Attachment I

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 05-E-0934 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Central Hudson Gas & Electric Corporation For Electric Service.

Case 05-G-0935 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Central Hudson Gas & Electric Corporation For Gas Service.

Ex. 66

STAFF STATEMENT IN SUPPORT OF RESTATED JOINT PROPOSAL

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PRELIMINARY STATEMENT

Procedural History

On July 29, 2005, Central Hudson Gas & Electric Corporation (Central Hudson) filed amendments to its tariff schedules, P.S.C. No. 15 - Electricity, and P.S.C. No. 12 - Gas, that would substantially increase its rates for electric and gas delivery service. Under the filing, the utility's annual electric revenues would rise by $60,948,000, and its annual gas revenues by $19,471,000 for the period from July 1, 2006 through June 30, 2007, from annual electric operating revenues of $176,631,000, and annual gas operating revenues of $45,023,000. Central Hudson also proposed additional revenue increases for the years ending June 30, 2008 and 2009 that totaled $11,107,000 for electric and $2,750,000 for gas. Over the three-year period, the entire proposed revenue increase is $72,055,000 for electric and $22,221,000 for gas.

By Order issued August 24, 2005, the Commission initiated these proceedings and suspended the operation of the tariff amendments until December 26, 2005. The suspension period was later extended to June 26, 2006. In addition, Central Hudson proposed a one month extension by letter to the Secretary and an additional one month extension on the record of a Pre-Hearing Conference held on March 9, 2006; both extensions are subject to make whole provisions.

On September 30, 2005, the Presiding Administrative Law Judges (ALJs) issued a Ruling establishing the procedural schedule. In accordance with the procedural schedule, Staff and Intervenor direct testimony was filed on November 21, 2005, and rebuttal testimony was filed on December 14, 2005. The supplemental testimony of Central Hudson witness Paul Haering was filed on November 19, 2005, and the Department of Defense (DOD), on behalf of the United States Military Academy at West Point (USMA or West Point) filed the initial testimony of Kenneth Kincel on December 19, 2005.

Moreover, the ALJs' Second Procedural Ruling in these proceedings, issued November 5, 2005, determined that monthly gas balancing issues would be heard in these proceedings. In addition, the November 29 Balancing Order required Central Hudson to make a filing addressing some daily gas balancing issues in these proceedings.[1] In response to that directive, Central Hudson filed the supplemental testimony of Glynis Bunt on January 4, 2006.

In a Notice Canceling Evidentiary Hearings issued January 13, 2005, the ALJs granted requests for additional time to pursue negotiations, intended to culminate in a joint proposal, without first conducting evidentiary hearings. Settlement discussions commenced on January 12, 2006, in response to Central Hudson's Notice of Impending Negotiations dated January 6, 2006, and continued through February 17, 2006. On March 9, 2006 a Settlement Judge, ALJ Jeffrey Stockholm, was appointed, and he commenced mediation of the negotiations on March 10, 2006. Further negotiating sessions were conducted through April 4, 2006.

In a Procedural Ruling on Further Revised Schedule and Process issued April 5, 2006, the ALJs established a revised schedule calling for the submission of a Joint Proposal on April 17, submission of statements in support or opposition or any evidentiary presentations opposing the Joint Proposal on May 1, 2006, commencement of hearings on May 4, 2006 and submission of briefs (limited to thirty pages) on May 12, 2006. Negotiations

[1] Case 04-G-0463, Central Hudson Gas & Electric Corporation, Order Approving Real-Time Metering Plans, Adopting Daily Balancing Charges and Procedures, and Establishing Further Proceedings (issued November 29, 2005).

continued after the Procedural Ruling was issued, through April 17, 2006.

As a result of the extensive settlement processes, on April 17, 2006, Department of Public Service Staff (Staff), Central Hudson, and Multiple Intervenors (MI) filed with the ALJs a Joint Proposal intended to resolve all outstanding issues in the above-captioned proceedings. The Joint Proposal was restated on April 19, 2006, to properly capture an understanding on gas balancing misstated in the April 17 Joint Proposal, and to correct typographical errors. The Restated Joint Proposal was joined by an additional party, USMA. This Statement is submitted in full support of the Restated Joint Proposal (RJP).

Overview of the Joint Proposal

The Restated Joint Proposal establishes a three-year Rate Plan that resolves all issues raised by Central Hudson's July 29, 2005 filing initiating these proceedings. It limits the overall electric revenue increase to $53,033,000. The impact of that increase is moderated through a phase-in over a three year period, with revenues increasing by approximately $17,888,000 annually as of July 1, 2006, July 1, 2007, and July 1, 2008. The overall gas revenue increase is limited to $14,060,000, spread over two years, with revenues increasing by $8,003,000 as of July 1, 2006 and by $6,057,000 as of July 1, 2007. These rate increases are inevitable, because they are driven primarily by rising pension and other retirement benefit costs and increasing expenditures necessary to preserve and enhance electric and gas system reliability and safety.

Besides limiting the size of revenue increases, the Restated Joint Proposal addresses numerous other issues, including issues not readily resolved in a litigated case. RJP §V establishes gas balancing procedures that will enable large gas users and competitive gas suppliers to manage the delivery of gas commodity while maintaining gas delivery system reliability. As an additional benefit, this gas balancing agreement resolves a Central Hudson petition for rehearing filed against the November 29 Balancing Order.

At RJP §VI, the Restated Joint Proposal provides for the further unbundling of electric and gas rates into delivery and commodity components, so that the price of utility-supplied electric and gas commodity can be compared to the price offered by competitive suppliers. Under RJP §§VII and XIV, Central Hudson will increase spending on enhancing electric and gas system safety and reliability, as well as on measures to protect the public from stray voltage accidents and to more vigorously control within electric line rights-of-way (ROW) the growth of vegetation that might cause outages. The provisions on electric reliability incentives at RJP §XV encourage Central Hudson to improve its reliability performance, and result in the utility's withdrawal of a petition for rehearing, filed against the Rate Adjustment Order,[2] in which it requested that it be relieved from rate adjustments owed to ratepayers due to its failure to meet electric reliability targets in 2002 and 2004.

The Restated Joint Proposal comports with and advances the Commission's policies, by creating, in RJP §VIII, new programs to assist low income customers in meeting higher energy bills; by setting, in RJP§§ XIII and XIV, incentives that encourage the Company to maintain satisfactory customer service and preserve gas system safety; by establishing in, RJP §XVII, programs that facilitate the growth of retail electric and gas commodity markets; and, promote economic development.

The Restated Joint Proposal, at RJP §IV.C, also resolves disputes over the rates for gas delivery service to USMA at West Point that resolve potentially expensive and time-consuming litigation. The terms and conditions for developing those rates more accurately and reasonably define the rate design applicable to USMA, and properly set expenses attributable to continued service to Central Hudson's gas customers in the Village of Highland Falls, supplied downstream from West Point through USMA property and facilities.

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[2] Case 00-E-1273, Central Hudson Gas & Electric Corporation, Order Denying Petition and Establishing Rate Adjustments (issued September 30, 2005).

In sum, the necessary and inevitable rate increases identified in the Restated Joint Proposal are mitigated through a three-year rate plan, allowing consumers to engage in long-term planning for both energy use and conservation measures. The other provisions of the Restated Joint Proposal smooth compliance with existing Commission Orders and policies, and avoid difficult litigation. As a result, the Restated Joint Proposal is in the public interest.

Standard for Review

The Joint Proposal should be adopted because it satisfies the criteria the Commission has established for judging the reasonableness of settlements. In evaluating such proposals, the Commission is primarily concerned with determining whether such proposal satisfies the Public Service Law's (PSL) requirement that safe and adequate service be provided at just and reasonable rates.[3] The Commission, to aid it in making the determination that such a proposal satisfies the PSL, has asked that the sponsors of the proposal demonstrate that its implementation would achieve a fair balance of interests among the parties and customers, and would produce constructive results that may not have been achievable except through a negotiated agreement.

[3] See, e.g., Case 00-E-1273, et al., Central Hudson Gas & Electric Corporation - Electric and Gas Rates, Order Establishing Rates (issued October 5, 2001)(2001 Rate Order).

To further guide settling parties, Opinion No. 92-2 identifies a number of criteria for judging whether a Joint Proposal setting forth a settlement is in the public interest.[4] In considering a Joint Proposal, the Commission reviews the extent to which it is supported by generally adverse parties, and it determines whether the record for the decision is adequate. Also, to gain approval, a Joint Proposal should be consistent with law and public policy, have a rational basis, balance the interests of consumers and the utility, and compare favorably with the outcome of litigation. The Restated Joint Proposal under consideration here satisfies these criteria.

A. Support Among the Parties

There is sufficient support for the Joint Proposal warranting its approval. Both Central Hudson and Staff have executed it. Additionally, MI representing a section of the customer base served by the utility, has joined in the proposal, as has USMA, another customer. The support of MI and USMA, parties adverse to utility interests, is particularly important.

The rate increases agreed to by the parties are necessary mainly to meet escalating pension and other post-employment benefits (OPEB) costs and other inevitable cost increases. To mitigate the increases, the parties have devised rate design and rate phase-in mechanisms that, over the three

[4] Case 90-M-0255, Proceeding on Settlement Procedures and Guidelines, Opinion 92-2 (issued March 24, 1992).

years of the rate plan, alleviate the rate shock consumers would otherwise experience. Additionally, the three-year term of the rate plan affords some level of certainty on the magnitude and timing of the rate increases, such that consumers can engage in effective long-term planning for their energy usage.

It seems that the Consumer Protection Board (CPB), the Public Utility Law Project (PULP) and the Small Customer Marketer Coalition (SCMC) will oppose certain provisions of the Restated Joint Proposal. Their anticipated opposition, however, should not prevent approval of the proposed Rate Plan. Their objections lack merit, because they advance positions that either run counter to Commission policy or are unreasonable.

B. Adequacy of the Record

The record is adequate to justify adoption of all the Joint Proposal's terms. The financial terms included in the Joint Proposal are based on figures Central Hudson supplied in its pre-filed testimony during the course of discovery, or during the negotiation of the Restated Joint Proposal. Parties had ample opportunity to review the utility's documentation and conduct extensive discovery into their content and development. Moreover, hundreds of pages of both initial and rebuttal testimony were submitted by all parties before the commencement of settlement negotiations. An additional round of discovery took place during the time between the filing of the Restated Joint Proposal and the hearings that are to be conducted on it.

The appendices to the Restated Joint Proposal represent a detailed agreement between the sponsoring parties as to the costs and revenues underlying the proposed base rates. These costs and revenues, and the other terms of the Restated Joint Proposal, are a sound evidentiary base on which to determine that the proposal is reasonable.

C. Conclusion

The remaining criteria for judging whether a Joint Proposal is reasonable are directed towards ascertaining whether the proposed terms are in the public interest. As demonstrated below, the Restated Joint Proposal meets the public interest standard, and thus, should be approved.

DISCUSSION

The Restated Joint Proposal sets forth a balanced and comprehensive approach to a new rate plan for Central Hudson that recognizes the current economic realities facing the Company while mitigating the impacts of those realities on its customers. It also brings Central Hudson into compliance with Commission policies on gas balancing, rate unbundling, safety and reliability, customer service, low income programs and retail access, ensuring that customers will realize the full benefits of those policies. The Restated Joint Proposal therefore yields benefits that could not have been obtained through litigation, while arriving at a balancing of utility and ratepayers interests that is likely superior to the outcome of a litigated proceeding.

Term of the Rate Plan

The Restated Joint Proposal establishes a three-year Rate Plan for both electric and gas rates, commencing July 1, 2006 and continuing through June 30, 2009, with the potential to remain in effect thereafter. The three-year term is in the public interest as it affords customers long-term certainty, enabling them to better plan for energy use and conservation, and to better pursue competitive market opportunities. Central Hudson also benefits, in securing a dependable revenue stream that bolsters its financial stability and furnishes the resources necessary to fulfill its responsibility to provide safe and adequate service in conformance with Commission policies.

Moreover, the three-year term extends the time between rate filings, enabling Central Hudson to focus on reducing costs and increasing efficiencies instead of on preparing rate filings. Falling costs and enhancements to efficiencies will inure to the benefit of ratepayers, because the utility will realize higher earnings in the short-term, which it will share with ratepayers under the Restated Joint Proposal. Over the long-term, the result is better service to customers at lower rates.

Electric Rates

Income statements, containing projected revenues, operating expenses and other deductions for the three electric rate years are set forth in RJP App. A. Successive rate increases of $41,383,000 in the first rate year, an additional $6,121,000 in the second rate year, and another $5,529,000 in the third rate year, are moderated to increases of $17,888, $17,889 and $17,888 for each respective rate year. RJP App. B contains the rates of return as allocated among the customer classes, and RJP App. C contains a table of electric bill impacts and electric delivery rates, including the new Merchant Function Charges (MFC). RJP App. H shows that after calculating the various categories Central Hudson is provided a pre-tax weighted cost of capital of 10.01%, 10.05% and 10.09% on electric rates for each respective rate year, with a 9.60% return on common equity (ROE), based on a 45% equity ratio.

As the income statements demonstrate, the substantial increase in revenue requirement is constrained by providing for a reasonable, but modest, ROE and a three year rate phase-in. Absent this moderation, an extremely large year one increase would have been required.

Gas Rates

Income Statements, containing projected revenues, operating expenses and adjustments, for the three years of the gas rate plan are set forth in RJP App. The numbers result in an overall increase of $14,060,000, which, when phased in, results in an $8,003,000 revenue increase in the first rate year and an additional increase of $6,057,000 in the second rate year. There is no rate increase in the third rate year. RJP App. E contains the embedded cost of service summary for gas, while RJP App. F contains a table of gas delivery rates.[5] RJP App. D shows that after calculating the various categories — Central Hudson is provided a weighted cost pre-tax weighted cost of capital of 10.01%, 10.05% and 10.09% on gas rates for each respective rate year, with a 9.60% return on common equity, based on a 45% equity ratio.

As with the electric rates, the gas income statements demonstrate the substantial increase in revenue requirement is constrained by providing for a reasonable, but modest, rate of return. By delaying the amortization and recovery of net regulatory assets to rate year two, the rate plan provides for some moderation of the rate year one increase to rate year two.

[5] One of the aspects of the new rate plan for gas is the creation of the new service class, SC-11DLM, "Distribution Large Mains." This subclass was created specifically to address issues raised in this proceeding by USMA, for service to it and, through it, to the Village of Highland Falls.

Additionally, there is no increase in the third rate year, a benefit to customers.

Reasonableness of the Rate Increase

Although the size of the rate increase provided for under the Restated Joint Proposal is sizeable, these rate increases are inevitable. They are driven by pension and OPEB expenses incurred in conformance with the OPEB Statement and Order,[6] and by spending on safety and reliability measures. Pension and OPEB obligations cannot be escaped, and preserving safe and reliable service requires that the forecast safety and reliability expenditures be made. Given the inevitability of these expenditures, additional adjustments to them would not be reasonable.

The pension and OPEB increases in particular are attributable to unfortunate and uncontrollable events. Under the 2001 Rate Plan Order, rates were based on the assumption that Central Hudson would actually earn money on its pension and OPEB plans, and could credit some of those earnings to the benefit of ratepayers. Those earnings, however, were premised upon the dramatic increases in stock valuation during the late 1990's, which proved unsustainable.

[6] Case 91-M-0890, Accounting and Ratemaking Treatment For Pensions and Post-Retirement Benefits Other Than Pensions (OPEB), Order and Statement of Policy Concerning Pension and Other Post-Employment Benefits (issued September 7, 1993).

With the subsequent downturn in financial markets, Central Hudson stopped earning on its plans and became responsible for making substantial contributions to those plans. Under current market conditions, it remains responsible for making sizeable contributions. Therefore, rates made here must recognize that the earnings from pension and OPEB plans will no longer be available as an offset to rates, and also that the utility's substantial contributions to its plans must be funded. Reversing the credit and funding the increased expenses has a dramatic impact on the rates Central Hudson must charge its customers.

As can be seen from Attachments I and II, over the three-year term of the rate plan, pension and OPEB expense drive 55% of the electric rate increase and 47% of the gas rate increase. Recovery of regulatory assets for gas, in part attributable to prior pension and OPEB expense deferrals under the 2004 Rate Modification Order,[7] account for another 32% of the gas rate increase.

Reliability expenditures and other inevitable costs of compliance with Commission directives amount to another 20% of the electric increase, and 8% of the gas increase. As a result, inevitable expenditures -- 75% of the electric increase and 87% of the gas increase -- constitute the bulk of the rate increase.

[7] Case 00-E-1273, supra, Order Modifying Rate Plan (issued June 14, 2004).

Where expenditures are discretionary -- amounting to only 25% of the electric increase and 13% of the gas increase -- they have been properly controlled under the Restated Joint Proposal. As a result, the size of the rate increases is necessary.

Moreover, the impact of the rate increases has been mitigated. Bill impacts have been constrained. As can be seen from RJP App. C, Sheet 5, a typical residential electric customer using 500 kWh per month will see a 5.40% bill impact in rate year one. Since, under the rate moderation approach, equivalent amounts of electric revenues are added in rate year two, and rate year three, the customer will see that impact repeated, on a somewhat smaller percentage basis of 5.00% in rate year two, and 4.60% in rate year three, as shown on Attachment III.

As to gas rates, as seen at RJP App. F, Sheet 5, a typical residential annual heating customer will see a 6.36% bill impact in rate year one. As shown on Attachment IV, this will be followed by an impact of a ~~3.7%~~ 5.17% bill increase in rate year two; rate year three rates will remain the same.

Under the circumstances, these bill impacts are acceptable. Central Hudson cannot default on its pension and OPEB obligations, and spending must be directed towards system safety and reliability or customers will risk suffering more from the cost of service outages and safety problems than they would gain from avoiding a portion of the rate increase.

Finally, these rates have been structured so that there are no hidden costs which will force rate increases upon the end of the Rate Plan's three-year term. If expenses remain stable, the Rate Plan might be able to continue in effect for a substantial period of time beyond the three-year term, affording customers with additional rate certainty stability. As a result, the rates proposed in the Restated Joint Proposal are just and reasonable.

Electric Rate Design

A. Commodity Costs

The Restated Joint Proposal's electric rate design accords with Commission policy on hedging electric commodity costs as discussed in the Statement of Policy on Further Steps Toward Competition in Retail Energy Markets (Retail Market Policy Statement) issued August 25, 2004 in Case 00-M-0504. As discussed there, it is expected that over the longer term, utilities would no longer hedge commodity prices for larger commercial and industrial customers.[8] RJP §III.C.2 achieves that goal, by providing that there will be no new hedges for Central Hudson's SC-3 or SC-13 classes, where larger commercial and industrial customers experience real-time commodity prices.

[8] Retail Market Policy Statement, p. 32.

The Retail Market Policy Statement, however, noted that utilities should continue in the near term to maintain a balanced contract portfolio supporting residential customer commodity service.[9] As a result, the Restated Joint Proposal provides that hedging for those customers will continue, with the costs recovered from those customers through a commodity rate. Recovery of hedging costs in the commodity rate correctly ties the costs of the hedges to the cost of commodity.

Notwithstanding the arguments anticipated from SCMC, recovery of hedging costs through delivery rates would inappropriately sever the tie between those costs and Central Hudson's charges for commodity service, and would also result in other adverse impacts. Recovery through delivery rates would dilute the value of the hedges, requiring Central Hudson to purchase additional hedges to achieve the same level of protection. Moreover, customers of ESCOs would benefit from the hedges, when they should depend upon their ESCO supplier for their commodity service, instead of leaning on the utility to reduce the cost risk of ESCO supply.

[9] Retail Market Policy Statement, p. 29.

B. The FPO Issue

The Restated Joint Proposal does not provide for Central Hudson to offer a Fixed Price Option (FPO) for gas or electric service. PULP and CPB may take the position that the utility should be required to offer FPOs. This position runs counter to Commission policy, and, thus, is no reason to withhold approval of the Restated Joint Proposal.

The Commission recently examined the issue of FPOs in the FPO Order.[10] There, it noted that a then-existing Central Hudson FPO for gas commodity service "distorts the market, acts as a barrier against ESCO entry into the market, and is an obstacle to innovation in the market." Although making an allowance for the potential continuation of an FPO for one year, November 1, 2005 through November 1, 2006, the Commission ordered the Company to thereafter terminate its fixed price option as of November 1, 2006. In response to the Order, Central Hudson decided to forego continuation of the FPO even during the year allowed, and terminated it as of November 1, 2005. The Restated Joint Proposal fulfills the conditions established in the FPO Order and so it cannot be said the

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[10] Case 05-G-0311, Small Customer Market Coalition, Order Directing the Future Termination, Subject to Conditions, of a Fixed Price Offer (issued July 22, 2005).

Restated Joint Proposal is not in the public interest because of its lack of an FPO.

Gas Balancing

Under the Restated Joint Proposal, RJP §V, Central Hudson will implement a new gas balancing program as of April 1, 2007. In the November 29 Balancing Order, the Commission noted that Central Hudson was "the only large local gas delivery company (LDC) in New York that does not have in place daily balancing procedures for its largest customers."[11] RJP §V rectifies that deficiency by properly implementing daily, and monthly, gas balancing for larger customers in SC-9 and SC-11 in conformance with the November 29 Balancing Order and the June 1 Balancing Order.[12] It also resolves outstanding issues from the Retail Access Order, and addresses other gas balancing issues affecting customers in SC-6, SC-12 and SC-13. Moreover, these provisions dovetail with and implement the monthly gas balancing and cashout provisions developed by Central Hudson under the Retail Access Order, as set forth in the utility's July 29, 2005

[11] November 24 Balancing Order, p. 7.

[12] Case 04-G-0463, supra, Order on Real Time Metering and Daily Balancing and Notice Soliciting Comments (issued June 1, 2005).

Report on Gas Balancing and Cashout Issues filed in response to that Order.[13]

With the implementation of these balancing and cashout provisions, obsolete provisions in Central Hudson's tariff will be eliminated. Imbalances are properly priced, sending the correct price signals that will impel customers, or their energy services companies (ESCO), to arrange for the delivery of their gas commodity as accurately as is feasible. As a result, system reliability is enhanced and deviations between amounts customers propose to use and amounts they actually have delivered are minimized.

Customers also may avail themselves of the choice between daily balancing and monthly balancing rates previously denied them even though available at practically every other large LDC in the State. Moreover, the daily and monthly balancing rates have been properly set to impose on customers the appropriate costs of the service they select, avoiding cross-subsidizations among customers that might exist under the present system. Customers also gain the opportunity to trade imbalances, allowing them to avoid potential imbalance penalties

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[13] Case 05-M-0332, Central Hudson Gas & Electric Corporation's Plan For Retail Energy Markets, Order Accepting Retail Access Plan, Modifying Rate Plan, and Establishing Further Procedures (issued June 1, 2005).

during times when Central Hudson's overall system is largely balanced.

Arriving at the comprehensive gas balancing and cash-out provisions and procedures set forth in the Restated Joint Proposal would have been difficult to achieve through litigation. Realizing the benefits attending gas balancing promptly and efficiently is another reason justifying the Restated Joint Proposal's adoption.

Gas Service to West Point

The Restated Joint Proposal resolves a contentious dispute between Central Hudson and USMA over rates for gas delivery service to West Point. USMA had imposed on Central Hudson a unilateral modification of the contract between the two for gas delivery service, reducing the amounts USMA paid to the utility. Central Hudson had appealed the unilateral modification to the Armed Services Board of Contract Appeals, where the outcome was uncertain.

Not only did this dispute render it impossible to accurately forecast revenues from USMA, it could have made it difficult to set rates that reflect the costs of service to Central Hudson's 250 customers downstream from West Point that depend upon USMA facilities for service. Adding to the problems attending the dispute were the difficulty in assembling accurate cost data for a 6-inch pipeline that was installed in 1931, and disagreement over the allocation of costs for a new 10-inch pipeline installed in 2003. Uncertainties also affected ownership of various gas facilities located on West Point property, and the responsibility for maintaining them.

This complex and contentious dispute could have disrupted ratemaking for many years. The Restated Joint Proposal, however, settles the dispute on terms just and reasonable to all parties. Cost-based delivery rates for West Point are set, in the new SC-11 DLM sub-classification. This new classification ensures appropriate treatment for both USMA and other SC-11 customers. Moreover, USMA also agrees to accept the newly-arrived at methods for gas balancing and the related rates and requirements, after, however, an interim period that will enable it to adjust its operations to the requirements of the new balancing system.

Achieving settlement of this complex dispute is a major benefit of the Restated Joint Proposal. Besides arriving at cost-based rates, expensive and time-consuming litigation in front of the Armed Services Contract Board of Appeals, and over possible appeals from its initial decision, is averted. Outcomes in that venue were difficult to predict.

<u>Unbundling</u>

At RJP §VI, the Restated Joint Proposal further unbundles Central Hudson's rates in conformance with the

Statement of Policy on Unbundling and Order Directing Tariff Filings issued August 25, 2004 in Case 00-M-0504 (Unbundling Policy Statement). There, utilities were directed to present unbundled rates when filing new rate cases. The rate unbundling provisions arrived at here are in full conformance with the Unbundling Policy Statement, and reflect the most recent policy developments.

Commodity-related expenses and lost revenues attending customer migration are treated in conformance with the Unbundling Policy Statement requirements. The existing back-out credits first adopted in the 2001 Rate Plan Order, which are not cost-based, are replaced with MFCs that are cost-based. These MFCs are set at tiered levels, depending upon whether the customer purchases its commodity from Central Hudson or from a competitive supplier.

Tiering the MFCs recognizes the relationship, in particular affecting uncollectibles expense, between the costs attributable to supplying commodity to a customer of an ESCO that participates in Central Hudson's Purchase of Receivables (POR) program, and costs to those ESCO customers outside the ambit of a POR program. Establishing and coordinating MFCs and

POR program expenses and charges in this fashion comports with the most recent policy developments.[14]

Updating Central Hudson's approaches to commodity service in competitive markets is an outcome that would have been difficult to achieve in a litigated proceeding. It furthers the Commission's policies promoting the growth of competitive markets and is a major step forward for the development of retail access at a utility where the growth of retail markets has long lagged.[15]

Depreciation Expense

Another contentious dispute resolved in the Restated Joint Proposal is the issue of depreciation expense. Staff and Central Hudson took widely divergent positions in their initial testimonies over the proper calculation of electric and gas depreciation, and the size of excess electric depreciation reserve. RJP §VIII resolves those disputes, and the size of the electric depreciation excess reserve available as an electric rate moderator is set in RJP Appendix J. Moreover, the contents and analyses required of a depreciation study to be filed in subsequent proceedings is established, eliminating a potential

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[14] See, e.g., Case 00-M-0333, Niagara Mohawk Power Corporation, Order Clarifying and Adopting Joint Proposal on Competitive Opportunities (issued April 20, 2006).

[15] Retail Access Order, p. 13.

source of dispute in the future. Resolution of the depreciation issue is another benefit of the Restated Joint Proposal.

Deferrals and Earnings

The Restated Joint Proposal at RJP §IX establishes conditions governing deferrals, capital structure and earnings sharing. These provisions resemble those common to rate plans adopted by the Commission, and are consistent with prior practice. They appropriately apportion the responsibility for risk between Central Hudson and its ratepayers.

A. Deferral Offsets and Provisions

Of particular importance is RJP §X.B.6, which offsets certain deferrals against Central Hudson's share of any over-earnings. This provision protects ratepayers in the event that Central Hudson both accumulates significant deferrals in its favor and also over-earns, by ensuring that the Company will bear its fair share of costs under those circumstances.

As to individual deferral items, of particular note is that the utility will be liable for certain costs during the term of the rate plan related to environmental clean-up costs at its former Manufactured Gas Plant (MGP) sites. Pursuant to RJP §X.I, the utility is permitted to defer for future recovery the differences between actual costs for MGP site investigation and remediation and the rate allowances, with carrying charges on the deferred balance (net of tax) for both debit and credit balances at the pre-tax authorized rate of return. This approach is consistent prior practice.[16]

Additionally, Central Hudson remains subject to the OPEB Policy Statement. RJP §XI.J establishes the parameters for the ratemaking calculations that will be used in implementing that Policy Statement.

B. Earnings Sharing

Earnings sharing under the Restated Joint Proposal also conforms with numerous other similar rate plan provisions the Commission has adopted. A 100 basis point deadband is established at RJP §X.B, between a 9.6% ROE and a 10.6% ROE, where Central Hudson retains earnings. Thereafter, the utility shares earnings between 10.6% and 11.6% evenly, 50% shareholders/50% ratepayers, and shares earnings between 11.6% and 14% ROE at 35% shareholders/65% ratepayers. Any earnings above a 14% ROE are deferred for customer benefit.

The structure of this earnings sharing provision resembles that adopted in the 2001 Rate Plan Order, and reflected in other Rate Plans. Its allocation of benefits and risks is appropriate. As a result, it should be adopted.

[16] Case 01-G-1821, Central Hudson Gas & Electric Corporation, Untitled Order (issued October 25, 2002).

C. Equity Ratio and ROE

The assumption of a 45% equity ratio underlying the Restated Joint Proposal is consistent with the ratio adopted for Central Hudson in the 2001 Rate Plan Order and reiterated in the 2004 Modification Order. It is a reasonable equity ratio for an electric and gas utility with Central Hudson's business risk profile and should allow it to maintain its current "A" bond rating.

Central Hudson is also allowed to use actual capitalization in calculating over-earnings, but only up to an actual equity ratio of 47%. This provision allows the utility to make the calculation based upon actual experience, subject to an appropriate limitation.

The rates in the Restated Joint Proposal are based upon an ROE of 9.6%. This amount is reasonable. Staff in its initial testimony began with a recommendation on ROE of 8.7%. Staff updated that number to 9.09%, by eliminating CH Energy Group from its proxy group of comparison companies, by correctly commencing the calculation of the stock valuation adjustment based on the number of shares outstanding beginning in 2006 instead of beginning in 2005, and by changing the weighting of its zero beta CAPM calculation in the overall ROE determination from 25%/75% to 50%/50%.

The 9.09% ROE was then updated to reflect one-half of the change in the risk-free interest rate from the time of the initial testimony to month-end March 2006. That calculation yielded fourteen additional basis points, resulting in an ROE of 9.23%. Finally, a stay-out premium of .38% was added to the calculation, to recognize that Central Hudson had agreed to a rate plan that extended for a three-year term, instead of litigating a rate that could be revised again after one year. The length of the term increases risk to the utility. The 9.6% ROE that results is reasonable.

This figure is well below those adopted in recent Rate Plan Orders,[17] recognizing changes in financial and economic circumstances that have occurred recently, affecting the ROE calculation. Reflecting these changes that have inured to the benefit of ratepayers results in rates that are reasonable to them, while still allowing the utility to earn a reasonable return on its investment.

Reliability and Safety Expenditures

Under the Restated Joint Proposal, Central Hudson will significantly increase its spending on maintaining system reliability and enhancing gas safety. Under RJP §VII, it will increase its capital expenditures generally. In addition, under

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[17] See, e.g., Case 04-E-0572, Consolidated Edison Company of New York, Inc. - Electric Rates, Order Adopting Three-Year Rate Plan (issued March 24, 2005).

RJP §XI.E, it will build an additional substation needed to support reliability,[18] and, under RJP §XI.F, it will expand electric transmission ROW maintenance efforts. Finally, under RJP §XIV.E, it will increase spending on replacing gas cast iron and bare steel pipe. These expenditures are necessary to ensure that Central Hudson provides safe, adequate, and reliable service.

A. Capital Budget Expenditures

In past years, Central Hudson was able to fund electric system improvements with monies from the Benefit Fund established in the 2001 Rate Plan Order. Those funds, earned upon Central Hudson's divestiture of its generation, have been depleted. It is now necessary to move forward with enhancing electric reliability and with funds from the ratepayers that will benefit from that reliability.

The levels of expenditure expected are reasonable under these circumstances. The electric plant expenditures begin with the amount Central Hudson proposed in its testimony, including a $2.0 million distribution pole replacement program. This forecast recognizes that Central Hudson's actual spending on its electric capital budget was approximately 40% above the

[18] By letter dated April 24, 2006, Central Hudson appropriately requested trade secret protection for the amount it proposes to spend on the substation; it is still negotiating with various affected parties over those costs and setting an expenditure target publicly could undercut its negotiating position.

forecast presented for the 2001 Rate Plan, over the five-year period from 2000 through 2004.

As to gas capital expenditures, the amount again begins with that reflected in Central Hudson's initial testimony, which recognizes that the utility overspent its gas capital budget forecast by an average of about 2.75% per year during the five-year period from 2000 through 2004. As to common capital expenditures, again based on the Company's testimony, they reflect that Central Hudson in 2005 spent 11% more than was forecast in 2004, and 20% more than was forecast for that year in the 2001 Rate Plan Order.

B. ROW Maintenance

Expenditures on ROW maintenance are also reasonable. The projected expenditures for distribution ROW increase from $7.8 million in rate year one to $8.1 million in rate year two, and $8.4 in rate year three. These projected expenditures accord with the $8.0 million average amount Central Hudson expended for this purpose for calendar years 2002 through 2004. Some of those expenditures, however, were supported by drawing down the Benefit Fund. Since this source of funding is depleted and is no longer available, ratepayers must make up the difference.

Expenditures on transmission ROW maintenance have increased significantly. Under the Restated Joint Proposal, the amount grows from $2.1 million in Rate Year 1 to $2.2 million in Rate Year 2 and $2.3 million in Rate Year 3, well above the $1.1 million historic level for calendar year 2005 and the annual allowance of $643,000 under the 2001 Rate Plan Order. This increase in expenditures, however, is required to comport with Commission policy. A failure to adequately pursue transmission ROW maintenance was at the root of the 2003 Blackout that affected much of the Northeast and Midwest, causing substantial economic damages and threatening the public health and welfare. Responding to that event, the Commission established new guidelines for conducting transmission ROW maintenance, and these expenditures are necessary to conform with those requirements.[19]

C. Gas Safety Expenditures

Expenditures on replacement of cast iron and bare steel gas mains are also increased, as set forth at RJP §XIV.E. Those forms of piping are prone to leakage and corrosion, which could increase safety risks to the public. Preserving the public safety certainly warrants this increase in expenditure.

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[19] Case 04-E-0822, Transmission Right of Way Maintenance Practices, Order Requiring Enhanced Transmission Right-of-Way Management Practices By Electric Utilities (issued June 20, 2005).

D. Expenditure True-Ups

The Restated Joint Proposal provides an important protection for ratepayers for these expenditures.[20] If Central Hudson does not expend these amounts, the shortfalls are deferred for the benefit of ratepayers. This will encourage Central Hudson to make the expenditures necessary to preserve electric system reliability and gas system safety.

This type of spending shortfall provision is generally not available in a litigated one-year rate proceeding, where rates would be based on a forecast of expenditures instead of a requirement that funds actually be spent. As a result, the shortfall spending provisions are another benefit of the Restated Joint Proposal.

Low-Income Programs

Another area where Central Hudson moves from lagging behind Commission policy to the forefront in implementing those policies is the development of a low-income customer assistance program under the RJP §XII. Central Hudson's existing Low-Income Program was inadequate, and upon a utility petition, was modified earlier this year.[21] Under this modification, funds

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[20] Distribution ROW maintenance costs are not subject to a true-up, because, unlike the rest of these expenditures, spending is set close to historic levels and, consequently, it appears likely the utility can readily achieve the spending target.

[21] Case 00-E-1273, supra, Order Reallocated Surplus Ratepayer Funds to Provide a $200 Supplemental Energy Assistance Benefit to Low-Income Customers (issued January 18, 2006).

intended to benefit low-income customers, but unspent because of shortcomings in the program, were reallocated by Central Hudson, after consultation with Staff and approval by the Commission, to achieve their intended purpose.

Recognizing that the existing program must be replaced, the Restated Joint Proposal provides for rapid implementation of an interim program that will rectify the most serious deficiencies in the existing program. The interim program, in turn, will be replaced as soon as feasible with the Enhanced Powerful Opportunities (EPOP) Program. To ensure that the EPOP program is properly structured, however, the interim program will remain in effect until the EPOP Program is fully designed and ready for implementation.

The EPOP Program will be based on elements taken from the low-income program devised in the NFG Rate Plan Order,[22] which represents the Commission's most recent thinking on appropriate low-income program policies. The EPOP Program will carefully target assistance to the customers most able to benefit from that assistance, and will tailor the amountof the assistance to meet the particular needs of a participating household. This targeted approach offers the potential for not only assisting customers with meeting current bills but also for

[22] Case 04-G-1047, National Fuel Gas Distribution Corporation, Order Establishing Rates and Terms of Two-Year Rate Plan (issued July 22, 2005).

equipping them with the tools for arranging their finances so that they can meet current bills, eliminate arrears accrued prior to entry into the program, and avoid accumulating additional arrears in the future.

Moreover, the Restated Joint Proposal provides for adequate funding of these enhanced low-income customer assistance efforts. Funding will increase from $1.148 million in Rate Year 1, to $1.32 million in Rate Year 2, and $1.50 million in Rate Year 3. If, for some reason, Central Hudson under-spends the allocated funding, that amount will be deferred for use in subsequent years on low-income programs. If it overspends, by no more than 15% of the funding level, it may recover the difference. These measures ensure that the proper funding of the low-income programs is available, so that they may achieve their intended purposes.

Under the Restated Joint Proposal, Central Hudson will move from a low-income program that has experienced difficulties to a state-of-the-art approach. This sort of benefit would be difficult, if not impossible, to achieve in a litigated one-year rate proceeding.

Service Quality Incentive Mechanisms

The Restated Joint Proposal provides for Customer Service Quality Performance, Gas Safety, and Electric Reliability Mechanisms. These mechanisms have become common features of electric and gas utility rate plans, and the Restated Joint Proposal achieves the objectives intended for these mechanisms.

A. Customer Service Quality Performance and Gas Safety

The Customer Service Performance Quality Mechanism, at RJP §XIII, provides for rate adjustments if Central Hudson fails to meet a Customer Satisfaction metric, and a PSC Complaint Rate metric. Central Hudson will owe rate adjustments to ratepayers if it fails to satisfy the metrics. It also provides for the development of a Telephone Response Time metric, and there is an Appointments Kept provision that compensates a customer if the utility fails to timely keep a scheduled service appointment. The Gas Safety mechanism, at RJP §XIV, is based upon Leak Management, Prevention of Excavation Damages, and Emergency Response metrics. Again, Central Hudson will return to ratepayers rate adjustments if it fails to meet the metrics.

Central Hudson's Customer Service Quality Satisfaction and Gas Safety performance in recent years has been satisfactory. The Restated Joint Proposal's metrics are intended to present the company with incentives to maintain and improve its performance in these areas. The approaches taken also resemble those adopted in other rate plans, and should not cause controversy.[23]

B. Electric Reliability

The electric reliability mechanism, however, has been the source of considerable controversy. In the 2001 Rate Plan Order, it was noted that Central Hudson intended to install a new Outage Management System (OMS) that would replace existing electric reliability data collection methods, based on reports collected from crews working in the field, with a computerized approach. The OMS system records phone calls received from customers regarding outages, and then makes projections of the extent and number of customers affected by the outage based on the telephone data. The 2001 Rate Plan Order allows Central Hudson to request appropriate adjustment of electric reliability indices if it could show the introduction of OMS affected the calculation of the reliability indices.

Following implementation of OMS, Central Hudson has had difficulty in meeting the SAIFI and CAIDI reliability indices.[24] In 2002, it failed to meet the SAIFI metric, and in

[23] See, e.g., Case 03-E-0765, Rochester Gas & Electric Corporation, Order Adopting Provisions of Joint Proposals With Conditions (issued May 20, 2004).

[24] The System Average Interruption Frequency Index (SAIFI) is the average number of times a customer is interrupted during a year; the Customer Average Interruption Duration Index (CAIDI) is the average interruption duration time for those customers that experience an interruption during a year.

2004 it failed to meet both the SAIFI and CAIDI metrics. It petitioned for adjustments to the metrics, arguing that OMS had affected the calculation of the reliability indices. In the Rate Adjustment Order, the Commission decided that Central Hudson had not adequately demonstrated that its failure to meet reliability metrics was in fact due to the installation of OMS. Central Hudson promptly requested rehearing of the Rate Adjustment Order, arguing, among other things, that it was entitled to a hearing to test the evidence underlying the Commission's decision. While the Petition For Rehearing remained under consideration, Central Hudson again incurred rate adjustments upon failing both the SAIFI and CAIDI metrics in 2005.

Under the Restated Joint Proposal, all issues affecting Central Hudson's compliance with the electric reliability mechanism established in the 2001 Rate Plan Order are resolved, at RJP §XV. The Commission's decision reached in the Rate Adjustment Order will remain in effect, and Central Hudson will return to its ratepayers the rate adjustments it incurred for failure to satisfy the electric reliability indices during 2002 and 2004. Central Hudson, however, is excused from the rate adjustment incurred for 2005.

This compromise is reasonable. At the very least, Central Hudson probably would have been entitled to a hearing to make its case on its OMS-based contentions. The issues the OMS system raises regarding the impact of moving from reliance on field reports to use of a computerized system, and the interaction between the two systems while both are in place, that would have been difficult to evaluate in litigation. Moreover, the hearing could easily have grown into a broader attack upon the calculation of the indices to include the definition of the major storm exclusion, which establishes the circumstances that justify excluding data from the calculation of the indices, and other aspects of the calculation.

The litigation on this matter likely would have been lengthy, with the prospect that reaching a definitive result would be difficult. In the meantime, Central Hudson would likely focus on the litigation, distracting it from improving its reliability performance in comparison to the reliability indices, whatever the cause of its failure to satisfy targets in 2002, 2004 and 2005. The compromise avoids this distracting litigation, which ultimately would have been likely barren of positive results.

Instead, Central Hudson can now focus on meeting the reliability indices in the future. The SAIFI and CAIDI indices have been re-set at a level that Central Hudson should be able to achieve, and will create an incentive for it to improve reliability, regardless of the impact of OMS. Besides these metrics, an additional incentive, is established, for timely installing major equipment projects that will improve reliability (such as the East Fishkill Substation).

Moreover, because the Restated Joint Proposal allows the utility additional funds for reliability purposes, and, at RJP §XV.C.2 encourages it to hire additional line crew, the utility should have the means to improve its performance. As a result, the Restated Joint Proposal allowed all parties to escape the fruitless process of trading blame and accusations in contentious litigation and to move forward with achieving better compliance with reliability indices.

Resolving the litigation over electric reliability performance is a major benefit of the Restated Joint Proposal. The resolution arrived at is reasonable, and should establish the means for avoiding similar disputes in the future.

Billing and Metering

The Restated Joint Proposal provides for several studies on improving approaches to billing and metering that might benefit Central Hudson's customers. Central Hudson is the only combination gas and electric utility in New York that still bills most of its customers on a bi-monthly basis instead of a monthly basis. Under RJP §XVI, the utility will conduct a study of the cost and benefits of moving to monthly billing. The results of that study can then be used by the Commission to decide if and when the utility should commence monthly billing, and the appropriate recognition of any costs that might be incurred as a result.

The Restated Joint Proposal also provides for an Automated Meter Reading (AMR) Pilot Program. Under the AMR Pilot, Central Hudson will gain experience with AMR technology, upon the installation of approximately 5,000 meters. Such a pilot is of sufficient size for the utility to learn more about the cost and benefits of installing this type of metering. The program will be funded from unused competitive metering funds remaining in the Benefit Fund and from excess electric depreciation reserve, so that ratepayers will not see any bill impacts. The Pilot Program is reasonable, because it will allow the utility to experiment with up-to-date metering technology that might facilitate retail access and otherwise benefit customers.

Retail Access and Economic Development

The Restated Joint Proposal's Retail Access provisions, at RJP §XVII, have been tailored to advance the Commission's policies for creating competitive opportunities in retail energy markets. The provisions give Central Hudson clear direction on the best practices for furthering Commission policy on retail access, and are in conformance with the Retail Access Order and the Retail Access Policy Statement.

The Commission's economic-development policies are also furthered. The existing economic development plan, which has been satisfactory, is continued, at RJP §XI.C.2.

Other Provisions

The remainder of the Restated Joint Proposal consists of terms and conditions in general conformance with those commonly seen in rate plans of this type. Accordingly, the Restated Joint Proposal is just and reasonable in all respects.

CONCLUSION

For all the foregoing reasons, the Joint Proposal should be adopted because it results in safe and adequate service at just and reasonable rates, achieves a fair balance of interests among the parties and customers, produces constructive results that may not have been achievable except through settlement, and otherwise conforms with Commission policies.

Respectfully submitted,

Leonard Van Ryn
Dakin Lecakes
Staff Counsel

Dated: May 1, 2006
Albany, New York

Central Hudson Electric Rate Drivers

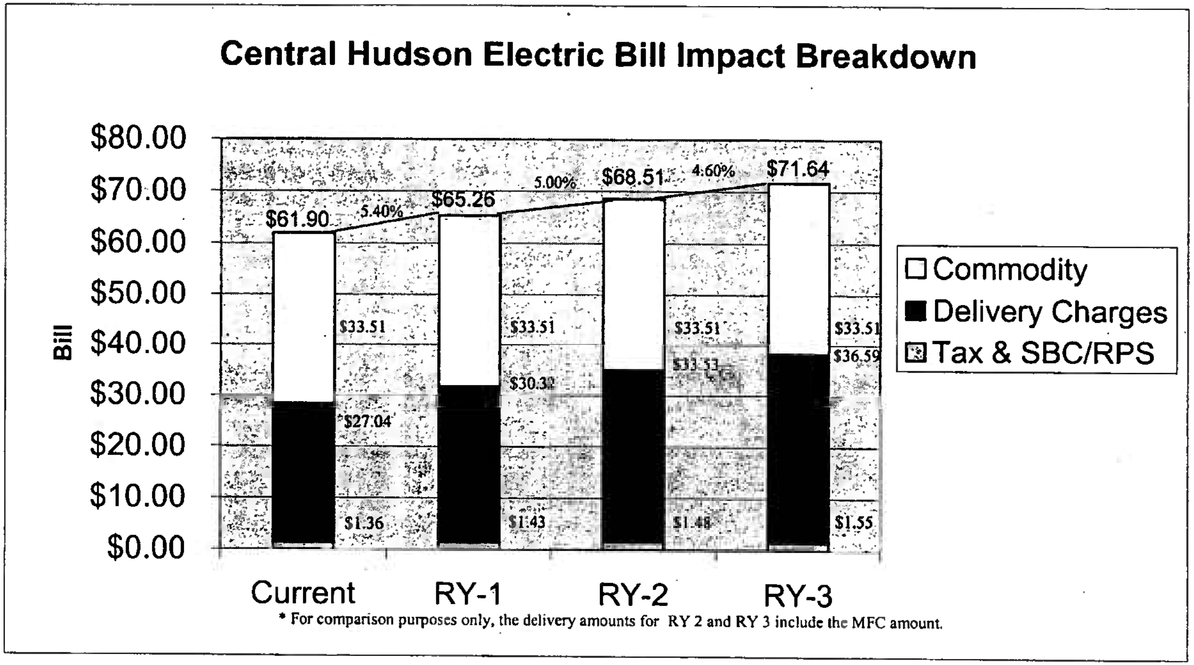
	Dollars	% of Total Increase
Total Un-Moderated Rate Increase	$53,033	100%
Reasons For Rate Increase:		
* Right of Way Maintenance Expense	$5,833	11%
Direct Labor Expense	1,342	3%
Fringe Benefits Expense	1,517	3%
* Other Post Employment Benefits (OPEB's) Expense	7,223	14%
* Pension Expense	21,585	41%
Contract Rent Expense	1,471	3%
Storms Expense	2,498	5%
* Stray Voltage Testing	2,389	5%
* Manufactured Gas Plant (MGP) Remediation Cost Recovery	1,454	3%
Depreciation Expense	3,168	6%
Property Tax Expense	3,518	7%
* Inclusion of State Income Tax	3,576	7%
Federal Income Tax Adjustments	7,875	15%
Increase in Rate Base	22,552	43%
Total	86,002	162%
Offsetting Items to Rate Increase:		
Sales Growth	($20,538)	-39%
* Reduction in Revenue Taxes	(2,099)	-4%
Deferred Federal Income Taxes	(9,800)	-18%
Change in Rate of Return	(3,900)	-7%
Total	($36,336)	-69%
Net of Other items	$3,367	6%
Total	$53,033	100%

* Unavoidable/Commission Policy Items	$39,962	75%
Discretionary Items	$13,071	25%
Total Rate Increase	$53,033	100%

Central Hudson Gas Rate Drivers

	Dollars	% of Total Increase
Total Un-Moderated Rate Increase	$14,060	100%
Reasons For Rate Increase:		
Direct Labor Expense	491	3%
Fringe Benefits Expense	432	3%
* Other Post Employment Benefits (OPEB's) Expense	1,713	12%
* Pension Expense	4,907	35%
* Manufactured Gas Plant (MGP) Remediation Cost Recovery	262	2%
* Recovery of Net Regulatory Assets	4,551	32%
Property Tax Expense	842	6%
* Inclusion of State Income Tax	1,257	9%
Federal Income Tax Adjustments	2,619	19%
Increase in Rate Base	4,270	30%
Total	21,343	152%
Offsetting Items to Rate Increase:		
Sales Growth	($5,033)	-36%
* Reduction in Revenue Taxes	(527)	-4%
Deferred Federal Income Taxes	(2,360)	-17%
Change in Rate of Return	(1,044)	-7%
Total	($8,964)	-64%
Net of Other items	$1,681	12%
Total	$14,060	100%

* Unavoidable/Commission Policy Items	$12,162	87%
Discrectionary Items	$1,898	13%
Total Rate Increase	$14,060	100%


Central Hudson Electric Bill Impact Breakdown
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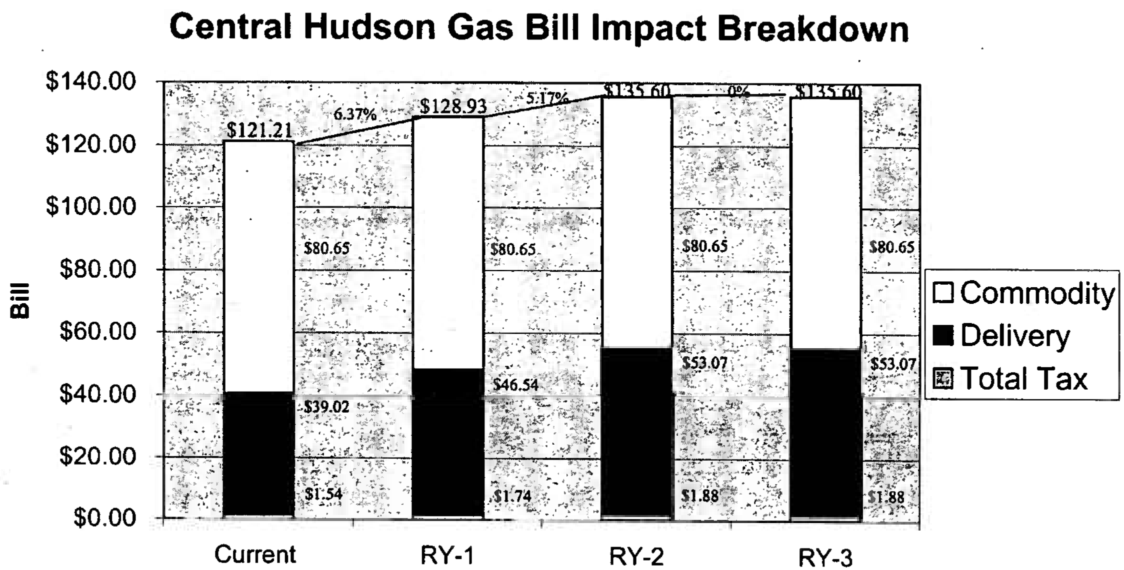
$70.00
$60.00
$50.00
$40.00
$30.00
$20.00
$10.00
$0.00
Bill
$61.90
5.40%
$65.26
5.00%
$68.51
4.60%
$71.64
$33.51
$33.51
$33.51
$33.51
$27.04
$30.32
$33.53
$36.59
$1.36
$1.43
$1.48
$1.55
Current
RY-1
RY-2
RY-3
Commodity
Delivery Charges
Tax & SBC/RPS
* For comparison purposes only, the delivery amounts for RY 2 and RY 3 include the MFC amount.

C. 05-E-0934&35 Statement in Support
Appendix IV



* For comparison purposes only, the delivery amounts for RY 2 and RY 3 include the MFC amount.

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