STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on June 13, 2013

COMMISSIONERS PRESENT:

Garry A. Brown, Chairman
Patricia L. Acampora
James L. Larocca
Gregg C. Sayre

CASE 13-G-0136 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of National Fuel Gas Distribution Corporation for Gas Service.

ORDER SETTING TEMPORARY RATES

(Issued and Effective June 14, 2013)

BY THE COMMISSION:

INTRODUCTION

In our order initiating this proceeding, we observed that the rates established for National Fuel Gas Distribution Corporation (NFGD or the Company) in December of 2007 may now be higher than needed to provide safe and adequate service. In particular, we noted that under current rates NFGD may be earning a return in excess of its cost of equity at the same time that deferral balances for which customers may ultimately be responsible are growing.[1] These circumstances, we said, suggested that customers may be paying more than a just and reasonable rate for natural gas service, such that the continuation of the *status quo* would not be in the public interest.

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[1] Order Instituting Proceeding and to Show Cause (issued April 19, 2013)(OSC).

For that reason, we instituted this proceeding to examine the need to revise the gas rates of NFGD and to provide ratepayers with appropriate and concomitant adjustments to the Company's deferred accounts, pursuant to our statutory authority under Public Service Law (PSL) §§66, 72, and 114. We recognized, however, that the full examination of NFGD's rates could take several months to complete, during which time the utility's customers would be without protection from rates that, at the conclusion of our full examination, might be found to be excessive. Therefore, we determined that we must consider the establishment of temporary rates pursuant to PSL §114. To initiate this process, we directed NFGD to show cause on or before May 8, 2013, why its current rates should not be made temporary, subject to refund. We called for the immediate assignment of an Administrative Law Judge (ALJ) and directed that the temporary rates phase of this proceeding be conducted on an expedited basis in order that we might make a timely and informed decision at our June 2013 session.

Consistent with that expedited schedule, the question of whether NFGD's current rates should be made temporary, subject to refund, is now before us for decision. We answer the question in the affirmative.

PROCEDURAL HISTORY

NFGD filed its response to our order to show cause, with supporting testimony and exhibits, on May 8, 2013, as required. On May 20, pursuant to a schedule adopted by the ALJ in consultation with the parties, Department of Public Service Staff (Staff) submitted testimony and exhibits addressing the Company's response. Two days later, NFGD filed rebuttal testimony.

An evidentiary hearing was held on May 23, 2013, at which all parties were afforded the opportunity to cross-examine

the witnesses of others and to present live rebuttal testimony of their own, if they chose to do so. In addition to Staff and NFGD, two parties were represented at the hearing: Multiple Intervenors (MI) and the Utility Intervention Unit of the New York Department of State.[2] MI and Staff conducted limited cross-examination of the Company's witnesses; NFGD cross-examined Staff's witnesses. No other party engaged in cross-examination.

On June 6, 2013, the parties submitted post-hearing briefs. Briefs were received from NFGD, Staff, and MI.

THE PARTIES' POSITIONS

NFGD. In its response to the OSC and its brief, the Company contends that:

- NFGD's earnings are a result of management efforts to improve efficiency and control costs. Those efforts have enabled the Company to operate for nearly six years without having to request an increase in rates. Combined with declining commodity costs, those fixed delivery rates have meant that NFGD's customers have experienced reductions in their overall bills and are now paying the lowest gas rates in the State. All of this has been achieved with no reduction in the quality or safety of service. NFGD has met or exceeded all Commission-established targets for customer service and system safety.

- The OSC was premised substantially on the assertion that NFGD earned a return on equity (ROE) of 13.15% in the fiscal year ended September 30, 2012, and was expected to realize similar

[2] Admitted parties New York State Electric & Gas Corporation, Rochester Gas and Electric Corporation, and the Public Utility Law Project did not participate in the hearing. PUSH Buffalo did not attend the hearing in Albany but observed the proceedings by video link from the Commission's Buffalo offices.

earnings in the 2013 fiscal year. Those figures were based on an unreasonably low equity ratio, as Staff has acknowledged. The Company asserts that using Staff's method, the recalculated earnings level for fiscal year 2012 using an assumed 48% ratio is 12.41%. If NFGD's actual equity ratio of 55% were used, the earnings would be no more than 11.30%.

- NFGD calculates that its earnings for the year ending May 31, 2014, will produce an ROE of 9.22%, just slightly above its allowed return of 9.1%. Staff makes adjustments to the Company's calculations which result in a projected earnings level of 11.06%. The most significant of these adjustments, for equity ratio, earnings base/capitalization, property tax expense, and a productivity imputation, are erroneous, according to NFGD, and should be disregarded. The modest overearnings resulting from this calculation do not warrant the imposition of temporary rates.

- Subjecting NFGD to an order to show cause concerning the establishment of temporary rates denies the Company equal protection because (a) there are now, and have been in the past, companies with overearnings similar to, or greater than, those of NFGD that have not been subjected to such an order, and (b) the Commission considers temporary rates only when a utility is overearning and not when it is underearning.

- The public interest will not be served by setting temporary rates in this case because doing so will send a signal to utility managers that it is more important to keep earnings below a level that will attract Commission scrutiny than it is to pursue effective cost control and efficiency.

- The expedited process by which the question of temporary rates is being considered denies the Company due process.

Staff. Staff, in its testimony and brief, asserts that:

- NFGD's ROE for the year ending May 31, 2014, conservatively estimated, will be 11.06% compared with a current cost of equity of approximately 9.0%. This translates to $10.3 million per year in rates in excess of what is required for safe and adequate service.
- The Company has not demonstrated that it will be harmed by making current rates temporary while adjustments to its permanent rates are considered.
- Use of a 9.0% cost of equity for the purpose of evaluating whether NFGD's rates are excessive is reasonable in light of returns recently authorized by the Commission, and the use of recently authorized returns for estimating the current cost of equity is consistent with Commission precedent.
- Staff's adjustments to NFGD's projection of earnings for the year ending May 31, 2014, for the earnings base/capitalization adjustment, property tax expense, equity ratio, and productivity, are reasonable and are consistent with Commission practice and precedent. Its adjustments related to net plant and the Medicare subsidy income tax deduction were not disputed by the Company.

MI. In its brief, MI makes the following points:

- The Commission need not resolve the differences between NFGD and Staff as to the Company's projected earnings for the year ending May 31, 2014, in order to find that delivery rates should be made temporary. It need only conclude that there is a reasonable basis to believe those rates are excessive.
- The continued recording of deferrals by NFGD highlights the inequity of the present situation. Shareholders are protected where costs have increased beyond existing rate allowances,

while ratepayers are afforded no relief where costs have been reduced below the levels allowed in rates. NFGD has no incentive to seek new rates under these circumstances. It is up to the Commission to make rates temporary, subject to refund, while a comprehensive rate review is conducted.

- The proper rates for NFGD can be determined only with reference to the Company's costs, revenues, and rate structures. Comparisons to other utilities are meaningless.
- If the Commission does not make all rates temporary, it should set the temporary amount at a level at least twice Staff's estimate of the amount by which NFGD's rates may be excessive in order to ensure that ratepayers are protected if Staff's estimate proves to have been understated.

DISCUSSION

We have carefully reviewed the evidence and arguments submitted by all parties to this proceeding, and we find it to be undisputed that NFGD has earned in excess of its allowed ROE from 2010 to the present, and is forecast to do so again in the year ending May 31, 2014. We conclude, therefore, that NFGD's customers may be paying rates that are in excess of what is required for the provision of safe and adequate service. Given our paramount obligation to ensure that the rates paid by all utility customers are just and reasonable, we are of the opinion that the public interest requires that NFGD's rates be made temporary, subject to refund, while we undertake to examine them comprehensively.

NFGD argues that the imposition of temporary rates is both punitive and unnecessary. It is neither. NFGD has presented no information that would suggest that it would be harmed by having its current rates made temporary, and we can think of no reason why it should be. Making current rates

temporary would not alter the Company's cash flow or revenues. NFGD would continue to collect the rates that were authorized for it in 2007, and which have been demonstrated to be sufficient to cover its full cost of service, including a return well above its allowed 9.1% cost of equity.[3]

In addition, contrary to the Company's assertion, establishing temporary rates would not require that any portion of the revenue collected while those rates were in effect be returned to ratepayers. If the full, permanent rate proceeding concludes with a finding that current rates are not excessive, there would be no basis for requiring any refund. Even if it is found that those rates were excessive to some extent, we would still have the obligation to determine the most appropriate disposition of those excess revenues. What that determination should be is a subject to be addressed by the parties in the permanent rates phase of this proceeding, and we do not prejudge it here.

NFGD also argues that the imposition of temporary rates effectively punishes the company for superior effort in the pursuit of efficiencies that have reduced costs and increased returns. Doing this, it suggests, would establish a bad precedent potentially deterring other utilities from aggressively pursuing similar cost-cutting measures.

We disagree. We took pains in the OSC to express our recognition of, and appreciation for, the efforts of NFGD to find ways to operate more efficiently. However, as we noted in the 2007 proceeding in which we set temporary rates for Orange and Rockland's electric service, we are interested in efficiency because it ultimately reduces the cost of service borne by

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[3] This exceeds the minimum return required by PSL §114, which mandates only that temporary rates be sufficient to provide a return of at least 5%.

ratepayers. If all efficiency gains are retained by utility shareholders, "our regulatory policy is thwarted, not fulfilled."[4]

Of course, if shareholders never benefited from cost reduction efforts, there would be very little incentive for utility managers to aggressively pursue efficiency gains. That is not how our system of regulation works, however. Between rate settings, utilities charge their authorized rates and are free to retain the revenues collected regardless of the actual cost of service they incur. This phenomenon is referred to as "regulatory lag" because there is normally a gap in time between the occurrence of changes in a utility's cost of service and the recognition of those changes in rates. This gap, or lag, provides an important incentive for utilities to reduce costs while the benefit of those cost reductions can be retained. The gap cannot be allowed to persist indefinitely, however, or once again, our regulatory policy would be thwarted rather than fulfilled. A utility has little or no incentive to end an overearning situation, so the Commission must act when such a condition persists.

In this case, it is undisputed that NFGD has earned a return in excess of its authorized ROE in each of its last three fiscal years and that it will do so again in the current fiscal year. In addition, even viewing all of the data and arguments presented by the parties in the light most favorable to the Company, it appears that NFGD will have excessive earnings in 2014. The only dispute is whether that excess will be small or

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[4] Case 06-E-1433 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Orange and Rockland Utilities, Inc. for Electric Service*, Order Making Temporary Rates Subject to Refund (issued March 1, 2007), p. 20.

large.[5] Under these circumstances, it is appropriate for the Commission to act now to protect ratepayer interests until a final determination can be made based on a full examination of NFGD's rates.

Unlike many utilities currently operating under negotiated rate plans, NFGD does not have an earnings sharing mechanism in place that would credit at least a portion of excess earnings to ratepayers. Therefore, unless current rates are made temporary, ratepayers will have no recourse for recovery of any excess rates they may pay while this case moves forward. If Staff's estimate that the Company may be overearning at a rate of $10.3 million per year proves to be correct, the cost to ratepayers is likely to be millions of dollars before we are able to render a final decision in this case.

This is exactly the type of situation for which the temporary rates provision of the Public Service Law was envisioned. As the Court of Appeals discussed in *Bronx Gas and Electric Co. v. Maltbie*, the determination of a fair utility return "has become an intricate, involved, tedious proceeding, extending into months and years," presenting "the opportunity

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[5] Staff and NFGD expend considerable effort debating the propriety of various adjustments that account for the difference between Staff's projection of an ROE of 11.06% for the Company for the year ending May 31, 2014, and NFGD's projection of 9.22%. In particular, NFGD argued that our policies for setting permanent rates should not apply in determining whether a utility is overearning for purposes of setting temporary rates. This debate will be significant in the permanent rates phase of this proceeding. It does not have to be resolved here, except to observe that the policies we use to decide permanent rates are relevant to deciding whether to set temporary rates. Temporary rates are appropriate when there is reason to believe that the utility is overearning and there is a need to hold ratepayers harmless while the exact level of such overearnings, if any, is investigated.

... for intentional delay ... whereby unwarranted profits may be obtained."[6] It found that PSL §114 was an appropriate and constitutionally valid protection for consumers in these circumstances. We find it to be an appropriate remedy in this case.

NFGD's complaint that it is the victim of arbitrary and unconstitutionally discriminatory action by the Commission is without merit. In essence, it argues that there have been in the past, and are currently, numerous examples of utilities that have earned more than their allowed returns without having their rates made temporary. Some of those companies are, or were, earning substantially higher returns than NFGD. Therefore, the Company says, there is no rational basis for singling out NFGD for the imposition of temporary rates. In so arguing, the Company fails to recognize the differences between its situation and those of other utilities operating under rate plans that have expired or are about to expire.

We are exercising our discretion to pursue temporary rates for NFGD to ensure that its rates remain just and reasonable. Unlike the major gas utilities it refers to, NFGD has been operating outside an established rate plan for over five years and has been earning above its authorized rate of return for at least the last four without an earnings sharing mechanism. Moreover, during those years NFGD has deferred costs for recovery from ratepayers. Further, NFGD's March 27, 2013, proposal to refine and rebalance its existing rate regime did not sufficiently address the imbalance between ratepayer and shareholder interests.

Moreover, if NFGD's interpretation of the law were correct, the Commission, in establishing temporary rates, would be precluded from looking at factors other than the authorized

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[6] 271 N.Y. 364, 371 (1936).

return, and would be required to use the same treatment for every utility experiencing comparable overearnings. Nothing in PSL §114 suggests that such inflexibility is required. To the contrary, the statute expressly grants the Commission very broad discretion. It states that temporary rates may be established when the Commission "is of the opinion" that such action is required by the public interest.

Such discretion is essential because the considerations underlying a decision to set temporary rates vary substantially from case to case. For example, NFGD points to the recent development of a rate plan for KEDNY, presented to the Commission at the same session as this order on temporary rates for NFGD. It argues that KEDNY benefited from higher earnings than those experienced by NFGD. In so arguing, however, NFGD only glancingly recognizes the existence of a rate plan for KEDNY which was in effect through December 2012. Under that plan, the impact on ratepayers of overearnings was mitigated by, among other measures, a multi-year rate plan having an earnings sharing mechanism. Further, in contrast to the Company's situation, KEDNY's overearnings are not likely to persist indefinitely, but rather are resolving themselves as a result of prompt negotiations at the end of KEDNY's rate plan.

For these types of issues, rigid numerical standards are not helpful; the total situation of the utility must be considered. In this case, we are of the opinion, based on the information provided by NFGD and the history of discussions between Staff and the Company over the last several months, that NFGD will continue to earn in excess of its allowed return and that a prompt negotiated resolution sufficient to fully protect the interests of ratepayers is unlikely. Under those circumstances, temporary rates are fully appropriate.

NFGD's second ground for asserting a denial of equal protection and arbitrary action -- that the Commission will not consider temporary rates in situations where a utility is underearning -- is wrong on two levels. First, it posits the need for symmetrical treatment of parties whose access to information, and the rate relief that might follow from it, is fundamentally asymmetrical. It is the utility that maintains all of the information necessary to assess its financial condition. With that information, the utility has the capability and the legal right to request an increase in rates not only when it is underearning, but even when it is merely concerned that its earnings might decline in the future. Ratepayers, and the Commission, by contrast, must wait for periodically required earnings reports from the utility and often, as here, perform an audit of those reports before it can be determined that an overearning situation exists. Even then, there is no rate case in place, and most of the information needed to reset rates must be discovered from the utility in a proceeding which, as the Court of Appeals noted, may be involved and protracted.

Second, NFGD's premise is simply wrong. The Commission can, and has, authorized temporary increases in rates when it has been demonstrably necessary to provide a utility with sufficient revenues. See, for example, *100 Park Avenue v. PSC,* 37 A.D.2d 404 (1971).

NFGD also suggests that the expedited schedule for the temporary rates phase of this proceeding may have denied it due process. The argument has no merit. As the Company notes in its brief, it was engaged in discussions with Staff concerning its earnings situation months before we issued our OSC. NFGD submitted a proposal for settlement of the issue on March 27, 2013, more than three weeks before the OSC. This proceeding was

not a bolt from the blue. Furthermore, since the issuance of the OSC, NFGD has had a full seven weeks, encompassing an evidentiary hearing with an opportunity for cross-examination of Staff witnesses, to address the very limited and simple issues involved at this time in this case: Is the Company overearning? If so, is there any reason why making its rates temporary would not be in the public interest? These questions have been appropriately addressed, and NFGD has not presented any information to suggest that additional time or process would make the answers either clearer or different.

Emergency Approval

NFGD's customers, who are located in an area of the State that has been severely adversely affected by the recent economic downturn, may be paying rates that exceed just and reasonable levels by hundreds of thousands of dollars every month. Under these circumstances, immediate action to protect ratepayer interests is warranted. As discussed, temporary rates hold ratepayers harmless against the possibility of overearnings. That possibility exists in this case and there is no reason why the Company's ratepayers should be denied a provisional remedy while permanent rates are set. Full compliance with the advance notice and comment requirements of SAPA §202(1) would frustrate that purpose and would be contrary to the public interest. Customers would be required to continue to pay potentially unjust and unreasonable rates without any legal means of avoiding or obtaining a refund of charges ultimately found to be excessive. Therefore, immediate issuance of this Order pursuant to SAPA §202(6) is necessary for the preservation of the general welfare and is in the public interest.

CONCLUSION

The evidence of overearning by NFGD warrants making the utility's current rates temporary, subject to refund. The appropriate disposition of any temporary rates collected that are determined to have been in excess of just and reasonable levels will be addressed in the permanent rates phase of this proceeding.

The Commission orders:

1. Effective on the issue date of this order, the gas distribution rates of National Fuel Gas Distribution Corporation are hereby made temporary under Section 114 of the Public Service Law subject to refund pending the determination of permanent gas rates in this proceeding.

2. This action is taken pursuant to the emergency procedures of §202(6) of the State Administrative Procedure Act (SAPA), based upon our finding that immediate action is necessary to preserve the general welfare and that National Fuel Gas Distribution Corporation's ratepayers would be harmed by the delay necessary for compliance with the notice provisions of SAPA.

3. This proceeding is continued.

By the Commission,

(SIGNED)

JEFFREY C. COHEN
Acting Secretary