return. (“A Study of the Comparative Costs of Electric
17 Service in Westchester County and the City of New York,” Berak, F.,
18 Arnett, H., Nadel, J, New York Department of Public Service Power
19 Division, Case 28157, January 29, 1982, pp. 4–5)

20 More specific support for this conclusion is presented in the workpapers
21 to the 1982 study (provided in response to IR NYC-S 14). For example, the
22 workpapers indicate that Westchester provided 11.8% of Con Edison’s sales, but
23 contributed 12.6% of the transmission peak loads. Westchester’s lower load
24 factor resulted in transmission costs per kWh that were 7% higher for West-
25 chester than New York City. Similarly, the workpapers show that Westchester
26 was responsible for 11.8% of kWh sold but for 14.3% of distribution plant,
27 14.9% of services and meters, and 14.5% of distribution expenses. This
28 difference in distribution plant per kilowatt of load is even more important than
29 the difference in load factor; Westchester’s distribution plant per kWh was 18%
30 more than New York City’s.

1 **Q: What is Mr. Arnett’s defense for his misstatement of the results of his 1982**
2 **study?**

3 A: When asked to reconcile his claim that subtransmission, distribution, and
4 customer costs showed no geographic cost differential “with the study’s finding
5 that distribution investments per kilowatt-hour of sales is higher in Westchester
6 than in New York City,” Mr. Arnett replied,

7 I do not believe that the study reached that specific finding, but it is correct
8 that in the 1982 study the direct percentage assignment of distribution plant
9 to Westchester was greater than its share of kWh sales. However, the
10 bottom line of this 1982 analysis was that revenues received from
11 Westchester customers were adequate to cover the costs of serving them.
12 (IR NYC-S 15a)

13 As the Staff noted in 1982, distribution costs per unit of sales were
14 considerably higher in Westchester than in New York City. Since the Staff study
15 allocated generation and transmission costs proportionately to the two areas, the
16 difference in return must have been primarily due to the differences in
17 distribution plant. The differentials in return on distribution plant alone, had
18 rates been unbundled at that time, would probably have exceeded the study’s
19 zone of tolerance. When the very different distribution costs were averaged in
20 with the transmission and generation costs, Westchester’s total return was low,
21 but tolerable.

22 Mr. Arnett’s reluctance to accept the findings of his own study, and his
23 continuing attempts to confuse the distribution costs with total costs, is
24 perplexing.

25 **Q: What is the importance of Mr. Arnett’s misstatement of the results of the**
26 **1982 study for his efficiency conclusions?**

27 A: If distribution costs are not the same between New York City and Westchester,
28 Mr. Arnett’s “reasonable assumption”—that market prices are the only costs that

1 vary between zones—is false. His entire efficiency argument rests on that
2 assumption. As we have seen, he presents no evidence to support it and the
3 available evidence indicates that the assumption is incorrect for both distribution
4 costs and stranded costs.⁴

5 Indeed, Mr. Arnett states that “The nature of the two geographic areas and
6 the manner in which both areas are served by their distribution systems, have
7 not changed enough to invalidate this finding of the 1982 study” (IR NYC-S
8 16). Were we to apply that reasoning to the study’s *actual* finding that
9 Westchester was not covering its cost of distribution service, the Commission
10 would need to reduce distribution rates in New York City, and increase them in
11 Westchester, before any change could be implemented in the MAC allocations.

12 ***B. Staff’s Equity Argument***

13 **Q: How does Mr. Arnett frame his approach to assessing the fairness of his**
14 **recommendation?**

15 A: Mr. Arnett defines fairness in terms of embedded costs: “a comparison of the
16 recommended rates with the allocation of embedded costs would be an
17 appropriate test of the fairness of my recommendation.... Another approach to
18 fairness would look at the allocated embedded costs that comprise the actual
19 revenue requirement that customers must pay and determine if they are being
20 fairly reflected in rates. As I will explain, my recommendation meets this test
21 as well” (Arnett Direct, pp. 6, 6–7).

⁴Mr. Arnett notes that it is “possible that the incremental delivery costs are different than the revenue requirement for delivery service,” but the incremental Westchester–NYC differentials may be either greater or smaller than the embedded differences.

1 **Q: How does Mr. Arnett demonstrate that that his recommendation results in**
2 **“allocated embedded costs...being fairly reflected in rates”?**

3 A: Mr. Arnett seems to be addressing two issues: total embedded costs and stranded
4 costs. He starts by admitting that he has not performed an embedded-cost
5 allocation. Instead, he points to the 1982 study and, as I explain above, misstates
6 the conclusions of the study. The 1982 study found that distribution costs were
7 significantly lower in New York City than in Westchester. So his first argument,
8 that the available evidence supports the idea that embedded distribution costs
9 are equal, is incorrect.

10 In fact, the 1982 study found that *total* costs were roughly equal across
11 Con Edison’s service territory, and perhaps somewhat lower in New York City
12 than in Westchester. So the embedded-cost fairness argument supports the
13 current treatment of stranded costs, rather than Mr. Arnett’s radical departure
14 from standard practice.

15 **Q: How is the current treatment of stranded costs consistent with standard**
16 **practice?**

17 A: The Commission’s standard practice in recovery of stranded costs can be
18 summarized as follows:

- 19 • The embedded generation cost (the generation revenue requirement) in
20 each class’s rates is identified.
- 21 • The market cost of power is determined for each class.
- 22 • The difference between the embedded generation cost and the market cost
23 of power is the class’s contribution to stranded-cost recovery.

24 Where the assessed market cost of power varies within a class (e.g., the various
25 zones of Con Edison, NiMo, and NYSEG), step 3 is conducted for each group
26 within the class.

1 These steps are employed at various frequencies—monthly (as in the
2 NYSEG rates, where monthly zonal market energy prices are simply subtracted
3 from the total rate to determine the rate for delivery customers), semi-annually
4 (as in the Con Edison MAC), or for multiple years (as in the NiMo computation
5 of CTCs)—but they are conceptually the same. This netting approach has been
6 used for allocating stranded costs for at least five New York utilities: Con
7 Edison, NYSEG, NiMo, CHG&E and RG&E.⁵

8 **Q: How does Mr. Arnett recommend allocating stranded costs?**

9 A: Mr. Arnett says, “my recommendation is that any difference between incre-
10 mental delivery costs and revenue requirement, whether it is positive or
11 negative, should best be recovered on an across-the-board basis” (Arnett Direct,
12 p. 5). Since the stranded costs either do not vary incrementally with consump-
13 tion (e.g., losses on sold generation, NUG buy-out charges) or decrease with
14 consumption (the above-market costs of operating NUGs and retained genera-
15 tion), stranded costs are part of Mr. Arnett’s “difference between incremental
16 delivery costs and revenue requirement.”⁶

17 **Q: Are you aware of any situation in which the PSC has ordered recovery of**
18 **stranded costs “on an across-the-board basis”?**

19 A: No. The recovery of stranded costs varies widely among classes within each
20 utility, with some paying zero stranded costs, and others paying substantial
21 amounts.

⁵Orange and Rockland also had CTCs that varied by class, so it is clear that the PSC did not adopt in those cases Mr. Arnett’s approach in this case.

⁶Recall that he considers stranded generation costs to be a component of delivery costs, even though they have nothing to do with delivery.

1 Also, for all three utilities with service territories that span multiple NY-
2 ISO zones with substantially different costs—Con Edison, NYSEG, and
3 NiMo—the recovery of stranded costs varies between zones.⁷

4 **Q: Has the Staff supported the stranded-cost allocation that Mr. Arnett is**
5 **sponsoring in this proceeding?**

6 A: No. Mr. Arnett himself testified in favor of the netting procedure in Case No.
7 96-E-0897 (Staff Panel Direct Testimony, p. 60) in March 1997. The Staff
8 signed a settlement in October that would preserve different CTCs for each
9 class, for each of three NiMo zones, and for different levels of monthly usage,
10 for terms of ten years. Mr. Arnett describes that settlement as follows:

11 The Joint Proposal in the NiMo-NGrid merger case continues the regional
12 differentials for the majority of NMPC service classifications. The Joint
13 Proposal does not provide a schedule for phasing-out the regional
14 Competitive Transition Charge (CTC) differentials. (IR NYC-S 4)

15 **Q: Does Mr. Arnett propose a phase-out schedule for the NYSEG and NiMo**
16 **differentials?**

⁷Mr. Arnett cites as the sole precedent for his approach the “revised straw proposal in the Standby Rates Proceeding, Case 99-E-1470.” He is apparently referring to the guideline (proposed in Appendix A (p. 2) to the October 26 2001 Opinion and Order in that case) that “The contribution to stranded costs by Standby Delivery Service customers should be established through a uniform percentage mark-up of the applicable rate components established for Standby Service such that standby customers contribute to stranded cost recovery in the same proportion of their delivery rates as customers in the otherwise applicable service classification.” This provision deals with a very different issue than the one in this case. Mr. Arnett does not provide any cite for the use of his “across the board” allocation of stranded costs for firm, full-requirements distribution customers.

1 A: No. Mr. Arnett admits that “The Commission has not established a phase out
2 schedule for either of these utilities,” and he has no proposal for such a phase-
3 out (IR NYC-S 3).⁸

4 **Q: Would it be equitable to apply the across-the-board recovery of stranded
5 costs in the Con Edison service territory only?**

6 A: No. Stranded costs are allocated by netting out market prices from the total
7 generation costs embedded in a rate for nearly all New York utilities, rate classi-
8 fications, and NY-ISO zones. It would be grossly inequitable to change that rule
9 just for the purpose of averaging stranded costs across the Con Edison zones.

10 In particular, part of Westchester is in NYSEG’s service territory and pays
11 delivery rates that are lower than in NYSEG’s districts in the western half of
12 New York State. Westchester thus benefits (as it should) from rate equalization
13 with the lower-cost NYSEG districts. Not surprisingly, Westchester has not
14 advocated equalizing delivery rates for NYSEG’s districts. It would be par-
15 ticularly unfair to allow one part of Westchester to benefit from the higher
16 market prices (and lower stranded costs) in New York City, while another part
17 of Westchester continues to benefit from the equalization of rates with western
18 New York State.

19 **Q: Does Mr. Arnett offer any rationale for the inconsistent positions of the
20 Staff with respect to the treatment of zonal cost differences?**

⁸Mr. Arnett asserts that NiMo’s “CTCs are expected to expire at the end of the ten-year Rate Plan Period.” (IR NYC-S 4) This is not correct. The Joint Proposal provides that NiMo’s recovery of stranded costs from its own generation will end by the end of the Rate Plan, but it also provides for continuing collection of stranded costs from NUGs, including unamortized costs of buying-down or buying-out contracts.

1 A: Mr. Arnett offers the following three justifications for his inconsistent positions
2 in Con Edison, as compared to NYSEG and NiMo (IR NYC-S 3b):

- 3 • “Equalizing delivery rates is not a current issue in either the NMPC or
4 NYSEG case.” The fact that consumers in the NiMo and NYSEG service
5 territories accept the equity of Commission precedent is hardly a justifi-
6 cation for reversing that precedent in Con Edison’s territory. Mr. Arnett
7 seems to suggest that Westchester County’s protest justifies abandoning
8 the principle of equal total rates in three years in Con Edison, while
9 locking that principle in for the next ten years in NiMo.
- 10 • “The differential cost for NMPC and NYSEG is not as large as it is for
11 Con Edison. For NMPC and NYSEG the differential cost is around 0.5
12 cents per kWh versus as much as 2.0 cents per kWh for Con Edison.” This
13 is a peculiar rationalization for a major policy change. Mr. Arnett is
14 proposing to undo the restructuring bargain in the Con Edison service
15 territory, where it has a large effect, rather than in the NYSEG and NMPC
16 territories, where it would be much less dramatic a reversal. He does not
17 explain why he proposes to implement his change only where it would be
18 most disruptive.
- 19 • “In addition, there are differences in load distribution for these three
20 utilities across the zones, which impacts how customers would be affected
21 by levelized delivery rates. Con Edison has an 88/12 split between its high
22 and low cost zones, NMPC has a 1/3 split for each high, middle and low
23 cost zones, and NYSEG has most of its load in the middle cost zone, with
24 only 15% in its higher cost zone.” This rationale is puzzling, as well. Mr.
25 Arnett seems to be taking the position that whatever benefits the smaller
26 portion of a service territory is to be preferred.

1 None of Mr. Arnett’s rationales for his inconsistency in applying his ad
2 hoc allocation principles is valid.

3 **Q: Suppose that Westchester’s 1982 petition to establish different rates in**
4 **Westchester and New York City had succeeded. How would those rates**
5 **have been unbundled in 1997, and what would be the current allocation of**
6 **stranded costs?**

7 A: Assuming that Con Edison had established separate rate classifications for
8 Westchester and New York City (perhaps SC 1W and SC 1N for residentials),
9 Con Edison would have set the MAC for each of those classification just as it
10 now sets the MAC for each classification: the total generation costs allocated
11 to the classification, minus the market supply cost for that classification.⁹

12 Alternatively, the Commission could have responded to Westchester’s
13 1982 petition by reorganizing Con Edison into two utilities (perhaps called NYC
14 Power and Westchester Power). In that case, under restructuring, the stranded
15 costs allocated to each rate class would be determined by its allocated share of
16 its utility’s generation costs, net of market prices.

17 In either case, New York City ratepayers would receive the full benefit of
18 the reduction in stranded costs that results from the high market prices in the
19 City.

20 **Q: Are there other equity-related problems with the Staff position?**

21 A: Yes. Mr. Arnett’s proposal would

⁹The starting distribution costs would likely have been lower in New York City than in Westchester, as suggested in the 1982 study; generation might have been higher, lower, or the same, depending on the allocation decisions made over the intervening 15 years.

- 1 • provide Westchester with a windfall from Con Edison’s historical decisions
2 regarding generation and transmission, without expecting Westchester to
3 pay for the benefits it receives.¹⁰
- 4 • fail to preserve the rate reductions promised to all customers in Con
5 Edison’s restructuring.
- 6 • inconsistently mixes competitive and regulatory perspectives.
- 7 I discuss each of these problems in turn.

8 **Q: How would Mr. Arnett’s proposal mismatch benefits and charges to**
9 **Westchester?**

10 A: Under Mr. Arnett’s proposal, Westchester would benefit from Con Edison’s
11 decision to build so much of its capacity outside of the City, and from the failure
12 to build enough transmission to bring that power into the City. If Con Edison
13 had built more capacity in the City, or more transmission capacity into the City,
14 Westchester’s market prices would be higher today. Since Westchester receives
15 the benefits of those decisions, it should pay more of the stranded costs of the
16 upstate generation.¹¹

17 Indeed, Mr. Arnett himself testified in the early 1980s that transmission to
18 New York City should be increased to eliminate the in-City capacity require-

¹⁰In contrast to Westchester County’s portrayal of its concern to minimize Con Edison’s power-supply costs by opposing the Sithe contract, the Panel concedes that Westchester County has not done anything to promote construction of transmission to New York City (IR NYC-W25).

¹¹Mr. Arnett’s proposal would also strengthen Westchester’s incentives to impede expansion of electric transmission to New York City and generation in the City, such as by opposing construction of gas transmission lines. Anything Westchester could do to increase New York City’s market prices would reduce Westchester’s MAC allocation. As Mr. Arnett acknowledges, if “market prices in New York City rose, reducing stranded costs” his approach “would allocate reduced stranded costs to both Westchester and NYC.” (IR NYC-S 21)

1 ment (Testimony in Case 27353, Phase II, pp. 8–9 (provided in response to
2 OCER-S 2)). If Con Ed had maintained that transmission standard, there would
3 be no in-City load pocket, except under thunderstorm watch circumstances, and
4 virtually no difference between New York City and Westchester market prices.
5 Under regulation, Con Edison underbuilt the in-City generation system and
6 transmission to the City, at least by the standards of the competitive market. Mr.
7 Arnett would assign all the costs of those decisions to New York City
8 customers, and share the associated benefits of reduced stranded costs with
9 Westchester, which bears none of the costs.

10 **Q: How does Mr. Arnett’s proposal fail to preserve the rate reductions?**

11 A: Mr. Arnett testified in March 1997 that Con Edison’s restructuring was to ensure
12 that “all classes of customers will receive reductions in rates” (Arnett Direct in
13 Case 96-E-0897, p. 4 (provided in response to OCER-S 2)). The existing
14 treatment of stranded costs maximizes the probability of maintaining those
15 reductions for all customers; Mr. Arnett’s proposal would not.

16 Staff witness Van Cook explains that

17 Prior to the NYISO becoming operational, Full Service Customers in New
18 York City and Westchester paid the same rates. If the Commission had
19 established equalized delivery rates for New York City and Westchester, a
20 shift in cost responsibility from Westchester to New York City would have
21 occurred, negatively impacting customers in New York City. (Van Cook
22 Direct, p. 7)

23 Neither he nor Mr. Arnett explains how implementing equalized stranded
24 costs today would avoid negative impacts for New York City any better than in
25 1997. In the aftermath of the destruction of the World Trade Center,
26 implementation of Mr. Arnett’s proposal would be even more devastating to
27 New York City.

1 **Q: Does Mr. Arnett properly and consistently apply competitive and**
2 **regulatory perspectives to this issue?**

3 A: No. Mr. Arnett mixes and matches competitive-market concepts with regulatory
4 concepts. Mr. Arnett acknowledges that the power markets in New York State
5 and New York City are not workably competitive, and that he does not “have
6 an estimate of when the market would be workably competitive” (IR NYC-S 1
7 and 2).

8 As Mr. Arnett testified in 1997, “Today’s Con Edison system has evolved
9 as an integrated system to *minimize costs within the franchise area*. Any
10 assignments of specific items of generation or transmission plant between
11 Westchester and New York City would have to be arbitrary” (Staff Rebuttal
12 Testimony in Case 96-E-0897, April 1997, pp. 4–5). His testimony in the
13 current proceeding reverses that position, abandoning the integrated-system
14 approach and assigning different generation costs to Westchester and New York
15 City. Mr. Arnett abandons his position from Case 96-E-0897, even though he
16 acknowledges that the New York electricity market is not yet workably com-
17 petitive.

18 **III. The County of Westchester Panel**

19 **Q: Does the direct testimony of the Westchester Panel contribute significantly**
20 **to the substantive issues in this case?**

21 A: No. The Panel’s testimony consists largely of a mix of unfounded speculation
22 about past motivations, future costs and market conditions, combined with and
23 inconsistent data, and repeated demonstrations of the fact (accepted by all
24 parties) that Westchester customers pay more towards stranded costs than their

1 contribution to Con Edison's sales. The Panel does not address the basic cost
2 issues in this proceeding.¹²

3 The Panel blames New York City for all manner of problems, including
4 Con Edison's decisions to site generation upstate, Con Edison's decision to sign
5 the Sithe contract, and the lack of additional transmission capacity through
6 Westchester to New York City.¹³ The Panel's hostility to New York City is hard
7 to reconcile with the fact that 106,400 Westchester residents worked in New
8 York City, earning \$19.5 billion dollars.¹⁴

9 **Q: How does the Panel engage in unfounded speculation about past**
10 **motivations?**

11 A: For example, the Panel asserts that "Con Edison has stated, and the Commission
12 has accepted that, the reason for instituting and perpetuating the
13 disproportionate MAC is to insure a small (2.75%) decrease in City rates by
14 instituting a large (18%) increase in Westchester rates" (Panel Direct, p. 29). On
15 discovery, the Panel points to the entire record in Case No. 96-E-0897 as
16 support for this assertion, without identifying any specific statements of Con
17 Edison or the Commission (IR NYC-W 36). In reading the Commission's order
18 in that proceeding, I see a concern with avoiding the shifting of costs and

¹²While the Staff provided no substantive evidence on the cost issues, at least the Staff stated its assumptions and provided some rationale for those assumptions. The Westchester Panel fails to do even that much.

¹³This hostility extends to the steam system, which the Panel treats as a burden on Westchester, without having any estimate of the effect of the steam system in reducing market prices for electricity or having the information necessary to estimate the effect of the steam system in reducing Con Edison's transmission-and-distribution costs (IR NYC-W 37).

¹⁴These values are from 1998, the last year for which the NYC Department of Finance has compiled the data.

1 assuring that the benefits of restructuring are fairly distributed among
2 customers, rather than an intention to increase Westchester rates.

3 Similarly, the Panel speculates that New York City might have supported
4 Con Edison's contract with Sithe based on "the City's belief that the plant would
5 diminish the amount of energy required to be generated in the City and hence
6 slightly improve air quality in the City" (Panel Direct, p. 35). The Panel pro-
7 vides no evidence for this speculation, and no evidence that the City supported
8 the Sithe contract. In any case, the City's suggested motivation is implausible,
9 since development of in-City NUGs (such as East Coast Generation and NUGs
10 at the Brooklyn Navy Yard and Kennedy International) would reduce pollution
11 much more than Sithe would, while (in most cases) providing the City with
12 some property-tax revenues. Upstate generation under contract to Con Edison
13 would not have improved New York City's air quality more than any other
14 upstate generation.¹⁵

15 **Q: How does the Panel engage in unfounded speculation about future costs and**
16 **market conditions?**

17 A: The following are a few examples:

- 18 • The Panel asserts, "It is difficult and expensive to construct power facilities
19 in the City. As a result, Con Edison's electric power rates historically have
20 been the highest in the nation" (Panel Direct, p. 7). Yet the Panel is unable
21 to provide any support for this claim, or any comparisons of the costs of
22 NUG or Con Edison generation within and outside New York City (IR

¹⁵Without support, the Panel treats the Sithe plant as a burden on Westchester imposed, in part, by some plan of New York City, but does not know how much higher market prices would be for Westchester customers if the Sithe plant had not been built (IR NYC-W 35).

1 NYC-W 7). Surprisingly, the Panel denies having relied on any such cost
2 comparisons in reaching this conclusion (IR NYC-W 7a and 7c).

3 Indeed, the Panel's claim is directly contradicted by the facts. Since
4 deregulation created an economic incentive to construct generation in the
5 City, proposals to construct 5,145MW of generation in the City have been
6 filed with the Electric Generation Siting Board.

- 7 • The Panel asserts that the NY-ISO's in-City capacity rule requirements
8 constitute a "floor" for capacity payments (Panel Direct, p. 10), but has no
9 supporting analyses or workpapers (IR NYC-W 10).
- 10 • Panel witnesses "expect a significant differential [in market prices between
11 New York City and Westchester] to be a persistent condition" (Panel
12 Direct, p. 10), yet they have no projections of capacity additions and
13 retirements in New York City and upstate, or of load growth in New York
14 City and upstate, or of projections of transmission additions connecting
15 New York City to PJM, New England, and Canada (IR NYC-W 5).¹⁶
- 16 • The Panel suggests that the current MAC mechanism prevents locational
17 marginal costs from giving proper price signals to potential suppliers,
18 discouraging building in New York City (Panel Direct, p. 11). On dis-
19 covery, the Panel both agrees and disagrees that the LBMP provides proper
20 signals to suppliers: "the MAC has impeded the LBMP from operating
21 properly because customers in the City and in Westchester are not

¹⁶In the same response, the Panel notes that "there have been no material increases in transmission capacity for at least 25 years, during which period loads grew substantially, most of the new generation being ex-City." This seems to be a hint that the Panel does not expect additional transmission to be built. In response to questions about Westchester's lack of support for new transmission, the Panel suggests that lots of new submarine transmission will be built, and there is no need to ask about transmission through Westchester.

1 receiving accurate price signals as to the actual marginal cost of providing
2 them with electricity. It is not our position that the LBMP does not provide
3 accurate price signals to suppliers. The cost differentials between
4 Westchester rates and City rates provide incorrect signals to customers
5 which, in the long run, induces suppliers to site plants out of the City” (IR
6 NYC-W 12). This statement is dead wrong. The allocation of the MAC to
7 retail customers has no effect on the wholesale-price incentives for
8 suppliers to build in the City.¹⁷ In any case, the Panel is unable to “provide
9 any analyses or workpapers which support this conclusion”—whatever it
10 is (ibid.).

11 **Q: How does the Panel use inconsistent data?**

12 A: The Panel asserts that Westchester represents 12% of Con Edison sales, and
13 compares that 12% value with the fraction of stranded costs recovered from
14 Westchester, even though the Panel’s own Exhibit B-R 7 shows 14.3% of Con
15 Edison’s sales being to Westchester.

16 **Q: Are the hypotheticals offered by the Panel useful?**

17 A: The Panel presents hypothetical computations for situations in which stranded
18 costs go to zero, and in which the MAC in New York City is persistently
19 negative. If those extreme situations constitute Westchester’s concern, it should
20 have proposed specific amendments to the current MAC allocation rules to deal
21 with them. The Commission, in applying its standard method of allocating
22 stranded costs, has sometimes set the stranded-cost component of rates

¹⁷If anything, lower prices in the City would stimulate demand in the City, encouraging development of more in-City generation.

1 (generally set for years at a time) so that it would not go negative for any
2 extended period of time.¹⁸

3 **Q: Does this conclude your rebuttal testimony?**

4 A: Yes.

¹⁸The MAC could go negative for a month or even all summer, but be positive for the year, since the monthly allocation of costs does not follow value: NUG charges are roughly equal between months, while market prices, especially for energy, tend to be much higher values in the summer.