

BEFORE THE
NEW YORK STATE
PUBLIC SERVICE COMMISSION

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Proceeding on Motion of the Commission as to the
Rates, Charges, Rules and Regulations of
Rochester Gas and Electric Corporation
for Electric Service

Case 09-E- _____

Proceeding on Motion of the Commission as to the
Rates, Charges, Rules and Regulations of
Rochester Gas and Electric Corporation
for Gas Service

Case 09-G- _____

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**DIRECT TESTIMONY OF THE
EMBEDDED COST OF SERVICE PANEL**

**Susan Morien
Carolyn A. Sweeney
Paul M. Normand**

September 17, 2009

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1 Q. Please state the names of the members on this Embedded Cost of Service
2 ("ECOS") Panel.

3 A. We are Susan Morien, Carolyn A. Sweeney and Paul M. Normand.

4 Q. Ms. Morien, please state your current position and business address.

5 A. I am a Lead Analyst in the Rates and Regulatory Economics Department for
6 Rochester Gas and Electric Corporation ("RG&E" or the "Company"). My
7 business address is RG&E, 89 East Avenue, Rochester, New York 14649.

8 Q. Please summarize your educational background and work experience.

9 A. I received a Bachelor of Science degree from Rochester Institute of Technology in
10 Business Administration in 1982. In the same year, I was employed by RG&E on
11 a full time basis in the Corporate Accounting Department. In 1988, I joined the
12 Corporate Tax Department of RG&E and worked there until 1996, when I joined
13 the Regulatory Affairs Department. My current responsibilities involve pricing,
14 which includes the development and preparation of the Company's ECOS and
15 marginal cost of service ("MCOS") studies, revenue allocation, rate design and
16 tariff analysis, and participation in regulatory proceedings involving pricing
17 issues.

18 Q. Have you previously testified in other proceedings before the New York State
19 Public Service Commission (the "PSC" or the "Commission") or any other state
20 or federal regulatory agency or court?

21 A. I was a member of the Cost of Service and Rate Design Panel for RG&E in Case
22 03-E-0765. I was also a panel member for RG&E in Case 00-M-0504.

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1 Q. Ms. Sweeney, please state your current position and business address.

2 A. I am a Lead Analyst in the Rates and Regulatory Economics Department for
3 RG&E. My business address is RG&E, 89 East Avenue, Rochester, New York
4 14649.

5 Q. Please summarize your educational background and work experience.

6 A. I received a Bachelor of Science degree in Business Administration from
7 LeMoyne College in Syracuse, New York in May of 1984, and a Masters of
8 Business Administration from Chapman University in Orange, California in May
9 of 1997. From October of 1991 through June of 1997, I worked as an Analyst in
10 the Gas Rates Department of Niagara Mohawk Power Corporation ("Niagara
11 Mohawk"). My work experience at Niagara Mohawk included the preparation
12 and analysis of both historic and pro forma ECOS studies, monthly gas margin
13 analysis and monthly and annual reconciliation of purchased gas costs incurred to
14 revenue recovered. Since September of 1997, I have been employed by RG&E as
15 both a contractor and an employee in the Regulatory Economics Department. My
16 current responsibilities involve a wide range of duties including participating in
17 and monitoring regulatory proceedings outside the rate case process, performing
18 and assisting with both embedded and marginal gas cost of service studies, rate
19 design and other pricing issues.

20 Q. Have you previously testified in other proceedings before the Commission or any
21 other state or federal regulatory agency or court?

22 A. I have provided expert testimony individually and on panels regarding the results
23 of gas ECOS studies, avoided cost studies and gas rate design while employed at

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1 Niagara Mohawk and at RG&E. Most recently, I was also on the Cost of Service
2 Panel in Case 05-E-1222 for New York State Electric and Gas Corporation
3 ("NYSEG").

4 Q. Mr. Normand, please state your current position and business address.

5 A. I am a management consultant and President of Management Applications
6 Consulting, Inc. ("MAC") located at 1103 Rocky Drive, Suite 201, Reading,
7 Pennsylvania 19609.

8 Q. Please summarize your educational background and work experience.

9 A. I graduated from Northeastern University in 1975, with a Bachelor of Science
10 degree and a Master of Science degree in Electrical Engineering-Power System
11 Analysis. I was employed by the Massachusetts Electric Company in the
12 Distribution Engineering Department while attending Northeastern University.
13 My principal areas of assignment included new service, voltage conversions, and
14 system planning. Upon graduation from Northeastern University, I joined
15 Westinghouse Electric Corporation Nuclear Division in Pittsburgh, Pennsylvania.
16 In that position, I assisted in the procurement and economic analysis of
17 electrical/electronic control equipment for the nuclear reactor system. In 1976, I
18 joined Gilbert Associates as an Engineer providing consulting services in the rate
19 and regulatory area to utility companies. I was promoted to Senior Engineer in
20 1977, Manager of the Austin office 1980, and Director of Rate Regulatory Service
21 in 1981. In June 1983, I left Gilbert to form a separate consulting firm and I am
22 now a Principal and President of Management Applications Consulting, Inc. My
23 principal areas of concentration have been in loss studies, economic analyses, and

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1 pricing. I have performed numerous accounting and MCOS studies, time
2 differentiated bundled and fully unbundled cost studies for both electric and gas
3 utilities since 1980. I have also used such studies in the design and presentation
4 of detailed rate proposals before regulatory agencies.

5 Q. Have you previously testified in other proceedings before the Commission or any
6 other state or federal regulatory agency or court?

7 A. Yes, I have testified before the following regulatory agencies: the Maine Public
8 Utility Commission; the Public Utility Commission of Texas; the Delaware Public
9 Service Commission; Illinois Commerce Commission; New Hampshire Public
10 Utilities Commission; New Jersey Board of Public Utilities; Pennsylvania Public
11 Utility Commission; the Massachusetts Department of Public Utilities; the
12 Kentucky Public Service Commission; the Arkansas Public Service Commission;
13 the Public Service Commission of Louisiana; the Public Utilities Commission of
14 Ohio; the Public Service Commission of Missouri; the Federal Energy Regulatory
15 Commission ("FERC"); and the Commission, including Cases 01-G-1668 and
16 05-E-1222.

17 Q. What is the overall purpose of the Panel's testimony?

18 A. The overall purpose of our testimony is to present the results of the electric and
19 gas ECOS studies and to provide support for the Company's revenue allocation
20 and rate design proposals. We also present support for the Company's proposed
21 rates for competitive services.

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1 Q. Please describe the format of the Panel's testimony.

2 A. First, we will provide an overview of the electric and gas ECOS studies. Second,
3 the Panel will discuss the functions included in the ECOS studies and the
4 methodologies used to functionalize costs. Third, the Panel will address the
5 allocation of costs to service classifications and the resulting rates of return by
6 class for both electric and gas. Fourth, the Panel will describe the development of
7 rates for competitive services based upon the functionalized cost of service
8 analysis. Finally, the Panel will address the Company's proposal for reconciling
9 revenues related to competitive services.

10 Q. Is this Panel sponsoring any exhibits?

11 A. Yes. The following exhibits support our testimony:

- 12 • Exhibit __ (RGEECOS-1) (list and description of electric service
13 classifications);
- 14 • Exhibit __ (RGEECOS-2) (list and description of the gas service
15 classifications);
- 16 • Exhibit __ (RGEECOS-3) (electric ECOS study summary of results and
17 indexed rates of return by service class);
- 18 • Exhibit __ (RGEECOS-4) (gas ECOS study summary of results and
19 indexed rates of return by service class);
- 20 • Exhibit __ (RGEECOS-5) (classification summary of the Demand, Energy
21 and Customer components at the "claimed" rate of return for the electric
22 study);
- 23 • Exhibit __ (RGEECOS-6) (classification summary of the Capacity,
24 Commodity and Customer components at the "claimed" rate of return for
25 the gas study);
- 26 • Exhibit __ (RGEECOS-7) (listing of all the major accounts in the electric
27 ECOS study by service class);

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- 1 • Exhibit __ (RGEECOS-8) (listing of all the major accounts in the gas
2 ECOS study by service class);
- 3 • Exhibit __ (RGEECOS-9) (electric ECOS study summary of results by
4 Function);
- 5 • Exhibit __ (RGEECOS-10) (gas ECOS study summary of results by
6 Function);
- 7 • Exhibit __ (RGEECOS-11) (listing of major accounts in the electric ECOS
8 study and how they are allocated to each function);
- 9 • Exhibit __ (RGEECOS-12) (listing of major accounts in the gas ECOS
10 study and how they are allocated to each function);
- 11 • Exhibit __ (RGEECOS-13) (explanation of electric and gas Allocation
12 Factors used in the ECOS study);
- 13 • Exhibit __ (RGEECOS-14) (electric and gas ECOS study customer care
14 analysis);
- 15 • Exhibit __ (RGEECOS-15) (analysis for FERC Accounts 907 – 917 for
16 both electric and gas);
- 17 • Exhibit __ (RGEECOS-16) (report of electric competitive energy
18 services);
- 19 • Exhibit __ (RGEECOS-17) (energy trading department analysis for
20 electric and gas);
- 21 • Exhibit __ (RGEECOS-18) (determination of gas reliability costs);
- 22 • Exhibit __ (RGEECOS-19) (calculation of the electric Merchant Function
23 Charge);
- 24 • Exhibit __ (RGEECOS-20) (calculation of the gas Merchant Function
25 Charge);
- 26 • Exhibit __ (RGEECOS-21) (calculation of the combined Bill Issuance and
27 Payment Processing ("BIPP") charge);
- 28 • Exhibit __ (RGEECOS-22) (calculation of the electric competitive meter
29 rates); and
- 30 • Exhibit __ (RGEECOS-23) (index of workpapers). A copy of the Panel's
31 workpapers was provided to Department of Public Service Staff.

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OVERVIEW OF EMBEDDED COST OF SERVICE STUDIES

- Q. What is the purpose of the ECOS study?
- A. The cost to serve customers of any utility company generally consists of operating expenses and return. For the historical test period, these costs are contained in the books and records of the Company and are readily available to establish the overall cost to serve the collective body of customers of the utility. The cost to provide service related to individual functions and to individual service classes can vary greatly based on the facilities used to provide service and the level of demand placed on the system. These costs, however, are not all readily available from a company's accounting system.

Historically, the ECOS study was developed to assign or allocate each relevant component of cost on an appropriate basis to service classifications to determine the cost to serve the respective classes. ECOS studies traditionally have been used as a guide in revenue allocation and rate design to provide a measure of the relationship between the revenues supplied by each service class and the cost of plant and expenses imposed on a utility's system by the customers in those classes. These studies enable a company to calculate a rate of return for each service class so that comparisons can be made between each class of service and the total system return. The Revenue Allocation and Rate Design Panel discusses how the Company used the results of the ECOS studies as a guide in establishing the proposed delivery service class revenue requirements for electric and gas service.

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1 With the advent of rate unbundling in New York, the ECOS study now
2 serves an additional purpose. As explained below, functionalization has always
3 been the first step in the cost of service process. This part of the process produces
4 a logical breakdown of costs that facilitates classification of costs into major
5 categories of Customer, Demand and Energy-related components prior to the full
6 allocation of costs to the various service classes. With unbundling, the
7 functionalization step takes on heightened importance because the embedded
8 costs of each functional service will provide the basis for developing unbundled
9 rates for the Commission-designated competitive services (e.g., Supply
10 Procurement (also referred to as the "Merchant Function Charge" or "MFC"),
11 BIPP, and Competitive Metering).

12 Q. Please provide an overview of the process for conducting an ECOS study.

13 A. The ECOS study process is essentially comprised of the following three steps:
14 1) functionalization; 2) classification; and 3) allocation.

15 Q. What is the first step in the cost of service process?

16 A. Starting with a historical revenue requirement, investments and expenses are
17 separated by the functional service categories that they support. In this case, for
18 both electric and gas, we started with the twelve-month period ended December
19 31, 2008 sponsored by the Revenue Requirements Panel. For the electric study,
20 the historic data is a delivery-only revenue requirement. For the gas study, the
21 historic data includes delivery and commodity supply revenues because the
22 Company only has a combined gas income statement. The functionalization step
23 involves the assignment of the dollars in each FERC account to a specific

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1 function. For both the electric and gas ECOS studies, the Company assigned
2 costs to functions consistent with the June 9, 2006 Recommended Decision
3 ("RD") in Case 05-E-1222, as adopted by the Commission in its August 23, 2006
4 Order Adopting Recommended Decision with Modifications ("August 23, 2006
5 Order"). The studies are also consistent with the Statement of Policy on
6 Unbundling and Order Directing Tariff Filings (the "Unbundling Statement of
7 Policy and Order"), issued August 25, 2004 by the Commission in Case 00-M-
8 0504 (the "End State Proceeding – Unbundling Track") and the Order Directing
9 Filing of Embedded Cost Studies, issued by the Commission on November 9,
10 2001 in the End State Proceeding – Unbundling Track ("November 9, 2001
11 Order"). A separate function has not been identified for Competitive Energy
12 Services. Transmission and Distribution are combined into one Delivery function
13 for both the gas and electric studies. The electric Delivery function includes the
14 fixed costs associated with Company-owned production assets. Commodity
15 supply and contract storage costs are also combined for the gas study.

16 The assignment of account dollars is either made directly to a function
17 ("direct assignment") or on the basis of some pattern or group of related accounts
18 ("indirect allocation" or "allocation"). For instance, the Uniform System of
19 Accounts ("USoA") identifies certain plant costs and expenses as electric
20 transmission-related. Including these accounts in the Transmission function
21 would be considered a direct assignment.

22 Indirect allocation requires additional analyses. For example, General
23 Plant accounts identified in the USoA contain costs relating to investments made

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1 to support more than one of the functions identified in the November 9, 2001
2 Order. Consequently, these accounts are indirectly allocated to functions in the
3 cost studies based on some related pattern or group of accounts. In the case of
4 General Plant, most accounts were allocated to a function in a manner consistent
5 with the functionalization of Labor in these accounts. This method is consistent
6 with generally accepted FERC standards and as a recommended approach in the
7 National Association of Regulatory Utility Commissioners ("NARUC") Electric
8 Utility Cost Allocation Manual.

9 Q. What is the second step in the cost of service process?

10 A. The second step in the study is classification, where functionalized costs are
11 classified based upon the characteristics of the type of service being provided --
12 whether the costs are primarily Customer-, Demand- or Energy-related. For
13 example, Transmission costs and mains are considered Demand-related, electric
14 hydro plant costs are considered Energy-related, and services, meters, and billing
15 costs are considered Customer-related.

16 Q. What is the third step in the ECOS process?

17 A. The classified costs are then allocated to the various service classes using a
18 variety of allocation factors developed to reflect the cost responsibility that each
19 class causes or imposes on the system for each element being allocated. A
20 summary of classified costs by service class can be found in Exhibits __
21 (RGEECOS-5 and 6).

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1 Q. What model did RG&E use to perform its ECOS study?

2 A. RG&E used a computerized microcomputer cost model, developed and licensed
3 by MAC to perform its ECOS study. This model follows a standard approach to
4 preparing an ECOS study. By using this application, the Company is able to
5 specifically model its operations, treat each element of rate base, revenue and
6 operating expenses in detail and assign or allocate each cost item to a specific
7 function or functions, as well as to service classes.

8 Q. Has the Company previously used this model?

9 A. No. However, this is the same model used by NYSEG to perform its most recent
10 ECOS study, filed in Case 05-E-1222, and its most recent gas study, filed in Case
11 01-G-1668. Both NYSEG and RG&E are utilizing consistent methodologies and
12 models for their ECOS studies in these rate case proceedings.

13 Q. Please provide an overview of the model.

14 A. As shown in Exhibits __ (RGEECOS-3 through 8), the cost model is essentially a
15 cost matrix. The vertical dimension of the study provides an itemized list of the
16 Company's costs to serve its customers. The cost of service model begins with
17 the development of rate base and continues with identifying revenues, operating
18 and maintenance ("O&M") expenses, taxes, the computation of internal allocation
19 factors, and a listing of external allocation factors.

20 The horizontal portion of the ECOS study consists of customer classes and
21 allocated results to each class. The computer model also produces a cost of
22 service report that contains only the underlying functional costs along the
23 horizontal axis (see Exhibits __ (RGEECOS-9 and 10)).

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1 Starting with the first page of the fully allocated component of the ECOS
2 study Exhibit __ (RGEECOS-7, 8, 11 and 12), each page has a column between
3 the list (description) of itemized costs and the numerical data marked "ALLOC,"
4 an abbreviation for "ALLOCATOR." The ALLOC column contains an acronym
5 to indicate the factor used to allocate the costs shown in the "Total System"
6 column to individual customer classes across the horizontal dimension of the
7 study. A list of these allocation factors, including a description of each, is
8 provided in Exhibit __ (RGEECOS-13). Using these allocation factors, the costs
9 shown in the "Total System" column are allocated to each customer class listed on
10 the horizontal line of the fully allocated component of the cost study.

11 **FUNCTIONALIZATION OF COMMON COSTS (ELECTRIC & GAS)**

12 Q. Please describe the Company's methodology for functionalizing costs that cannot
13 be directly assigned to one of the functions.

14 A. As we discussed earlier in our testimony, such costs must be indirectly allocated
15 on the basis of some related pattern or group of accounts. The categories of costs
16 that were indirectly allocated to the functions include General Plant,
17 Administrative & General Expense ("A&G"), Customer Care, and Uncollectibles.

18 Q. How did RG&E indirectly allocate general and common plant to the functions?

19 A. The majority of general and common plant accounts were allocated to each
20 function consistent with the functional distribution of labor costs to each account
21 and function.

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1 Q. How did RG&E indirectly allocate the costs recorded in the numerous A&G
2 expense accounts to each of the functions?

3 A. RG&E followed the methodology used in the electric study filed in NYSEG Case
4 05-E-1222 as accepted by the Commission in its August 23, 2006 Order. The
5 basic methodology is as follows: A&G accounts were reviewed and divided into
6 groups based on those more closely related to either labor or to plant.

7 A&G expenses in FERC Accounts 920 (Administrative and General
8 Salaries), 921 (Office Supplies and Expenses), 922 (Administrative Expenses
9 Transferred – Credit), 925 (Injuries and Damages), 926 (Employee Pensions and
10 Benefits), 929 (Duplicate Charges – Credit), 930.2 (Miscellaneous General
11 Expenses), 932 (Maintenance of General Plant for Gas), and 935 (Maintenance of
12 General Plant for Electric) were all allocated and functionalized on the basis of
13 Labor. Examples of such costs include Pensions and Employee Benefits expenses
14 and Company-wide costs, such as executive salaries, accounting and
15 bookkeeping. Since these accounts are primarily Labor-related, the ECOS study
16 allocated these costs using a Labor allocator. RG&E's allocation of these costs on
17 the basis of Labor is consistent with longstanding FERC practice and
18 Commission-accepted cost causation principles. The use of a Labor allocator is
19 also well recognized in the NARUC Utility Cost Allocation Manual as an
20 appropriate factor.

21 A&G expenses recorded in FERC Accounts 924 (Property Insurance) and
22 Accounts 931 (Rents) are not related to Labor, but are more closely tied to plant
23 investments and were, therefore, allocated on plant allocation factors.

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1 Q. How did the Company functionalize FERC Account 923 (Outside Services)?

2 A. RG&E subcategorized FERC Account 923 into the following two sub-accounts;
3 Utility Shared Services Corporation ("USSC") Labor; and Consultant and
4 contractor fees incurred from companies other than Energy East. Information
5 Technology ("IT") is a subset of USSC Labor. USSC charges represent RG&E's
6 portion of shared services such as human resources, accounting services and IT
7 support services. The allocations are consistent with the determinations set forth
8 in the RD (page 130) and the August 23, 2006 Order. The RD, as accepted by the
9 Commission, determined that the non-IT-related USSC portion of Account 923
10 should be functionalized and allocated on the basis of Labor whereas the other
11 two components should be functionalized and allocated on the basis of a three-
12 part weighted allocator.

13 Q. What is the three-part weighted allocator?

14 A. The weighted allocator is a broad based general allocator that is equally weighted
15 using one-third Labor, one-third Revenues, and one-third Rate Base. This
16 approach to developing a general allocator embodies the various functional
17 weightings from the most significant cost of service elements.

18 Q. How was FERC Account 928 (Regulatory Commission Expenses) functionalized?

19 A. FERC Account 928 is made up of the actual PSC general assessment and
20 expenses associated with regulatory proceedings. The August 23, 2006 Order
21 determined that it is reasonable to functionalize the regulatory assessment entirely
22 to delivery. The RD also stated that any legal expenses attributable to regulatory

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1 proceedings should be functionalized on the basis of the broad based weighted
2 allocator. RG&E has complied with both of these determinations.

3 Q. How was FERC Account 930.1 (General Advertising Expense) functionalized?

4 A. RG&E functionalized this account entirely on the weighted three-part allocator
5 consisting of one-third Revenues, one-third Rate Base, and one-third Labor, as
6 determined by the RD (page 129).

7 Q. How did RG&E allocate Customer Care-related costs to the various functions?

8 A. RG&E reviewed all of its expenses within the FERC Accounts 901 (Supervision),
9 903 (Customer Records and Collection Expenses), and 905 (Misc. Customer
10 Accounts Expenses) and categorized the expenses into costs relating to: Credit
11 and Collections; Customer Relations Center (Call Center); BIPP; and Delivery-
12 related expenses (see Exhibit __ (RGEECOS-14)). RG&E moved all the credit
13 and collection related costs to sub-account 906A and all of its call center activity
14 and customer satisfaction expenses to sub-account 906B. Both 906A and 906B
15 were functionalized on the basis of revenues. This method was accepted in the
16 RD (page 124). The revenues for 906A "Credit and Collections" were further
17 assigned to service classifications in the same manner as Account 904. Account
18 904 allocates the majority of costs to residential customers, which are responsible
19 for the majority of uncollectibles and creates the Credit and Collection activities.

20 The balance of costs included in Accounts 901, 903 and 905 not assigned
21 to 906A and 906B were separated by department and allocated to functions based
22 on a review of departmental data. For example, the supervisors of the Field
23 Customer Service Department provided input on activities performed in the field

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1 offices as to how much time was spent on each activity. Costs associated with
2 administering low income programs were assigned to the Delivery function.

3 Q. What determination was made to identify BIPP costs?

4 A. The Company received information from departmental personnel to determine
5 what activities were being charged to the Customer Care accounts. The Company
6 directly assigned any costs identified within FERC Accounts 901, 903, or 905 to
7 the BIPP function that were related to printing and mailing bills and receiving and
8 processing payments. For example, postage and bill print expenses were
9 identified and directly assigned to the BIPP function. Expenses associated with
10 the Remittance Processing department were also directly assigned to the BIPP
11 function. A portion of the credit and collections costs and call center costs
12 identified in Accounts 906A and 906B were allocated to the BIPP function based
13 on revenues.

14 Q. What Customer Care costs were functionalized to the Delivery function in the
15 ECOS study?

16 A. As we previously explained, costs in Accounts 901, 903 and 905 were segregated
17 by department. Customer Care costs that were directly assigned to the Delivery
18 function include all billing expenses not related to BIPP, low income program
19 costs, customer service quality costs related to mandated PSC reporting and field
20 customer service costs related to service calls not Credit and Collections related.
21 The Delivery function also receives an indirect allocation of Credit and Collection
22 costs and Call Center costs based on revenues.

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1 Q. How did the Panel address the allocation of Uncollectibles to functions?

2 A. Uncollectibles are the Company's accounts receivable write-offs that are
3 accumulated in FERC Account 904. RG&E functionalized and allocated
4 Uncollectibles on the basis of total revenues (including commodity) since these
5 write-offs are a function of revenues that will not be collected. Because the
6 Uncollectibles costs are primarily related to residential customers, RG&E
7 weighted the allocation by service classification to reflect this fact.

8 Q. How did the Panel develop the revenue allocator used to allocate Uncollectibles?

9 A. The electric ECOS study does not include Commodity revenues. Consequently, it
10 was necessary to develop an allocator that included Commodity revenues in order
11 to allocate properly Uncollectibles to functions. The Panel reviewed the
12 Company's electric revenues for the year ending December 31, 2008, and
13 determined that 65% of the Company's total revenues were Commodity-related.
14 The Company, therefore, directly assigned 65% of Uncollectibles to the Supply
15 Procurement (MFC) function.

16 Unlike the electric study, the gas study includes a Commodity function
17 comprised of commodity expenses and revenues. Gas Uncollectibles are
18 allocated to the functions on the basis of total revenues. The Supply-related
19 portion of Uncollectibles is correctly assigned to the Supply Procurement (MFC)
20 function since the MFC will be used to collect Supply-related Uncollectibles.

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- 1 Q. Did the Company follow the same methodology to develop the revenue
2 component of the weighted allocator in the electric ECOS study?
- 3 A. Yes, it did. For the electric study, a fixed percentage of 65% of total revenues
4 were functionalized to Supply Procurement for the revenue component of the
5 weighted allocator. For the gas study, the cost model actually determined the
6 correct functional amount relating to commodity revenues.
- 7 Q. How did the Panel functionalize FERC Accounts 907 (Supervision), 908
8 (Customer Assistance Expenses), 909 (Informational and Instructional Expenses),
9 910 (Customer Service and Information Expenses), 912 (Demonstrating and
10 Selling Expenses), 913 (Advertising Expenses), and 916 (Miscellaneous Sales
11 Expenses)?
- 12 A. First, the Company identified all System Benefits Charges ("SBC"), Renewable
13 Portfolio Standard Charges ("RPS"), and Energy Efficiency Portfolio Standard
14 ("EEPS") Charges, which are mandated charges passed through to customers by
15 the utility through surcharges. These costs were excluded from the FERC 907 –
16 916 Accounts and were combined and entered in a "dummy" account labeled as
17 Account 917 (SBC/RPS/EEPS). These costs were directly assigned to Delivery
18 and were allocated to service classification on the basis of customer usage. Next,
19 the Company followed the RD and the August 23, 2006 Order's determination for
20 the assignment of these accounts to functions. The RD and August 23, 2006
21 Order clarified that Account 908 and 910 costs (excluding Voice Your Choice
22 ("VYC")) costs should be functionalized to delivery. In addition, the RD (page
23 129, footnote 213) stated that Accounts 912 and 916 and any general advertising

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1 expenses should be functionalized on the three-part weighted allocator. See
2 Exhibit __ (RGEECOS-15).

3 Q. How was Account 907 functionalized in the ECOS studies?

4 A. The electric and gas expenses in FERC Account 907 were related to SBC and
5 energy efficiency expenses. These expenses were moved the SBC/RPS/EEPS
6 Account 917 and were functionalized to Delivery. The electric and gas study did
7 not have a balance in Account 907 after Account 917 was created.

8 Q. How was Account 908 functionalized in the ECOS studies?

9 A. Account 908 for both the electric and gas study was functionalized to Delivery.

10 Q. How was Account 909 functionalized in the ECOS studies?

11 A. In the electric study, Account 909 contains Marketing and Sales expenses similar
12 to the expenses that settle to Account 908. Therefore, a decision was made to
13 functionalize these costs directly to Delivery. In the gas study, Account 909 has a
14 zero balance.

15 Q. How was Account 910 functionalized in the ECOS studies?

16 A. In the electric study, the RPS expenses from Account 910 were moved to Account
17 917. The balance of the expenses remaining in Account 910 were related to a
18 VYC Deferral and were netted against RG&E VYC expenses in Account 930.1 to
19 ensure that similar costs were addressed in the same manner. As previously
20 mentioned when we discussed A&G, Account 930.1 was functionalized using the
21 three-part weighted allocator. RG&E gas Account 910 had a zero balance.

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1 Q. How were Accounts 912-916 functionalized in the ECOS studies?

2 A. These accounts were functionalized on the basis of the three-part weighted
3 allocator as per the RD (page 129, footnote 213).

4 Q. Did the electric ECOS study include a Competitive Energy Service function?

5 A. No. Consistent with the Unbundling Statement of Policy and Order, RG&E has
6 separately tracked Energy Services. Exhibit __ (RGEECOS-16) includes the
7 report on Competitive Energy Service costs and revenues required by the
8 Commission.

9 Q. How were Accounts 907-917 allocated to Service Class?

10 A. RG&E made a determination as to the percentage of the expenses in these
11 accounts that related to Residential programs versus Non-residential programs.
12 The allocations to service class were based on class delivery revenues weighted
13 by the identified residential and non-residential percentages. (See Exhibit __
14 (RGEECOS-15)).

15 Q. How did the Company functionalize and allocate Labor costs?

16 A. Labor costs from each O&M account were identified separately as a subset of the
17 total expense in each cost of service study. These Labor costs were allocated and
18 functionalized in the same manner as the total account.

19 Q. Did the Panel directly assign any Labor costs to functions rather than follow the
20 assignment of the O&M expense?

21 A. Yes, we did, and billing costs are an example. A significant amount of this O&M
22 account is Postage which should be properly functionalized to BIPP. There is no
23 Labor associated with Postage and, therefore, the functionalization of the Labor

EMBEDDED COST OF SERVICE PANEL

1 for Billing Costs is not proportional to the O&M expenses. The Labor within this
2 account should more properly be spread between Bill Calculation (Delivery) and
3 BIPP, and this split was determined through a review of the customer care
4 accounts.

5 Q. What costs were functionalized to BIPP?

6 A. The Company maintains no accounts that include only BIPP costs. Consequently,
7 this function includes the portion of Customer Care costs related to BIPP and the
8 allocated portion of General Plant, A&G expenses, Credit and Collections, and
9 Uncollectibles. We discussed the treatment of Customer Care costs previously in
10 our testimony. The same BIPP charge is calculated for both gas and electric
11 service.

12 **ELECTRIC COST OF SERVICE STUDIES - GENERAL**

13 Q. Please describe the Service Classes represented in the RG&E electric ECOS
14 Study.

15 A. See Exhibit __ (RGEECOS-1) for a list of electric service classifications.

16 Q. How were Power for Jobs customers and Negotiated rate customers handled in the
17 ECOS study?

18 A. These customers were included in their otherwise applicable service classification
19 ("OASC") in the cost of service study.

EMBEDDED COST OF SERVICE PANEL

1 Q. How were Standby Customers (Service Classification ("SC") 14) handled in the
2 ECOS study?

3 A. SC 14 customers were removed from the class cost study and related allocation
4 factors. Consistent with this approach, Standby delivery revenues were allocated
5 based on their respective cost allocation to all classes.

6 Q. Were there any adjustments made to the data in the electric ECOS study?

7 A. The Company made a \$2.8 million adjustment to the level of Uncollectibles
8 (FERC Account 904) to exclude accounting reserves. This adjusted amount
9 represents the annual level of write offs made by the Company. In addition, the
10 Company also increased the level of working capital by \$5.1 million to reflect an
11 additional amount needed for working capital on purchase power.

12 Q. What functions are included in the electric ECOS study?

13 A. The electric study functionalized costs into:

- 14 1) Supply Procurement (MFC);
- 15 2) Transmission & Distribution (Delivery);
- 16 3) BIPP;
- 17 4) Meter Reading (Meter Data Services);
- 18 5) Meter Ownership; and
- 19 6) Meter Services.

20
21 The Company did not include a Supply function because RG&E has previously
22 unbundled Delivery from Supply and rates for the Supply function are set on the
23 basis of market prices.

EMBEDDED COST OF SERVICE PANEL

FUNCTIONALIZATION AND ALLOCATION OF COSTS - ELECTRIC

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Q. What was the Company's rationale for allocating costs to the functions identified above?

A. As we will discuss in more detail, the Company generally functionalized dollars by account in accordance with Attachment A to the November 9, 2001 Order.

Q. What costs were included in the Electric Supply Procurement (MFC) function?

A. This function includes those "Supply-related" costs within RG&E's Energy Supply department that are associated with the acquisition of energy and capacity required to serve retail load. RG&E directly assigned working capital associated with the Commodity business to the Supply Procurement function. Additionally, the Company indirectly allocates a percentage of General Plant costs and Customer Care, Uncollectibles, Credit and Collections and A&G to Supply Procurement as well as to the other functions. The methodology for allocating these costs to the various functions was discussed earlier.

Q. How did the Company determine what portion or percentage of the Energy Supply department costs to include in the Electric Supply Procurement (MFC) function?

A. RG&E conducted special studies to categorize the activities and quantify those costs within the Energy Supply department that are associated with the Supply and Delivery functions (see Exhibit __ (RGEECOS-17)).

Q. Did the Company assign working capital to Supply Procurement?

A. The Company assigned working capital to Supply Procurement and reflected a six-day lag for purchased power costs. This approach follows the treatment

EMBEDDED COST OF SERVICE PANEL

1 endorsed in the March 24, 2003 Recommended Decision in the End State
2 Proceeding – Unbundling Track, as adopted by the Commission in the
3 Unbundling Statement of Policy and Order. This approach was also used in Case
4 05-E-1222.

5 Q. What costs were functionalized to Delivery?

6 A. The Delivery function includes direct costs associated with Fixed Production,
7 Transmission, and Distribution. The Fixed Production component includes the
8 Company-owned production plant costs and related O&M accounts. The
9 Transmission component includes all of the Transmission plant and Transmission
10 O&M accounts specified in the USoA. The Distribution component encompasses
11 all Distribution plant, and Distribution O&M consistent with the USoA. The
12 Delivery function also includes indirect costs related to General Plant and A&G
13 expenses, which are a result of the overall allocation process.

14 Q. What costs were functionalized to Meter Investment?

15 A. Meter Investment includes meter plant as defined by the USoA with the exception
16 of investment associated with metering transformers. This investment was
17 included in Delivery consistent with the Commission's determination in the
18 Competitive Metering proceeding (Case 00-E-0165) that the Delivery company
19 will continue to provide metering transformers. Capitalized meter installation
20 costs were directly assigned to the Meter Services function as required by the
21 Unbundling Statement of Policy and Order.

EMBEDDED COST OF SERVICE PANEL

1 Q. What costs were functionalized to Meter Services?

2 A. Meter Services includes the Meter Operations and Maintenance Accounts under
3 the USoA. RG&E also included capitalized meter installation costs in the Meter
4 Services function.

5 Q. How did the Company functionalize costs to Meter Reading?

6 A. Meter Reading includes the expenses recorded in FERC Account 902 (Meter
7 Reading Expenses).

8 Q. What allocation methods did the Company use to apportion the major rate base
9 and expense items to service classes?

10 A. Production-related investments consist of steam, hydro and peaking facilities.
11 The steam and hydro facilities were allocated to classes using an energy allocator
12 that considers only the RG&E sales customers. This allocation approach properly
13 recognizes the varied load level throughout the year by both actual generation and
14 customer loads. The peaking-related costs were allocated to classes using a 2
15 Coincident Peak average method ("2CP") to better capture the higher load level or
16 peaking characteristics of rate classes in assigning these costs that are generally
17 used for a very limited number of hours in the year. Both of these allocation
18 factors were adjusted for losses in deriving the final class allocation factors. For
19 electric service, Transmission costs were classified as Demand-related and
20 allocated to classes based on a 12 Coincident Peak ("12CP") methodology. The
21 12CP method calculates the average of the class contribution to the 12 monthly
22 system peaks. This approach recognizes the diverse capability requirements of
23 the Company to provide safe and adequate service for all hours of the year. By

EMBEDDED COST OF SERVICE PANEL

1 recognizing the 12 highest peaks, we also recognize that the service from RG&E
2 to customers must provide for the delivery of a diverse mix of energy resources to
3 all customers year round throughout its service territory.

4 Q. How were the Company's overhead and underground distribution facilities
5 allocated to customer class in the electric ECOS model?

6 A. Substations, overhead lines (plant Accounts 364 and 365), and underground lines
7 (plant Accounts 366 and 367) were allocated to customer classes based on class
8 peaks adjusted for losses. The first step of the allocation process was to separate
9 each of these accounts into a primary and secondary voltage classification prior to
10 any allocation of costs. By identifying these voltage level cost separations, we
11 can more properly assign costs to rate classes and ensure that a large amount of
12 these costs, such as secondary, are not incorrectly allocated to primary customers
13 who are not served from these facilities. Using the Company's adjusted load data,
14 class peak allocators were derived for each customer class and adjusted for losses.
15 These allocators were then used to allocate the primary and secondary cost
16 categories identified in the ECOS model.

17 Q. How did the Panel allocate line transformer costs (Account 368)?

18 A. Line transformer costs were allocated to all customers in a similar manner as
19 secondary conductors by using non-coincident class peaks excluding any primary
20 customers.

EMBEDDED COST OF SERVICE PANEL

1 Q. How did the Panel allocate Customer-related Distribution plant costs in the
2 electric ECOS model?

3 A. Customer-related plant costs were identified as relating to either services
4 (Account 369) or meters (Account 370). Services were allocated only to
5 secondary customers based on a weighting of current typical costs for each class
6 times the estimated number of services for each class. Meters were allocated to
7 each customer class based on the current typical meter costs times the number of
8 meters.

9 Q. What other plant costs were included in developing the Company's rate base
10 detail?

11 A. The remaining rate base costs included General Plant, which was primarily
12 allocated on a labor allocation factor, as previously discussed. All of this plant
13 data was reduced by the corresponding functional account-by-account
14 depreciation reserves using the matching plant allocated results to arrive at net
15 plant. Finally, several additions and deductions to net plant were made and
16 allocated using a variety of allocation factors (mostly plant or labor) to arrive at a
17 determination of rate base in each study.

18 Q. How did the Panel allocate the various RG&E O&M expenses in the electric
19 ECOS study?

20 A. O&M expenses were detailed by account and allocated on their corresponding
21 allocated plant costs except as detailed in our earlier testimony.

EMBEDDED COST OF SERVICE PANEL

1 Q. What allocation factors were used in the electric ECOS study?

2 A. As we previously discussed, the results of the ECOS study include a report
3 identifying and describing the allocation factors used to allocate each cost to
4 service item as shown in Exhibit __ (RGEECOS-7). Exhibit __ (RGEECOS-13)
5 provides a description of all allocation factors.

6 Q. How did RG&E treat its economic development rate incentives in determining the
7 Company's fully allocated Delivery revenue requirement?

8 A. Revenues and usage associated with all customers receiving rate incentives
9 pursuant to economic development programs were included in the customers'
10 OASCs. The revenues taken from the books and records of the Company for each
11 service classification reflected the discounted amount for customers receiving the
12 above-listed economic incentives. For the purposes of the ECOS study, the
13 Company adjusted service class booked revenues to allocate the total economic
14 incentive discounted amount for the year back to the class where the customers
15 receiving the discounts reside. RG&E made a second revenue neutral adjustment
16 to redistribute the total discounts resulting from the above-referenced economic
17 development programs to all retail customers based on their kWh usage. By
18 making these adjustments, the economic development discounts do not reduce the
19 returns for only the service classifications that include customers receiving
20 incentive rates. Instead, the impact of these discounts is spread to all classes that
21 support the economic development programs.

EMBEDDED COST OF SERVICE PANEL

1 Q. Did RG&E make a similar adjustment for Flex Rate discounts?

2 A. Yes. The SC 10 and SC 11 customers are included in with their OASC at the
3 currently effective rates for the OASC. The discounted amount was spread to all
4 customers consistent with the collection of the revenue collection of the economic
5 development fund.

6 **ELECTRIC ECOS STUDY RESULTS**

7 Q. Have you made any changes to the detailed cost of service analysis in this filing?

8 A. As part of the ECOS analysis, a careful review was made of the relevant voltage
9 level separation typically recognized in cost of service studies. In our current
10 filing, we have maintained a recognition of the traditional major categories of
11 primary and secondary voltage separation in the Company's delivery system.
12 However, the Company's identification of higher voltage separations between
13 transmission and subtransmission has been eliminated in the cost of service detail
14 in this filing. This change was necessitated by the evolution of large-scale
15 integrated networks, such as the NYISO, PGM and other regional power systems,
16 which has greatly masked and redefined the traditional definitions between
17 transmission and subtransmission systems. In the last ten years of the power
18 industry, traditional subtransmission definitions have been morphed into the more
19 classic role of either transmission or distribution facilities. As a result of these
20 integrated regional power systems, the distinct identity of a traditional
21 subtransmission segment (slice) of the power system, which recognized some
22 voltage definitions, has been redefined or categorized as to being more properly
23 related to either a part of the integrated transmission system or to a more localized

EMBEDDED COST OF SERVICE PANEL

1 or expanding distribution delivery system definition. This change has also been
2 well recognized by FERC in its efforts over the last decade to also reclassify
3 facilities using a "seven factor" transmission or distribution evaluation along with
4 the Commission.

5 Q. Would the Panel describe the output of the model based on the process described
6 above?

7 A. The outputs of the model include a "top-down" rate of return study by service
8 classification, Exhibit __ (RGEECOS-3), and a "bottom-up" study by service
9 classification, Exhibit __ (RGEECOS-5). Additionally, Exhibit __ (RGEECOS-
10 9) displays the results from both the "top-down" and the "bottom-up" rate of
11 returns by function.

12 Q. Please describe the "top-down" and "bottom-up" cost of service analyses
13 performed by RG&E.

14 A. The Company first performed the traditional "top-down" ECOS study to develop
15 an overall delivery system rate of return and an individual rate of return for each
16 service class. The "bottom-up" study is designed to actually measure the revenue
17 that would be needed from each class to provide a return equal to a total system
18 return on a uniform or equalized basis. In the Company's "bottom-up" study, the
19 rates of return for each service class were set equal to the overall rate of return
20 proposed by the Company. Using the same "bottom-up" method, RG&E
21 computed the revenues needed from each functional service to achieve this
22 proposed uniform return. The results of this "bottom-up" analysis were used to
23 develop the competitive service rates, which we will discuss in more detail later.

EMBEDDED COST OF SERVICE PANEL

1 Q. What historic period did RG&E use to derive the overall delivery system rate of
2 return?

3 A. As we previously mentioned, the electric ECOS study is based on the twelve-
4 month period ending December 31, 2008. A summary of the income statement
5 and rate base for the year ending 2008 is included in the Revenue Requirements
6 Panel's workpapers.

7 Q. What is the relative rate of return by service class that resulted from the electric
8 ECOS study?

9 A. The service class rate of return is derived by dividing the net operating income
10 associated with each service class by the rate base allocated to each service class.
11 The relative rate of return index for each service class is determined by taking the
12 calculated service class rate of return and dividing it by the overall system
13 average rate of return. The results of this calculation are shown in Exhibit __
14 (RGEECOS-3).

GAS COST OF SERVICE STUDY – GENERAL

16 Q. Describe the most significant changes in general functionalization or allocation
17 methodologies used in this study that are different from the last filed studies?

18 A. The major change is that RG&E's current study is now consistent with the
19 methodologies followed by NYSEG, the RD and the August 23, 2006 Order.

20 Q. Please describe the Service Classes represented in the RG&E gas ECOS Study.

21 A. See Exhibit __ (RGEECOS-2) for a list of gas service classifications.

EMBEDDED COST OF SERVICE PANEL

1 Q. Were any adjustments made to the data in the gas ECOS study?

2 A. As described under the electric discussion, the Company made a \$2.5 million
3 adjustment to the value for Uncollectibles (FERC Account 904) to exclude
4 accounting reserves. Also, an adjustment of \$3.6 million was made to add a
5 working capital component for purchased gas similar to the RG&E electric study.
6 An additional adjustment to working capital of \$10.9 million was also made to
7 account for the commodity hedge margin account. Furthermore, the gas study
8 includes an adjustment to align commodity revenues with purchase gas expense.
9 This adjustment essentially eliminates any commodity revenues or commodity
10 expenses that do not relate to calendar year 2008.

11 Q. What functions are included in the gas ECOS study?

12 A. The gas study functionalized costs into:
13 1. Supply Procurement (MFC);
14 2. Transmission & Distribution ("Delivery"); and
15 3. BIPP.

16 Commodity supply and storage costs are included in the gas cost of
17 service study and allocated to a separate column. The commodity and contract
18 storage costs were not treated as a separate function in that they were not
19 allocated any common costs such as general plant, customer care or A&G
20 expenses. All common costs related to commodity supply service were assigned
21 to the Supply Procurement (MFC) function.

EMBEDDED COST OF SERVICE PANEL

FUNCTIONALIZATION AND ALLOCATION OF COSTS - GAS

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Q. What was the Company's rationale for allocating costs to the functions identified above?

A. The Company generally functionalized dollars by account in accordance with Attachment A to the November 9, 2001 Order.

Q. How were storage costs treated in the gas ECOS study?

A. As stated above, storage costs were segregated in the study but not treated as a separate function. RG&E does not own any storage facilities. Storage costs for RG&E gas consists of storage demand costs contained in FERC Account 804 and working capital costs related to underground gas storage inventory. A portion of storage demand costs and working capital for gas storage inventory were determined to be reliability related and functionalized to Delivery. Reliability related costs are discussed more fully later in our testimony. The balance of storage demand costs not related to reliability are considered a pass through cost and collected from sales customers in the Gas Supply Charge ("GSC"). The balance of working capital costs related to underground gas storage inventory not considered reliability related are included in the MFC function.

Q. What costs were included in the Gas Supply Procurement (MFC) function?

A. This function includes those "Supply related" costs within RG&E's Energy Supply department that are associated with the acquisition of gas commodity and capacity required to serve firm load. The methodology used for the Gas Supply Procurement Function is consistent with the development of the Electric Supply Procurement Function. As previously mentioned, RG&E directly assigned the

EMBEDDED COST OF SERVICE PANEL

1 storage inventory component of working capital not related to reliability to the
2 Supply Procurement (MFC) function. Additionally, the Company indirectly
3 allocated a percentage of General Plant costs and Customer Care, Uncollectibles,
4 Credit and Collections and A&G to Supply Procurement (MFC) as well as to the
5 other functions. We discussed the methodology for allocating these costs to the
6 various functions earlier.

7 Q. How did the Company determine what portion or percentage of the Energy
8 Supply department costs to include in the Gas Supply Procurement function?

9 A. RG&E conducted special studies to categorize the activities and quantify those
10 costs within the Energy Supply department that are associated with the Supply
11 and Delivery functions (see Exhibit __ (RGEECOS-17)). This is the same
12 process used for the Electric Supply Procurement (MFC) function.

13 Q. Did the Company assign O&M working capital and underground gas storage
14 inventory to Gas Supply Procurement?

15 A. Yes. The Company assigned O&M working capital to Gas Supply Procurement
16 in the same manner as was assigned for the Electric Supply Procurement function
17 described above. Underground gas storage inventory not determined to be
18 reliability related was allocated to the Gas Supply Procurement function. In
19 addition, the gas study also allocated the portion of working capital related to the
20 commodity hedge margin account to the Supply Procurement function.

21 Q. Would the Panel identify the costs functionalized to Delivery?

22 A. Gas plant Accounts 325-387 were directly assigned to the delivery function.
23 Intangible plant and general plant were indirectly allocated to all the functions

EMBEDDED COST OF SERVICE PANEL

1 primarily on Labor costs. Transmission and distribution O&M expenses,
2 Accounts 856-894, were functionalized 100% to Delivery. Consistent with the
3 other functions, the Delivery function was indirectly also allocated a portion of
4 Customer Care, Uncollectibles, Credit and Collections, Call Center, and A&G
5 expenses.

6 Q. How were reliability-related costs identified and assigned to the Delivery
7 function?

8 A. Reliability costs identified in the gas ECOS study include an allocation of
9 capacity resources contained in FERC Account 804 and an allocation of working
10 capital for underground storage. The allocation of reliability costs in the gas
11 ECOS study is consistent with the testimony of the Electric and Gas Supply
12 Panel. The Electric and Gas Supply Panel testimony discusses in further detail
13 the supply planning process and the need to designate a portion of supply costs
14 and underground storage for reliability purposes. The Company is proposing to
15 collect the reliability-related costs identified in the gas ECOS study in a separate
16 reliability surcharge, as discussed in the Revenue Allocation and Rate Design
17 Panel testimony (see Exhibit __ (RGEECOS-18)).

18 Q. What methods did the Company use to apportion the major rate base and
19 associated expense items to service classes?

20 A. The major rate base items in the gas ECOS study include Account 376
21 (Distribution Mains), Account 381 (Meters) and Account 380 (Services).
22 Distribution mains are classified as entirely Demand-related and allocated to
23 service classes based on a design day allocator. Meters are classified as 100%

EMBEDDED COST OF SERVICE PANEL

1 Customer-related and allocated to service class using the average meter cost per
2 service class from the gas MCOS study weighted by the average number of
3 customers per class based on Company data. Services are also classified as 100%
4 Customer-related and are allocated to service class using the average service line
5 cost per service class from the gas MCOS study multiplied by an estimated
6 number of services per class based on Company data. Distribution expenses,
7 Accounts 870 to 894, are allocated consistently with the Distribution plant
8 allocations.

9 Q. What other plant costs were included in developing the Company's rate base
10 detail?

11 A. The remaining rate base costs included General Plant, which was primarily
12 allocated on a Labor allocation factor, as we previously discussed. All of this
13 plant data was reduced by the corresponding functional account-by-account
14 depreciation reserves using the matching plant allocated results to arrive at net
15 plant. Finally, several additions and deductions to net plant were made and
16 allocated using a variety of allocation factors (mostly plant or labor) to arrive at a
17 determination of rate base in each study.

18 Q. How were O&M expenses allocated in the gas ECOS model?

19 A. Gas costs were allocated based on gas commodity revenues to each service class.
20 The remaining transmission and distribution O&M expenses were allocated
21 following the corresponding plant allocations to each customer class.

EMBEDDED COST OF SERVICE PANEL

- 1 Q. How did RG&E treat its gas economic development rate incentives in
2 determining the Company's fully allocated Delivery revenue requirement?
- 3 A. Similar to the electric economic development discussion, revenues and usage
4 associated with all customers receiving gas rate incentives pursuant to the
5 Economic Development Zone, Empire Zone Rate, and the Incremental Load Rate
6 programs were included in the customers' OASCs. The revenues taken from the
7 books and records of the Company for each service classification reflected the
8 discounted amount for customers receiving the above-listed economic incentives.
9 For the purposes of the ECOS study, the Company adjusted service class booked
10 revenues to allocate the total economic incentive discounted amount for the year
11 back to the class where the customers receiving the discounts reside. RG&E
12 made a second revenue neutral adjustment to redistribute the total discounts
13 resulting from the above-referenced economic development programs to all retail
14 customers (excluding customers receiving special contract rates) based on usage.
15 By making these adjustments, the economic development discounts do not reduce
16 the returns for only the service classifications that include customers receiving
17 incentive rates. Instead, the impact of these discounts is spread to all classes that
18 support the economic development programs.

GAS ECOS STUDY RESULTS

- 19
- 20 Q. Describe the most significant changes in general functionalization or allocation
21 methodologies used in this study that are different from the last filed studies.
- 22 A. The major change is that RG&E's current study is now consistent with the
23 methodologies followed by NYSEG, the RD and the August 23, 2006 Order.

EMBEDDED COST OF SERVICE PANEL

1 Q. What was the output of the model based on the process described above?

2 A. The outputs of the model include a "top-down" rate of return study by service
3 classification, Exhibit __ (RGEECOS-4), and a "bottom-up" study by service
4 classification, Exhibit __ (RGEECOS-6). Additionally, Exhibit __ (RGEECOS-
5 10) displays the results from both the "top-down" and the "bottom-up" rate of
6 return by function.

7 Q. Please describe the "top-down" and "bottom-up" cost of service analyses
8 performed by RG&E.

9 A. The Company first performed the traditional "top-down" ECOS study to develop
10 an overall delivery system rate of return and an individual rate of return for each
11 service class. In the Company's "bottom-up" gas study, the rates of return for
12 each service class were set equal to the overall rate of return proposed by the
13 Company. Using the same "bottom-up" method, RG&E computed the revenues
14 needed from each functional service to achieve the proposed return. The results of
15 this "bottom-up" analysis were used to develop the competitive service rates,
16 which we will discuss later.

17 Q. What historic period did RG&E use to derive the overall delivery system rate of
18 return?

19 A. As we previously mentioned, the ECOS study is based on the twelve-month
20 period ending December 31, 2008. A summary of the income statement and rate
21 base for the year ending 2008 is included in the Revenue Requirements Panel's
22 workpapers.

EMBEDDED COST OF SERVICE PANEL

1 Q. What relative rate of return by service class resulted from the gas ECOS study?

2 A. The service class rate of return is derived by dividing the net operating income
3 associated with each service class by the rate base allocated to each service class.
4 The relative rate of return index for each service class is determined by taking the
5 calculated service class rate of return and dividing it by the overall system
6 average rate of return. The results of this calculation are shown in Exhibit __
7 (RGEECOS-4).

8 **DEVELOPMENT OF RATES FOR COMPETITIVE SERVICES**

9 Q. Did RG&E use the results of the ECOS study to develop unbundled rates for
10 competitive services?

11 A. Yes. The Company developed unbundled rates for Electric and Gas Supply
12 Procurement (MFC), BIPP, and Electric Competitive Metering based on the
13 functionalized costs for each of these services. Exhibits __ (RGEECOS-19
14 through 22) includes the unbundled rates for these functions.

15 Q. Does the Company propose that the Commission adopt the unbundled rates
16 shown in the Exhibits __ (RGEECOS-19 through 22)?

17 A. The Company proposes that the Commission adopt the process used to develop
18 the MFC rates. The final rates will be included in the Company's compliance
19 filing submitted after an order is issued in this case. The final rates will update
20 the uncollectibles, working capital for purchase power and purchase gas,
21 underground storage and working capital for gas commodity hedge margin
22 components of the MFC rates using current information, as we will describe later.
23 The Company proposes that the BIPP charge and meter charges be adopted as

EMBEDDED COST OF SERVICE PANEL

1 shown in Exhibits __ (RGEECOS-21 and 22) subject to any necessary
2 modifications as a result of Commission changes to the Company's ECOS study.

3 Q. How did RG&E calculate the electric MFC?

4 A. Based on the "bottom-up" study for the Supply Procurement function, the
5 Company developed separate MFCs for the small and large customer groups, as
6 defined in Exhibit __ (RGEECOS-19). To calculate the MFC, RG&E first
7 aggregated the Supply Procurement function revenue requirement for the service
8 classifications contained in the small and large customer groups. Next, the
9 Company divided the revenue requirement for each of the groups by the non-retail
10 access kWhs forecasted for the rate year twelve months ending August 31, 2011
11 for each of the groups to obtain a MFC rate per kWh. These calculations resulted
12 in an MFC for small customers of \$.0071 per kWh and for large customers of
13 \$.0068 per kWh, as shown on Exhibit __ (RGEECOS-19).

14 Q. Does the Company currently have an electric MFC in place?

15 A. No. Pursuant to RG&E's current electric rate plan and its effective tariffs, the
16 delivery rates applicable to customers electing the energy service company
17 ("ESCO") Price Option ("EPO") reflect a credit of 4 mills/kWh, thus creating a
18 charge for delivery services that excludes the negotiated credit for Supply
19 Procurement and associated Customer Care. The Company is adopting an
20 unbundled charge for the Merchant Function service that will be applied to the
21 bills of customers that take supply from the Company. The Company is
22 proposing a shift from a backout credit applied to bills of customers that migrate

EMBEDDED COST OF SERVICE PANEL

1 to a competitive supplier to an unbundled charge applied to bills of customers that
2 take a competitive service from the Company.

3 Q. How did RG&E calculate the gas MFC?

4 A. The same methodology used to calculate the Electric MFC was used to develop
5 the gas MFC. To calculate the gas MFC, RG&E aggregated the Supply
6 Procurement function revenue requirement into residential and non-residential
7 customer groups. Next, the Company divided the revenue requirement for each
8 group by the forecasted therms for sales customers for the twelve month period
9 ending August 31, 2011. The calculations resulted in an MFC for residential
10 customers of \$0.0811 per therm and for non-residential customers of \$0.0513 per
11 therm, as shown in Exhibit __ (RGEECOS-20).

12 Q. What methodology did RG&E utilize to calculate the proposed BIPP unbundled
13 rate?

14 A. RG&E computed the unbundled rate applicable to BIPP on a system-wide basis
15 rather than differentiating it by Service Class or by service type. RG&E added
16 electric and gas BIPP revenues for both gas and electric service at the claimed rate
17 of return, shown on Exhibit __ (RGEECOS-21), and this total was used as the
18 numerator. The denominator reflects an annual number of invoices for all
19 electric, gas, and combination customers as of December 31, 2008.

20 Q. How will this charge be applied to combination electric and gas customers,
21 electric only customers and gas only customers?

22 A. A combination electric and gas customer will receive one BIPP charge applied to
23 the bill. An electric only or gas only customer will also receive one BIPP charge

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1 applied to each bill. The BIPP charge for a combination customer will be the
2 same as that for an electric only customer and also for a gas only customer.

3 Q. How will RG&E charge ESCOs for consolidated billing?

4 A. If an ESCO is providing both electric and gas service, they will be billed an
5 amount equivalent to the BIPP charge for each consolidated bill. If the ESCO is
6 only providing a consolidated bill for either gas or electric service, they will also
7 be billed an amount equivalent to the BIPP charge per consolidated bill. If a
8 customer has separate ESCOs for electric and gas, the charge for consolidated
9 billing will be prorated between ESCOs.

10 Q. If a customer receives consolidated billing from the utility, what will the customer
11 pay for BIPP?

12 A. A customer receiving consolidated billing from the Company will not see a BIPP
13 charge on their RG&E delivery bill. They will, however, be billed for BIPP
14 services from their ESCO.

15 Q. What process did RG&E use to update its proposed unbundled rates for
16 Competitive Metering?

17 A. Competitive Metering rates, applicable to eligible customers with a demand of 50
18 kW or greater, are differentiated by service class and contain all components of
19 the related metering services. These components include Meter Reading, Meter
20 Services, and Meter Ownership. A customer may elect to receive a portion of
21 these from RG&E and others from an alternative supplier.

22 The ECOS model produces a separate cost analysis summary for each
23 function (e.g., Meter Reading, Meter Services, and Meter Ownership) containing

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1 the development of a revenue requirement by Service Class using the claimed, or
2 "bottom-up," rate of return. Those separate cost analyses allow the Company to
3 produce unbundled rates that differ by Service Class. The Company calculated
4 the numerator by summing the unbundled revenues from the Meter Reading,
5 Meter Services, and Meter Ownership functions by service class. The Company
6 then divided that total sum by the number of meters by service class. RG&E
7 calculated the monthly rate by dividing the annual rate by twelve (see Exhibit __
8 (RGEECOS-22)).

9 Q. How are the rates for Competitive Metering shown on a customer's bill?

10 A. As we previously testified, Competitive Metering consists of three components:
11 Meter Reading; Meter Services; and Meter Ownership. Each of these components
12 is shown separately on the bill for eligible customers.

RECONCILIATION OF COMPETITIVE SERVICES

14 Q. Is the Company proposing to implement a revenue recovery mechanism for the
15 electric and gas MFCs?

16 A. The Company is proposing to implement a revenue recovery mechanism similar
17 to the recovery mechanism agreed to and implemented in Case 05-E-1222, with a
18 few modifications.

19 Q. What revenue recovery mechanism does the Panel propose?

20 A. The electric MFC revenue requirement can be divided into three main
21 components: Uncollectibles; working capital for purchase power; and
22 administrative. The administrative category includes Energy Trading Department
23 expenses and allocations for A&G, common plant, customer care and other

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1 miscellaneous overheads and common allocations. The gas MFC includes two
2 additional components for working capital: underground storage and working
3 capital for commodity hedge margin. The revenue recovery mechanism being
4 proposed for both electric and gas MFCs are summarized as follows:

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1

	Electric MFC	Gas MFC
Components	<ul style="list-style-type: none"> ▪ Commodity Uncollectibles ▪ Working Capital for Purchase Power ▪ Administrative 	<ul style="list-style-type: none"> ▪ Commodity Uncollectibles ▪ Working Capital for Purchase Gas ▪ Working Capital for Underground Storage ▪ Working Capital for Commodity Hedge Margin ▪ Administrative
Reconciliation by Component	<ul style="list-style-type: none"> ▪ Commodity Uncollectibles – reconcile to actual costs for period ▪ Working Capital for Purchase Power- reconcile to actual costs for period ▪ Administrative – reconcile to negotiated amount; determine under/over collection due to variance in actual and forecast sales 	<ul style="list-style-type: none"> ▪ Commodity Uncollectibles – reconcile to actual costs for period ▪ Working Capital for Purchase Gas - reconcile to actual costs for period ▪ Working Capital for Underground Storage – reconcile to actual costs for the period ▪ Working Capital for Commodity Hedge Margin – reconcile to actual costs for the period ▪ Administrative – reconcile to negotiated amount; determine under/over collection due to variance in actual and forecast sales
Updates	<p>The following components will be updated annually:</p> <ul style="list-style-type: none"> ▪ Commodity Uncollectibles – updated every September 1 based on a recent twelve month period ▪ Working Capital for Purchase Power- updated every September 1 based on a recent twelve month period ▪ The units used to derive the MFC rate will be updated annually based on the most recent forecast data. 	<p>The following components will be updated annually:</p> <ul style="list-style-type: none"> ▪ Commodity Uncollectibles – updated every September 1 based on a recent twelve month period ▪ Working Capital for Purchase Gas - updated every September 1 based on a recent twelve month period ▪ Working Capital for Commodity Hedge Margin – updated every September 1 based on a recent twelve month period ▪ Working Capital for Underground Storage- updated every September 1 based on a recent twelve month period ▪ The units used to derive the MFC rate will be updated annually based on the most recent forecast data
Under/Over Collections	<ul style="list-style-type: none"> ▪ Uncollectibles & Working Capital – under/over collections collected or passed back to VPO sales customers ▪ Administrative - under/over collections collected or passed back to all customers 	<p>Under/over collections for all components collected or passed back to sales customers</p>

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1 Q. How do the above MFC reconciliation methods differ than the currently effective
2 mechanisms?

3 A. The process for reconciling the gas MFC is consistent with the current practice.
4 The proposed methodology for reconciling the electric MFC is consistent with the
5 NYSEG electric MFC with a few modifications. The Company proposes to
6 reconcile the commodity uncollectibles and the working capital for purchase
7 power components of the electric MFC with actual costs for the period. This is
8 the current practice used for both the RG&E and NYSEG gas MFCs.

9 Q. Are any additional updates to the electric and gas MFCs being proposed?

10 A. Yes. The Company also proposes to update the MFC rates more frequently than
11 annually if the results of an interim reconciliation show an under- or over-
12 collection of MFC revenues that are outside a reasonable tolerance level.

13 Q. Would a similar reconciliation methodology be applied to the Meter Function?

14 A. Yes. However, there are no customers currently taking competitive metering
15 services.

16 Q. Is a similar reconciliation required for the BIPP function?

17 A. No. If the marginal change in migration is from Company service to an ESCO for
18 whom the Company prepares a consolidated bill, there would be no lost revenue,
19 since the Company will charge the ESCO a fee equal to the otherwise applicable
20 charge to the customer.

21 Q. Does this conclude the Panel's direct testimony at this time?

22 A. Yes, it does.