

Case No. \_\_\_\_\_

**NEW YORK STATE ELECTRIC & GAS  
CORPORATION**

**DIRECT TESTIMONY OF  
THE NORTHBRIDGE PANEL**

David W. Segal  
Neil S. Fisher

April 5, 2007

## The NorthBridge Panel

1 Q. Please state your name.

2 A. My name is David W. Segal. I am also joined by my colleague, Neil S. Fisher, to  
3 form the NorthBridge Panel on behalf of New York State Electric & Gas  
4 Corporation ("NYSEG" or the "Company").

5 Q. Mr. Segal, please summarize your educational background.

6 A. I graduated from Brown University in 1985 with a Bachelor of Science degree in  
7 applied mathematics and economics. I obtained a Masters in Business  
8 Administration from Harvard University in 1990.

9 Q. Please describe your work experience.

10 A. The NorthBridge Group is an economic and management consulting firm  
11 providing advice to clients in the electric and natural gas industries. Since joining  
12 NorthBridge in 1992, I have consulted with electric utility clients regarding  
13 industry restructuring, asset divestitures, stranded cost measurement, risk  
14 management, and general industry strategy. Before joining NorthBridge, I was an  
15 associate with Putnam, Hayes & Bartlett where I also advised electric utility  
16 clients.

17 Q. Have you testified in other proceedings before the New York State Public Service  
18 Commission ("PSC" or the "Commission")?

19 A. Yes. I have testified in Case 01-E-0359, the Electric Price Protection Plan of New  
20 York State Electric & Gas Corporation, in Cases 02-E-0198 and 01-G-0199, the  
21 most recent electric and gas rate proceedings for Rochester Gas and Electric  
22 Corporation ("RG&E"), and in Case 05-E-1222, the NYSEG 2005 Electric Rate  
23 Plan Extension Filing.

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1 Q. Mr. Fisher, please summarize your educational background.

2 A. I graduated from Swarthmore College in 1984 with a Bachelor of Arts in  
3 Economics with Honors. I obtained a Masters in Business Administration from  
4 Yale University in 1989.

5 Q. Mr. Fisher, please describe your work experience.

6 A. I am a Principal at The NorthBridge Group, which is an economic and  
7 management consulting firm providing advice to clients in the electric and natural  
8 gas industries. Since joining NorthBridge in 1993, I have consulted with electric  
9 utility clients regarding industry restructuring and default service design. I have  
10 also developed strategies for unregulated retail electric service companies  
11 interested in participating in retail markets. Before joining NorthBridge, I was an  
12 associate with Putnam, Hayes & Bartlett where I also advised electric utility  
13 clients.

14 Q. Mr. Fisher, have you testified in other proceedings before this Commission?

15 A. Yes. I testified in Case 05-E-1222, the NYSEG 2005 Electric Rate Plan  
16 Extension Filing, and in Case 96-E-0891 in regard to NYSEG's rate design issues  
17 associated with the retail access credit.

### 18 I. Introduction and Purpose

19 Q. What is the purpose of your testimony?

20 A. The purpose of our testimony is threefold:

21 1. Briefly describe the changes proposed by the Company to its supply  
22 service and how the changes will benefit customers and preserve and  
23 enhance customer choice;

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1           2.     Describe the proposed methodology to establish NYSEG's rates based on  
2                     market price evidence and to index that price for future market price  
3                     changes; and

4           3.     Discuss the adequacy and fairness of financial benefits to customers, and  
5                     risk and compensation for the Company.

6    Q.     Please summarize your major conclusions.

7    A.     We have three of them.

8           1.     The proposed changes to NYSEG's supply service will provide all  
9                     customers with significant financial benefits and preserve and enhance  
10                    customer choice.

11          2.     NYSEG's proposed fixed rate is priced to be consistent with market price  
12                     evidence from recently conducted fixed price power solicitations in the  
13                     region.

14          3.     The proposed supply service will provide customers guaranteed benefits  
15                     with the potential for additional earnings sharing, while appropriately  
16                     compensating the Company for assuming the risks of the proposed fixed  
17                     price service.

18    **II.     The Proposed Changes to NYSEG's Supply Service Will Provide All**  
19            **Customers With Significant Financial Benefits And Preserve**  
20            **Customer Choice**

21    Q.     Can you briefly summarize the proposed changes to the Company's supply  
22                     service?

23    A.     Yes. The Company proposes to simplify its supply service offerings, to provide  
24                     customers a guaranteed and immediate rebate related to the provision of supply

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1 service, to make price comparisons easier for consumers, and to preserve and  
2 enhance the customer's ability to choose suppliers.

3 Q. How will NYSEG's supply service be simplified?

4 A. The Company will offer customers one supply service option. Customers taking  
5 service under SC1, SC2, SC3, SC5, SC6, SC8, SC9, SC12 and street lighting, as  
6 well as customers taking service under SC7-1, SC7-2, SC7-3, SC7-4 and SC11  
7 with demands below 500 kW ("Small Customers"), who do not choose an energy  
8 service company ("ESCO"), will receive fixed price supply service from NYSEG.  
9 Customers with demands equal to or greater than 500 kW taking service under  
10 SC7-1, SC7-2, SC7-3, SC7-4 or SC11, who do not chose an ESCO, will receive  
11 supply service from NYSEG pursuant to the Company's current hourly pricing  
12 tariff, which is currently mandatory for customers with loads above 1 MW and  
13 voluntary for smaller demand-billed customers. The Company will also eliminate  
14 the enrollment period in which customers may select among competing utility and  
15 ESCO supply options.

16 Q. How will this program preserve and enhance customer choice?

17 A. For larger customers with competitive supply options, NYSEG will expand the  
18 application of the Mandatory Hourly Pricing ("MHP") program to more  
19 customers. The expansion of the MHP program will allow ESCOs an opportunity  
20 to offer such customers fixed price products. For Small Customers who have  
21 fewer supply options, NYSEG will establish a fixed rate consistent with market  
22 prices and will allow customers to move from NYSEG's fixed price service to an  
23 ESCO at any time without penalty.

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1 Q. How will price comparisons be made easier for customers?

2 A. The Company's Non-Bypassable Charge ("NBC") will be fixed for all customers  
3 and be trued-up on an annual basis. This change will simplify price comparisons  
4 for customers. A customer could simply compare the Company's fixed supply  
5 rate to ESCO supply offers without the need to compare the balance of the  
6 customer's rate structure, much of which may be confusing to customers.

7 Q. How will customers receive a guaranteed rebate?

8 A. In 2008, the Company will add a guaranteed \$20 million credit to the NBC, which  
9 customers will keep even if the pre-tax margin from offering fixed rate supply  
10 service is less than that level (and even if it is negative). In addition, customers  
11 would receive in the following year's NBC half of any pre-tax margin above \$20  
12 million.

13 Q. How will customers benefit from the proposed changes in NYSEG's supply  
14 service?

15 A. There are five important customer benefits associated with the Company's  
16 proposal. First, customers will benefit from the simplicity of having one standard  
17 NYSEG supply service. Currently, the enrollment period enables customers to  
18 choose either a fixed or a variable rate offer from NYSEG or to choose from  
19 among qualified ESCOs. While choices are often valuable, many customers  
20 appear to be confused by their supply options. Based on a recent survey  
21 conducted by BRX for NYSEG and the statements of consumer advocacy groups,  
22 it is apparent that customers prefer a fixed price option. The NYSEG Panel  
23 describes the results of the customer survey in more detail. Absent an affirmative

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1 choice, customers currently are defaulting to a variable option, not the customer-  
2 preferred fixed price option. Second, under the Company's new proposal,  
3 residential and small commercial and industrial ("C&I") customers will receive  
4 the protection and stability of fixed rate supply service. Currently, such  
5 customers receive a variable rate if they do not affirmatively choose a supplier.  
6 Third, customers will receive a guaranteed credit of \$20 million, or approximately  
7 \$1.33 per MWH through the NBC as a part of this proposal, and will have the  
8 opportunity to receive even more benefits through earnings sharing. The fourth  
9 benefit for customers is the freedom to switch to an ESCO at any time without  
10 penalty. This option is a great benefit to customers, but a substantial risk to the  
11 Company. If prices fall subsequent to the setting of the fixed rate, ESCOs can  
12 offer savings. Since customers will be free to switch from NYSEG to an ESCO at  
13 any time, customers could take advantage of any lower rates offered by ESCOs.  
14 If prices rise subsequent to the setting of the fixed rate, then customers get the  
15 benefit of rate protection. Thus, customers get the best of both worlds – if prices  
16 rise, customers have rate security and stability, and if prices fall, customers have  
17 the ability to shop for lower prices and to switch suppliers. The fifth benefit is the  
18 ability to compare easily NYSEG's rate to ESCO offers. All customers within a  
19 service class will be charged the same NBC regardless of whether NYSEG or an  
20 ESCO provides the customers' supply service. Customers will be able to simply  
21 compare NYSEG's supply rate to ESCO price offers.

22 Q. Will customer choice be preserved and enhanced under the Company's supply  
23 proposal?

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1 A. Yes. There are five ways in which customer choice will be preserved and  
2 enhanced under the Company's proposal. First, NYSEG's fixed price service will  
3 be set based on direct market evidence for similar fixed price service. The current  
4 rate is set below the market price for such service as we will demonstrate in the  
5 next section of this testimony. A fair price for the service will provide ESCOs a  
6 better opportunity to offer savings to customers. Second, ESCOs will be better  
7 able to explain the difference between their offerings and a single Company  
8 supply service. Customers appear confused by the current program's multiple  
9 supply options with multiple ways to shop with an ESCO (the ESCO Price Option  
10 and the ESCO Option with Supply Adjustment). Simplifying the Company's  
11 supply service should make it easier for ESCOs to explain supply options to  
12 potential new customers. Third, customers will have the ability to switch at any  
13 time to an ESCO without penalty. While they have that ability under the current  
14 program, several ESCOs have argued in the past that the current program limits  
15 their ability to move customers once the enrollment period is completed.  
16 Therefore, NYSEG's proposal eliminates the enrollment period and, as a result,  
17 simplifies customer supply and switching decisions. Fourth, the fixed NBC  
18 allows customers to focus only on the supply portion of the rate when comparing  
19 ESCO price offers and the Company's supply rate. Finally, expanding the MHP  
20 will very likely encourage most customers larger than 500 kW, who have more  
21 competitive options, to switch to ESCOs. Market evidence from other  
22 jurisdictions indicates that large C&I customers that are exposed to an hourly  
23 price service are able to shop for supply.

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1 **III. NYSEG's Proposed Fixed Rate Is Priced To Be Consistent With Market**  
2 **Evidence From Fixed Price Power Solicitations**

3 Q. What market price evidence did NYSEG rely on to establish its proposed supply  
4 rates?

5 A. As described further below, we examined the results of recent wholesale  
6 solicitations and available market price and customer information to establish  
7 NYSEG's proposed retail rates.

8 Q. Applying the proposed rate setting methodology to current market prices, what  
9 would the proposed fixed supply rates be?

10 A. Based on current market prices, the proposed supply rate in 2008 for residential  
11 (SC1) would be 9.093 cents (or \$.0909) per kWh. Rates for other small customer  
12 service classes were developed by the NYSEG Panel. The Company proposes to  
13 adjust the 2008 rates shown in Exhibit \_\_ (NYSEG Panel-5) based on changes in  
14 market prices from the time they were measured for this filing and November 1,  
15 2007.

16 Q. What is the basis for the new supply rate structure?

17 A. The proposed rate structure allows NYSEG to charge prices consistent with  
18 market evidence for the supply service. Substantial market evidence was used to  
19 establish fixed prices for NYSEG. Recent solicitations indicate that the method  
20 for determining NYSEG's supply rates needs to be changed in order to reflect  
21 market prices.

22 Q. Have you reviewed the market price results of recent solicitations to supply full  
23 requirements service?

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1 A. Yes. We reviewed the market price results of recent solicitations to supply full  
2 requirements service to residential customers. The results were adjusted for  
3 significant differences relating to the supply product definition, timing, location,  
4 and associated risks. Based on the average of recent wholesale solicitation results  
5 adjusted for the differences that we will further describe, we developed a rate for  
6 SC1 residential customers. The SC1 rate was used to develop rates for other  
7 service classes as described by the NYSEG Panel.

8 Q. What do you conclude from this analysis?

9 A. The rate proposed by NYSEG for fixed-price supply service is priced to be  
10 consistent with the market prices observed in these solicitations, appropriately  
11 adjusted to reflect the differences in product structure and market conditions.

12 Q. Why should the Commission consider the results of recent full requirements  
13 solicitations?

14 A. Full requirements solicitations provide a strong measure of market prices at the  
15 time of the solicitation for the supply product being offered to customers in a  
16 particular location and, thus, show what another supplier would offer for the same  
17 service. This supply product involves certain types of costs (e.g., energy,  
18 capacity, load following, etc.) and risks (e.g., customer switching, general  
19 load/weather uncertainty, future market price risks, etc.). NYSEG must incur  
20 many of the same types of costs and must assume similar risks when serving its  
21 residential and small C&I customers. Several utilities in other service areas have  
22 outsourced the responsibility for these costs and risks to suppliers through  
23 solicitations to provide full requirements supply at fixed prices to residential and

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1 small C&I customers. The solicitations take the form of an auction or an RFP. In  
2 response to these solicitations, prospective suppliers indicate the prices at which  
3 they are willing to provide fixed-price supply service. The resulting price  
4 represents a fair indication of the prevailing market price for the supply of full  
5 requirements supply service for the product in the solicitation.

6 Q. Are you aware of a discussion that occurred during a recent Commission session  
7 regarding a proposal for electric utilities to engage in hedging on behalf of mass  
8 market customers?

9 A. Yes. The substance of the session was related to us by NYSEG personnel.

10 Q. In your opinion, is NYSEG's proposed fixed price supply service consistent with  
11 the Staff recommendations during that session?

12 A. Yes. While Staff has not issued specific recommendations regarding the level of  
13 price volatility that should be met, our understanding of its proposal is that  
14 utilities should offer stable supply rates within some level of accepted uncertainty.  
15 Under NYSEG's proposal, the rate for the fixed price supply service is completely  
16 fixed for one year. As such, the supply service will provide customers with price  
17 certainty and stability during the year and a measurable amount of volatility from  
18 year to year.

19 Q. Do the remaining legacy contracts provide further price hedging for customers?

20 A. Yes. The remaining NUG contracts and the nuclear legacy contract provide a  
21 hedge for all customers from one year to the next, thereby reducing the customers'  
22 total year-to-year price volatility. As market prices rise, the NUG and nuclear  
23 legacy contracts will cushion that rise through a reduction in the NBC. The one-

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1 year fixed price combined with the legacy contracts is quite consistent with the  
2 aims of the Staff hedging proposal.

3 Q. Earlier you mentioned the term "full requirements" service. What do you mean  
4 by that?

5 A. "Full requirements" supply service means that the supplier must satisfy a fixed  
6 percentage of all of the utilities' remaining customers' supply requirements  
7 throughout the delivery period, regardless of the customers' instantaneous changes  
8 in energy consumption, and regardless of how frequently customers switch onto  
9 or off of the supply service.

10 Q. What contributes to the full requirements service market price?

11 A. The full requirements supply service is comprised of components representing  
12 services or benefits provided to the customer and, correspondingly, costs and risks  
13 to the supplier. For example, full requirements service supply includes the  
14 obligation to meet the energy and capacity requirements (and sometimes  
15 transmission service) necessary to serve the load of retail customers.

16 In addition, full requirements service suppliers face costs and risks  
17 associated with customer switching. If the service is being provided at a fixed  
18 rate to customers, customers are likely to elect the service when market prices are  
19 higher than the fixed rate, and not elect it when market prices are lower than the  
20 fixed rate. This customer switching option can be very valuable for customers,  
21 but very expensive for service suppliers.

22 Q. Which solicitations for full requirements service supply to residential and small  
23 C&I customers did you analyze?

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1 A. We reviewed the recent competitive auctions in the New Jersey service areas of  
2 Atlantic City Electric Company ("AECO"), Jersey Central Power & Light  
3 Company ("JCPL"), Public Service Gas & Electric Company ("PSEG"), and  
4 Rockland Electric Company ("RECO"). We also considered the recent  
5 competitive RFPs in the Maryland service areas of Baltimore Gas & Electric  
6 Company ("BGE"), Allegheny Power ("Allegheny"), Delmarva Power  
7 ("Delmarva"), and the Potomac Electric Power Company ("Pepco"). Finally, we  
8 examined the recent solicitations in the service areas of Commonwealth Edison  
9 ("ComEd"), Penn Power and Pike County. Exhibit \_\_\_\_ (NorthBridge Panel-1)  
10 provides a list of the solicitations we considered and summarizes the term,  
11 customers included, and the date of the solicitation.

12 Q. Why did you consider these solicitations?

13 A. The solicitations satisfy several key criteria. First, the solicitations involve full  
14 requirements supply service to residential customers. Second, the solicitations  
15 were completed primarily within the last fifteen months, so the winning bids are  
16 relatively "fresh."<sup>1</sup> Third, we relied on solicitations where there was enough  
17 available market information to adequately analyze the solicitation.

18 Q. How do the winning bid prices in these solicitations compare to NYSEG's  
19 proposed service rates?

20 A. Exhibit \_\_\_\_ (NorthBridge Panel-2) shows the winning bid prices as compared to

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<sup>1</sup> The earliest bid date of all of these solicitations is December 2005.

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1 NYSEG's proposed SC1 supply rate of \$90.93/MWH (\$.0909/kWh). As can be  
2 seen in the exhibit, there appear to be significant differences across solicitations  
3 and the NYSEG proposed rate appears to be too low.

4 Q. Is this a fair comparison?

5 A. No. Looking at the raw data can be confusing and misleading. In order to  
6 properly compare the results of these solicitations with NYSEG's proposed rate,  
7 several adjustments are necessary to analyze these results on an apples-to-apples  
8 basis with NYSEG's proposed rates.

9 Q. What approach did you use to compare the results of these solicitations with  
10 NYSEG's proposed rate?

11 A. First, we removed line losses from NYSEG's proposed SC1 rate in order to  
12 compare them with solicitation prices without line losses in them. By removing  
13 7.28% for line losses, the resulting rate is \$84.80/MWH for residential SC1  
14 customers. Next, we adjusted the results of the solicitations so that they could be  
15 compared on an apples-to-apples basis with NYSEG's rate, net of line losses.  
16 These adjustments fall into three categories:

17 1. **Major definitional differences** – removing components that may be  
18 included in the bid price (e.g., transmission, ancillary services, line losses,  
19 taxes) that are not included in NYSEG's proposed rates (net of line losses).

20 2. **Locational and timing differences** – adjusting for the market cost  
21 differences (e.g., differences in locational energy prices, load shapes,  
22 capacity prices) and adjusting for timing differences (e.g., differences  
23 between market conditions at the time of the solicitation versus NYSEG's

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1 filing, and the term of the supply delivery period).

- 2 3. **Asymmetric risk differences** – considering the differences in costs  
3 associated with asymmetric risks; that is, risks that have greater downside  
4 than upside, such as risks related to customer switching.

5 We will describe each of these adjustments in greater detail later. Some of these  
6 adjustments are quite simple to explain and relatively easy to quantify. Others are  
7 just as real, and may be significant, but are more difficult to measure.  
8 Furthermore, it is important to note that while we have identified certain  
9 asymmetric risk differences between NYSEG's proposal and other solicitations,  
10 there certainly are other risks that are assumed by a fixed rate service supplier,  
11 whether it is NYSEG or a bidder in a solicitation.

12 Q. What risks will NYSEG assume under the fixed rate proposal?

13 A. NYSEG must assume numerous risks when providing a fixed rate under the  
14 Company's proposal, including:

- 15 • **Price (unhedged positions)**. The risk that wholesale market prices will  
16 rise once the fixed rates are established. This could occur for numerous  
17 reasons (e.g., higher fuel costs, increased demand, unanticipated plant  
18 outages).
- 19 • **Quantity**. The risk that retail customers use more or less load than  
20 expected, due to weather or other factors, such as changes in the

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1 economy.<sup>2</sup>

- 2 • **Load shape.** The risk that retail customers use more during peak periods  
3 when market prices are high, and less during off-peak periods, than was  
4 expected.
- 5 • **Basis differential.** The risk that prices rise in the NYSEG Zone as  
6 transmission congestion is reduced and lower cost generation can move  
7 from the NYSEG Zone to higher priced areas in the New York ISO (i.e.,  
8 the historical basis differential between the NYSEG Zone and other New  
9 York markets diminishes).
- 10 • **Unexpected changes in regulatory requirements, market rules, and**  
11 **laws.** The risk of unforeseen changes in market rules, regulations and  
12 laws that could increase supply costs.
- 13 • **Supplier default.** The risk that NYSEG could be forced to obtain  
14 replacement power at higher prices if its suppliers default on their  
15 contracts.
- 16 • **Collateral.** The risk that downward price movements or other  
17 circumstances would require NYSEG to post significant collateral under  
18 its contracts to purchase its supply.

19 Even though NYSEG will assume these risks, we did not make any adjustments to  
20 the solicitation results for these risks. Like NYSEG, fixed rate service suppliers

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<sup>2</sup> Customer switching risks are related to quantity risk, but are discussed later in the asymmetric risk

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1 that bid in structured solicitations typically assume similar risks, and seek  
2 compensation for such risk in their bids.

3 Q. Please describe the first category of adjustments - accounting for major  
4 definitional differences.

5 A. The winning bids in New Jersey and Penn Power solicitations include the cost of  
6 transmission service, while NYSEG's supply rate does not, so it was necessary to  
7 remove the cost associated with this service from the winning bids in these  
8 solicitations. Similarly, the winning bids in Maryland's and Pike County's<sup>3</sup>  
9 solicitations include the cost of line losses, so we netted the effect of these line  
10 losses from these bids. The Pike County rate also includes Pennsylvania gross  
11 receipts tax ("GRT"), which was removed. Finally, the cost associated with  
12 ancillary services was removed from all of the bids because they include coverage  
13 of ancillary services costs, but NYSEG's proposed supply rate does not.<sup>4</sup>  
14 Exhibit \_\_\_ (NorthBridge Panel-3) summarizes the definitional adjustments that  
15 were made, and Exhibit \_\_\_ (NorthBridge Panel-4) shows the resulting price  
16 comparison after adjusting for these definitional differences.

17 Q. Is this a fair comparison?

18 A. No. While it is more accurate than looking at the raw bid results, this comparison

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category.

<sup>3</sup> For Pike County, we reviewed the retail rates that resulted from the most recent solicitation.

<sup>4</sup> For purposes of discussion, we combined ancillary services and RTO administration costs together and refer to the combined costs as "ancillary services."

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1 still ignores several very important differences – namely locational and timing  
2 differences.

3 Q. Please describe your second category of adjustments - locational and timing  
4 differences.

5 A. Locational differences arise mainly because energy and capacity market prices  
6 differ by region. These differences can largely be attributed to differences in  
7 supply and demand in particular market areas, and transmission constraints  
8 between market areas. Exhibit\_\_\_(NorthBridge Panel-5) shows the differences in  
9 the average spot energy prices between the utility zones where the solicitations  
10 were held and the NYSEG Zone for the most recent twelve-month period. As can  
11 be seen in the exhibit, some of these basis differentials historically have been  
12 quite significant, ranging anywhere from negative \$13 per MWH to positive \$10  
13 per MWH. Large differences in market prices at different locations can also be  
14 observed by studying the differences in forward market prices (i.e., market prices  
15 for future delivery). Besides the basis differential, locational differences in the  
16 market cost of energy and capacity are driven by differences in customer  
17 consumption patterns (i.e., load shapes).

18 In addition, there are two important timing differences. First, the  
19 solicitations occurred at different points in time. Therefore, we considered how  
20 market conditions have changed since each solicitation was conducted. Second,  
21 the solicitations have different delivery periods, ranging from twelve to thirty-six  
22 months. Even if everything else is equal, the market price for supply over a  
23 shorter delivery period will likely be different than the prevailing market price for

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1 supply over a longer delivery period due to different market costs and  
2 expectations over the different periods. In addition, if a delivery period covers  
3 exactly one, two or three full years, the cost to provide load-following energy and  
4 capacity will be different than if the delivery period includes a disproportionate  
5 number of non-summer or summer months.

6 Q. How did you account for the locational and timing differences?

7 A. In order to adjust a given solicitation's result for locational and timing differences,  
8 we used available market price information as of the time of that solicitation and  
9 associated load data to quantify cost components related to energy, capacity, load  
10 shaping, etc.<sup>5</sup> We then summed these market values for the given solicitation's  
11 default service. Next, we used a consistent methodology to determine and sum  
12 the current market values of each of the same cost components for NYSEG's  
13 service supply. We then subtracted from that sum the aggregated value that we  
14 calculated for the given solicitation to calculate the quantifiable differences  
15 related to locational and timing differences. For a given solicitation, the net result  
16 reflects differences relative to the NYSEG Zone attributable to energy and  
17 capacity prices, load shapes,<sup>6</sup> delivery periods, and the point in time when the

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<sup>5</sup> Our analysis considered the differences between the customer load patterns for each utility solicitation and the applicable NYSEG customer class load pattern. Differences in Auction Revenue Rights credits were also accounted for in our analysis.

<sup>6</sup> In some instances, the solicitations combined supply procurement for residential and small C&I customers (e.g., New Jersey and ComEd). Our analysis reflects the differences between the combined load shape used for the solicitation and the NYSEG load shape for SC1.

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1 prices were established.<sup>7</sup>

2 Exhibit \_\_\_\_ (NorthBridge Panel-6) shows the price comparison with  
3 adjustments for the definitional differences as well as the locational and timing  
4 differences across solicitations. The average price of the solicitations that  
5 included residential load was \$84.80/MWH.<sup>8</sup> This exhibit demonstrates that the  
6 results across solicitations are more consistent than they appeared before any  
7 adjustments.

8 Q. Please explain the third category of adjustments - differences in asymmetric risks.

9 A. NYSEG assumes several asymmetric risks (i.e., risks that have greater downside  
10 than upside) when providing a fixed rate. The most significant of which is the  
11 customer switching risk. Winning bidders in solicitations may face similar types  
12 of asymmetric risks to some extent, but as we will explain later, the costs  
13 associated with these risks are significantly different under NYSEG's proposal  
14 than they are in the solicitations analyzed. As a result, NYSEG's rates should be  
15 considered in light of the product and risk differences when comparing the  
16 proposed rates with the results of structured solicitations.

17 Q. Why is customer switching risk asymmetric?

18 A. When a supplier such as NYSEG provides supply service at a fixed rate that is

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<sup>7</sup> We generally did not consider the processes utilities used to translate winning wholesale bid prices to retail rate schedules because our analysis already accounts for differences in line losses and customer load shapes. Other differences, such as averaging the results of the most recent solicitation with the results of solicitations in prior years as they do in New Jersey, are not applicable.

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1 passed through to customers, customers have the incentive and are likely to elect  
2 the NYSEG fixed rate when it is lower than ESCO offers, and they have the  
3 incentive and are likely to choose an ESCO when the NYSEG fixed rate is higher  
4 than ESCO offers. This customer switching option can be very valuable for  
5 customers, but very expensive for NYSEG as a supplier. The customer switching  
6 risk may result in losses for NYSEG. Although the size and likelihood of any  
7 such losses are largely dependent upon market price volatility and the likelihood  
8 that customers will take advantage of this switching option, they could be  
9 substantial for NYSEG.

10 Q. Why do you believe that customer switching risks are higher in NYSEG's service  
11 area than in other service areas where solicitations were held?

12 A. Like many other service areas, NYSEG has proposed in this filing to eliminate  
13 switching rules or restrictions on residential and small C&I customers that prevent  
14 them from switching back and forth between NYSEG's fixed price supply service  
15 and ESCO service. However, unlike most of the service areas that rely on  
16 solicitations, NYSEG currently has higher levels of customer shopping and more  
17 ESCOs actively marketing in its service territory. The principal switching risk  
18 associated with the customers currently served by ESCOs is that they will return  
19 to NYSEG service unexpectedly at a time when market prices are high, forcing  
20 NYSEG to obtain additional supplies at a cost exceeding the fixed price service

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<sup>8</sup> These figures do not include transmission, ancillary services, line losses or GRT.

## The NorthBridge Panel

1 contract prices. NYSEG's switching risk is exacerbated by the large  
2 concentration of shopping load served by a few ESCOs, any one of whom could  
3 suddenly decide to switch all of its customers back to NYSEG whenever it  
4 chooses. In addition, other states have been able to adopt certain measures to  
5 mitigate customer switching and gaming risks. In Maryland, there is a volumetric  
6 rate adjustment mechanism in the event customer switching levels increase  
7 significantly. Unlike NYSEG's proposal, this provision transfers risks from the  
8 default supplier to retail customers. Some states have approved seasonal rates  
9 (e.g., New Jersey) in order to mitigate seasonal gaming of service rates. For all of  
10 these reasons, customer switching risks in NYSEG's service territory will be  
11 higher than they are in many other regions.

12 Q. Does NYSEG's proposal present other risks that are not assumed by the  
13 competitive solicitation suppliers?

14 A. Yes. The Company is guaranteeing \$20 million to customers through the NBC  
15 regardless of the outcome of its supply service. Unlike bidders in the competitive  
16 wholesale solicitations, NYSEG is providing a guaranteed rebate and an  
17 additional earnings sharing mechanism (i.e., earnings in excess of \$20 million  
18 pre-tax would be shared 50/50 with customers). These differences are certainly  
19 additional risks relative to the service provided by suppliers in the wholesale  
20 solicitations.

21 Q. Based on your market analysis of the wholesale competitive solicitations how did  
22 you develop the SC1 rate?

23 A. As shown in Exhibit \_\_\_\_ (NorthBridge Panel-6), we calculated the average of the

## The NorthBridge Panel

1 solicitation results. To this figure, we added back the cost of the applicable line  
2 losses for the NYSEG service area. This resulted in an SC1 supply rate of 9.093  
3 cents (or \$0.0909) per kWh (as shown in Exhibit \_\_\_\_ (NorthBridge Panel-7)).  
4 The current SC1 fixed supply rate is 8.837 cents per kWh, so this represents only  
5 a very modest increase (0.256 cents) from current levels.

6 Q. Is there other market evidence to support the need for a change in the  
7 methodology for calculating NYSEG's supply rates to reflect market levels?

8 A. Yes. We reviewed thirty-two ESCO fixed price offers to residential customers in  
9 New York that were posted on the Customer Choice website.<sup>9</sup> We applied the  
10 same methodology to the ESCO offers as that used to evaluate the competitive  
11 wholesale solicitations, adjusting for definitional, locational and timing  
12 differences. After adjusting for these differences, the resulting ESCO price offers  
13 were significantly above both NYSEG's current fixed rate and the competitive  
14 solicitations for residential SC1 customers. Exhibit \_\_\_\_ (NorthBridge Panel-8)  
15 provides information and results on our analysis of the ESCO offers, similar to  
16 that provided for wholesale solicitations. Recognizing that the ESCO prices listed  
17 on the Customer Choice website represent retail offers to sell electricity, and not  
18 necessarily customer purchases, we did not rely on these figures in our calculation  
19 of NYSEG's rate. However, the ESCO price offers do provide further market  
20 evidence that the current methodology to establish NYSEG's fixed price service

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<sup>9</sup> Our analysis included fixed annual ESCO price offers available to customers as of December 2006. Green products were not included in the analysis.

## The NorthBridge Panel

1 does not accurately reflect market prices. In order to strike a balance between  
2 customers, ESCO and Company interests, the proposed rates are based on the  
3 winning bids of competitive market solicitations. These represent market prices  
4 between willing sellers and buyers of electricity.

5 Q. How does the proposed NYSEG rate strike a balance between customer and  
6 Company interests?

7 A. Presumably customers want the lowest fixed prices possible and, all other things  
8 being equal, would prefer to have customer sharing as opposed to no customer  
9 sharing. NYSEG, like ESCOs and bidders in competitive solicitations, wants to  
10 be compensated for the substantial costs and risks associated with providing fixed  
11 price service to retail customers. NYSEG's proposal balances these interests.

12 Q. What do you conclude about the level of NYSEG's proposed service supply rates?

13 A. NYSEG's proposed supply rates represent market prices and recover reasonable  
14 costs. The results of recent solicitations when adjusted properly for definitional,  
15 locational, timing, and risk differences support this conclusion.

16 Q. How will NYSEG adjust the fixed price based on changes in market prices?

17 A. NYSEG proposes to adjust the fixed supply rates each year based on changes in  
18 visible market prices that can be measured in a verifiable and objective manner.  
19 Initial rates are based on market prices near the time of the filing. Adjustments to  
20 the initial rates will be accomplished through application of a "Market Price  
21 Index" to the initial rates set forth in Exhibit \_\_ (NYSEG Panel-5). The Market  
22 Price Index will be calculated based on changes in wholesale electricity forward  
23 prices from the date when rates are initially established near the filing date, to the

## The NorthBridge Panel

1 first day of November 2007 for 2008 deliveries, and to the first day of November  
2 2008 for 2009 deliveries, and so forth. For example, on November 1, 2007,  
3 NYSEG will calculate the Market Price Index for calendar year 2008, which will  
4 be applied to the rate components for 2008 shown in Exhibit \_\_ (NYSEG Panel-  
5 5). Depending on market price movements over time, the Market Price Index  
6 may be less than or greater than one, resulting in either a decrease or increase in  
7 rates. A similar rate adjustment will be calculated on November 1, 2008 and  
8 become effective January 1, 2009. The steps involved in calculating the Market  
9 Price Index are described in more detail in Exhibit \_\_\_\_ (NorthBridge Panel-9).  
10 This exhibit also shows the calculation of the base index price.

11 Q. Is the adjustment to rates based on visible market prices that can be measured in a  
12 verifiable and objective manner?

13 A. Yes. The results can be replicated and are auditable. The Market Price Index will  
14 be calculated from a formula that uses the New York ISO Zone A electricity  
15 market prices reported by NYMEX, a data source that reports electricity forward  
16 market prices on a daily basis. Specifically, as explained in Exhibit \_\_\_\_  
17 (NorthBridge Panel-9), the formula used to calculate the Market Price Index  
18 involves the averages of electricity market prices reported by NYMEX over  
19 twenty-day periods.

20 Q. Why does the calculation use the average of electricity market prices reported by  
21 NYMEX spanning twenty trading days, rather than using the price reported on a  
22 single trading day?

23 A. A twenty-day period provides sufficient duration to smooth out anomalies that

## The NorthBridge Panel

1 might occur in a single day or in a week. Yet, a twenty-day period is short  
2 enough that it is still representative of current market conditions.

3 **IV. NYSEG's Proposal Will Provide Guaranteed Customer Benefits With**  
4 **Additional Potential Earnings Sharing, While Shareholders Absorb Risk**

5 Q. Is it your opinion that NYSEG's pricing and earnings sharing mechanism are fair  
6 to both the Company and customers?

7 A. Yes. The structure strikes a balance between the needs of customers to receive a  
8 fair price for fixed rate service and the Company's ability to earn compensation in  
9 return for substantial risk. Under the Company's proposal, the customer will  
10 always receive a greater share of any net income than will the Company.

11 Q. Should the profit opportunity be evaluated in concert with the regulated earnings  
12 expected from supplying delivery service?

13 A. No, it should not. The proposed supply service is a separate product with distinct  
14 risks being borne by the Company. While there is no direct and visible asset or  
15 ratebase on which to measure a return, the Company is assuming significant risks.

16 Q. Does this conclude your testimony?

17 A. Yes.

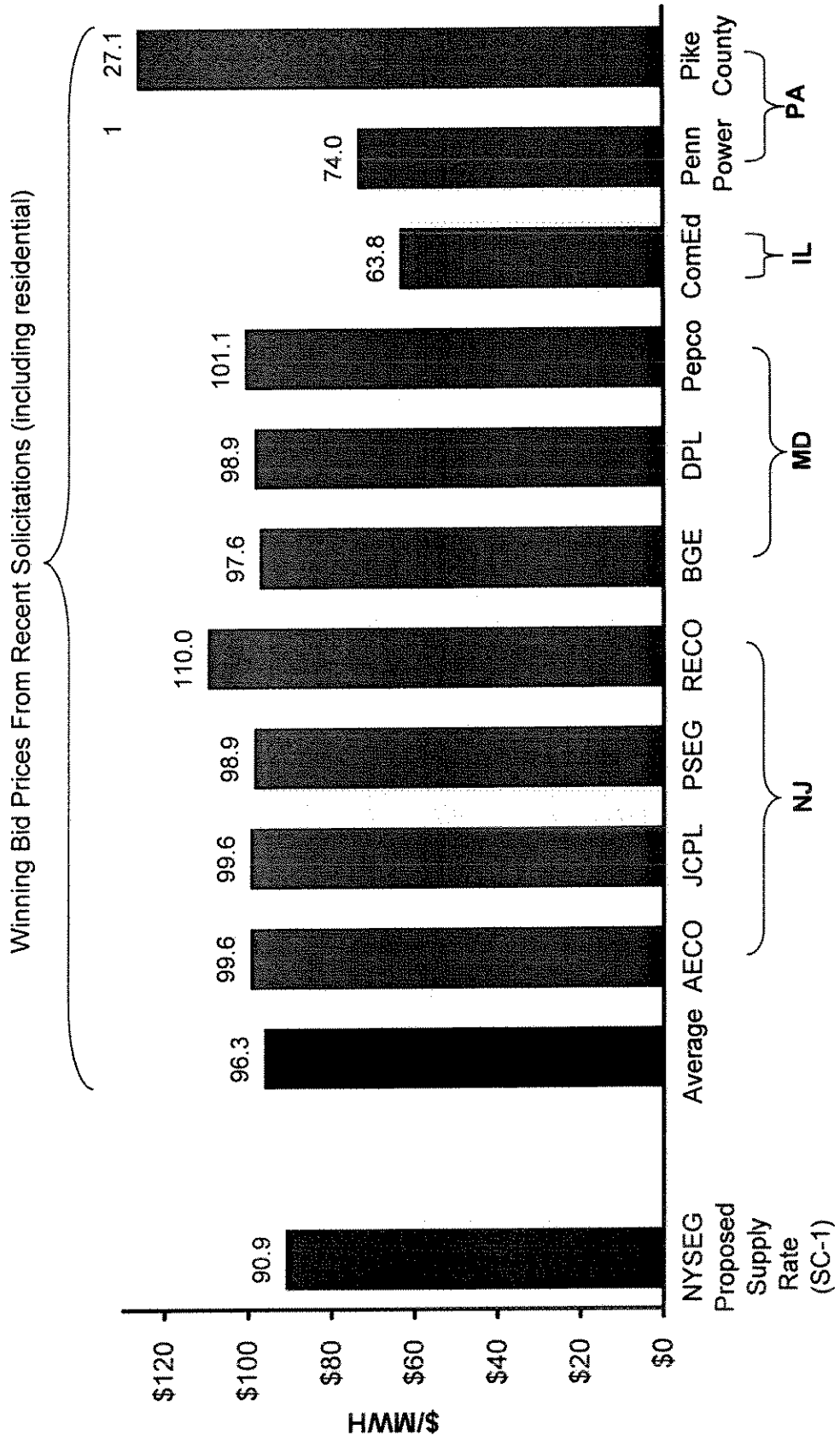
## **NorthBridge Panel Exhibits**

<b>Exhibit_(NorthBridge Panel-1)</b>	List of Reviewed Solicitations
<b>Exhibit_(NorthBridge Panel-2)</b>	Comparison of NYSEG's Proposed Rate and the Results of Recent Solicitations
<b>Exhibit_(NorthBridge Panel-3)</b>	Summary of Key Definitional Differences in Recent Solicitations
<b>Exhibit_(NorthBridge Panel-4)</b>	Comparison of NYSEG's Proposed Rate and the Results of Recent Solicitations Adjusted for Definitional Differences
<b>Exhibit_(NorthBridge Panel-5)</b>	Locational Spot Energy Basis Differentials Between NYSEG and Other Utility Zones
<b>Exhibit_(NorthBridge Panel-6)</b>	Comparison of NYSEG's Proposed Rate and the Results of Recent Solicitations Adjusted for Definitional, Locational, and Timing Differences
<b>Exhibit_(NorthBridge Panel-7)</b>	Proposed SC-1 Supply Rate
<b>Exhibit_(NorthBridge Panel-8)</b>	Comparison of NYSEG's Proposed Rate and Recent ESCO Offers
<b>Exhibit_(NorthBridge Panel-9)</b>	Description of the Market Price Multiplier and Calculation of the Base Index Price

**SOLICITATIONS REVIEWED**

Utility Solicitation	Term	Customer Class	C&I Breakdown	Date
<u>New Jersey</u> AECO JCPL PSEG RECO	36 Months 36 Months 36 Months 36 Months	Residential and Small C&I Residential and Small C&I Residential and Small C&I Residential and Small C&I	up to 1250 kW up to 1250 kW up to 1250 kW up to 1250 kW	2/7/2007 2/7/2007 2/7/2007 2/7/2007
<u>Maryland</u> BGE DPL Peppo	11,23,35 Months 12,24 Months 12,24 Months	Residential Residential Residential		12/5/05, 1/23/06, 2/21/06 12/5/05, 1/23/06, 2/21/06 12/5/05, 1/23/06, 2/21/06
<u>ComEd</u> ComEd	17, 29, 41 Months	Residential and Small C&I	up to 400 kW	9/8/2006
<u>Pennsylvania</u> Penn Power Pike County	17 Months 19 Months	Residential Residential and C&I	All Secondary Voltages	5/31/06, 7/18/06 4/26/2006
<b>NYSEG's Default Service Plan</b>				
<u>NYSEG</u>	12 Months	Residential		Mar 2007, subject to index Nov 2007

**NYSEG's 2008 Rate vs. Winning Bid Prices (Residential)**



Key Definitional Differences: Solicitations vs. NYSEG's Supply Rates

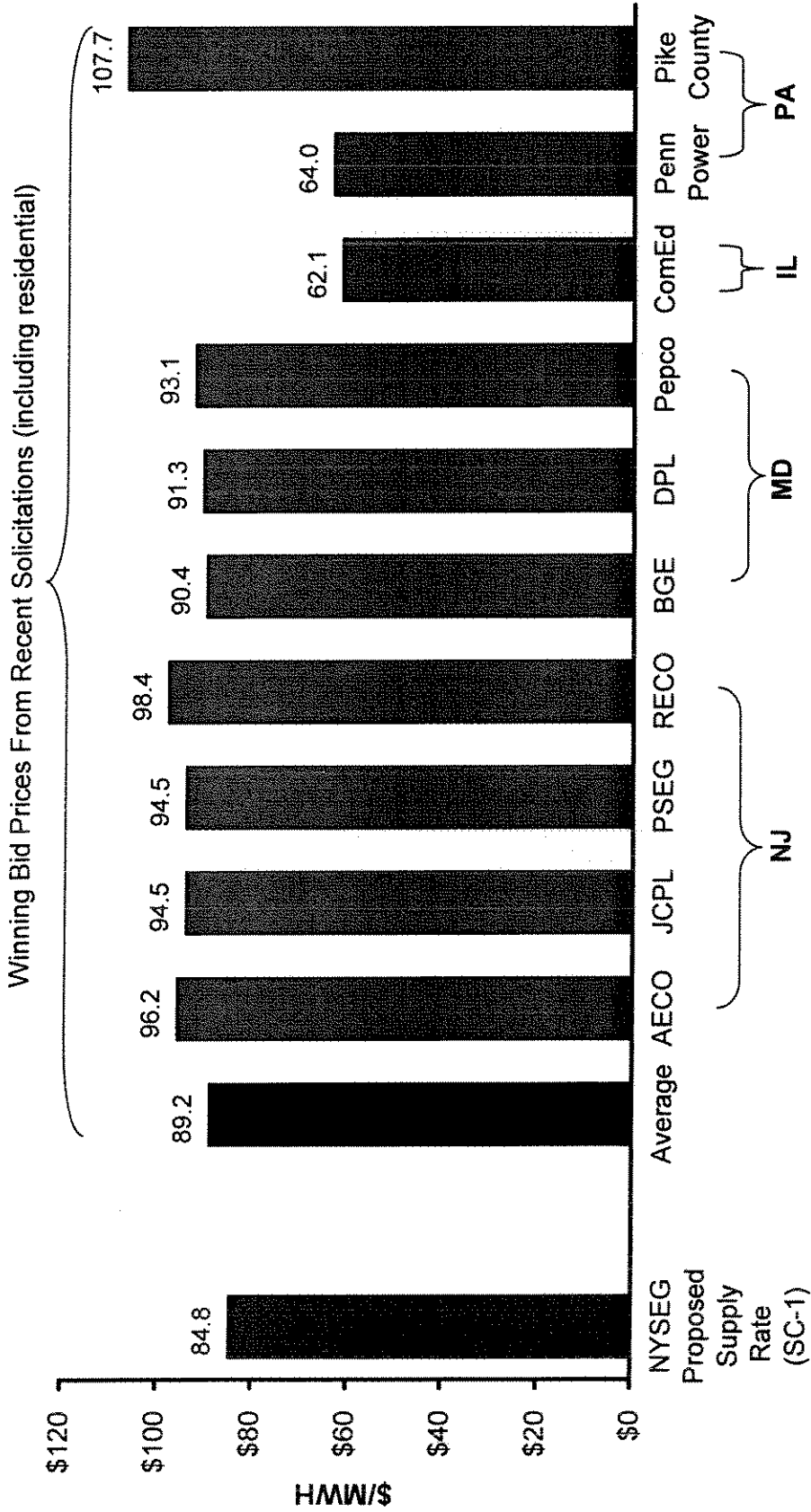
Utility Solicitation Bids	Components Included in Solicitation				Definitional Adjustments _a/
	Line Losses	Network Transmission	Ancillary Services _b/	Gross Receipts Taxes	
New Jersey AECO JCPL PSEG RECO	No No No No	Yes Yes Yes Yes	Yes Yes Yes Yes	No No No No	Transmission and ancillary services were subtracted from bid prices.
Maryland BGE DPL Pepco	Yes Yes Yes	No No No	Yes Yes Yes	No No No	Line losses and ancillary services were subtracted from bid prices.
Illinois ComEd	No	No	Yes	No	Ancillary services were subtracted from bid prices.
Pennsylvania Penn Power	No	Yes	Yes	No	Transmission and ancillary services were subtracted from bid prices.
Pike County _c/	Yes	No	Yes	Yes	Line losses, ancillary services and GRT were subtracted from retail rates.
NYSEG's Supply Rates	Yes	No	No	No	Line losses were subtracted from retail rates.

\_a/ When available, values for each component were based on data specific to each utility.

\_b/ Including RTO administrative costs.

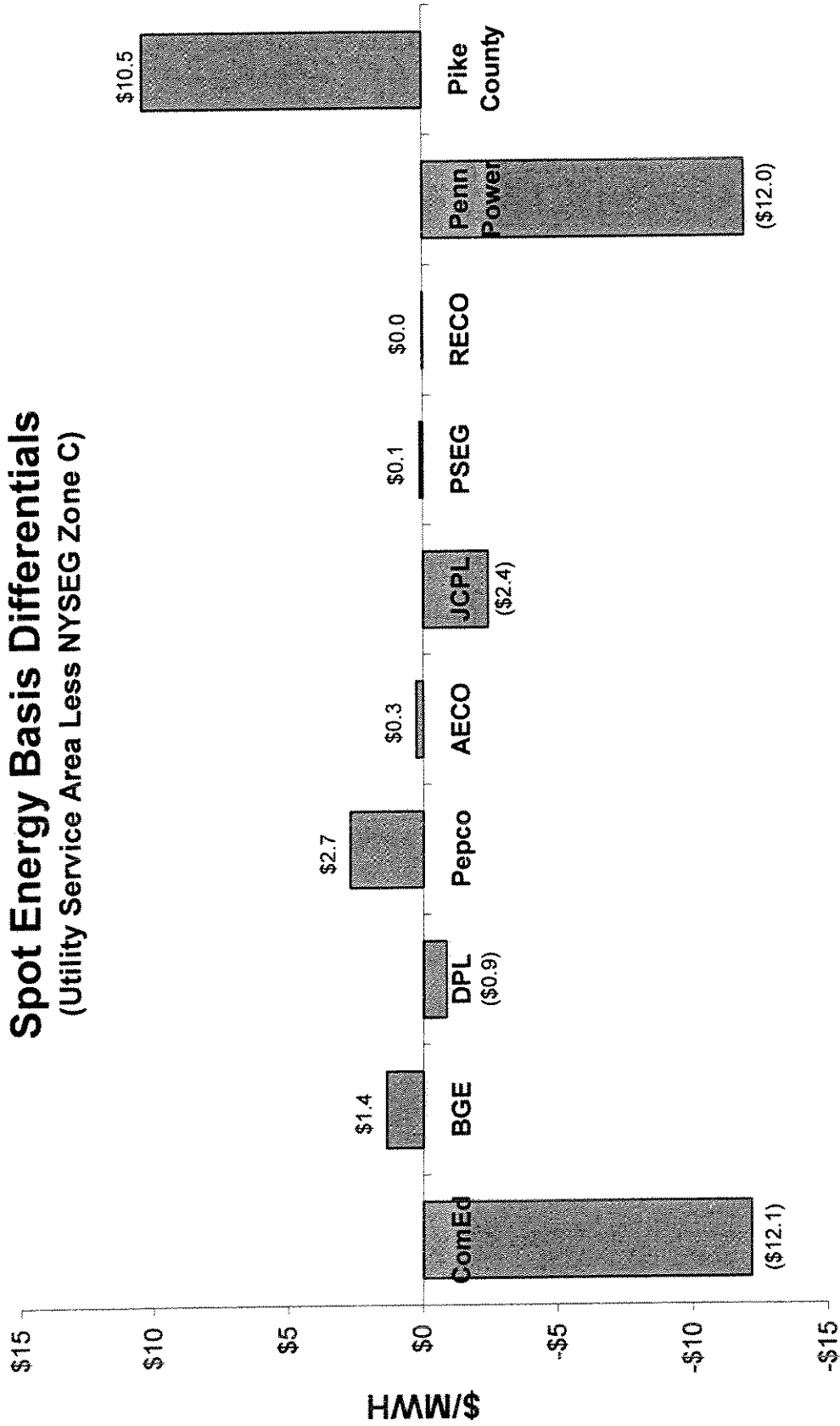
\_c/ For Pike County, the retail rates resulting from the solicitation in April 2006 were used.

**NYSEG's 2008 Rate vs. Winning Bid Prices (Residential)  
Adjusted for Definitional Differences**



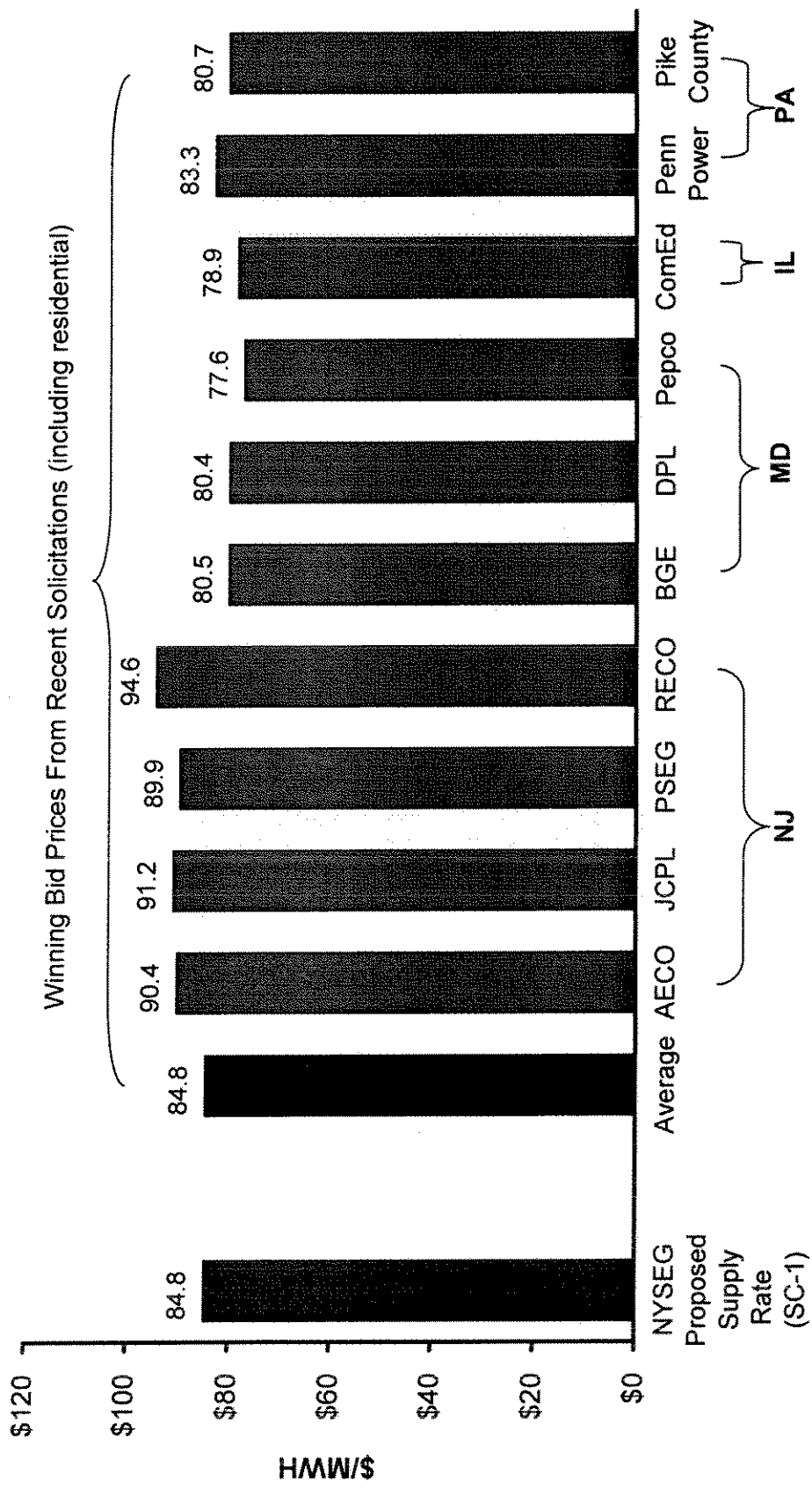
Note: Prices do not include transmission, ancillary services, line losses or taxes. Some solicitations also included small C&I customers.

### Spot Energy Basis Differentials (Utility Service Area Less NYSEG Zone C)



Note: Twelve months ending February 28, 2007.

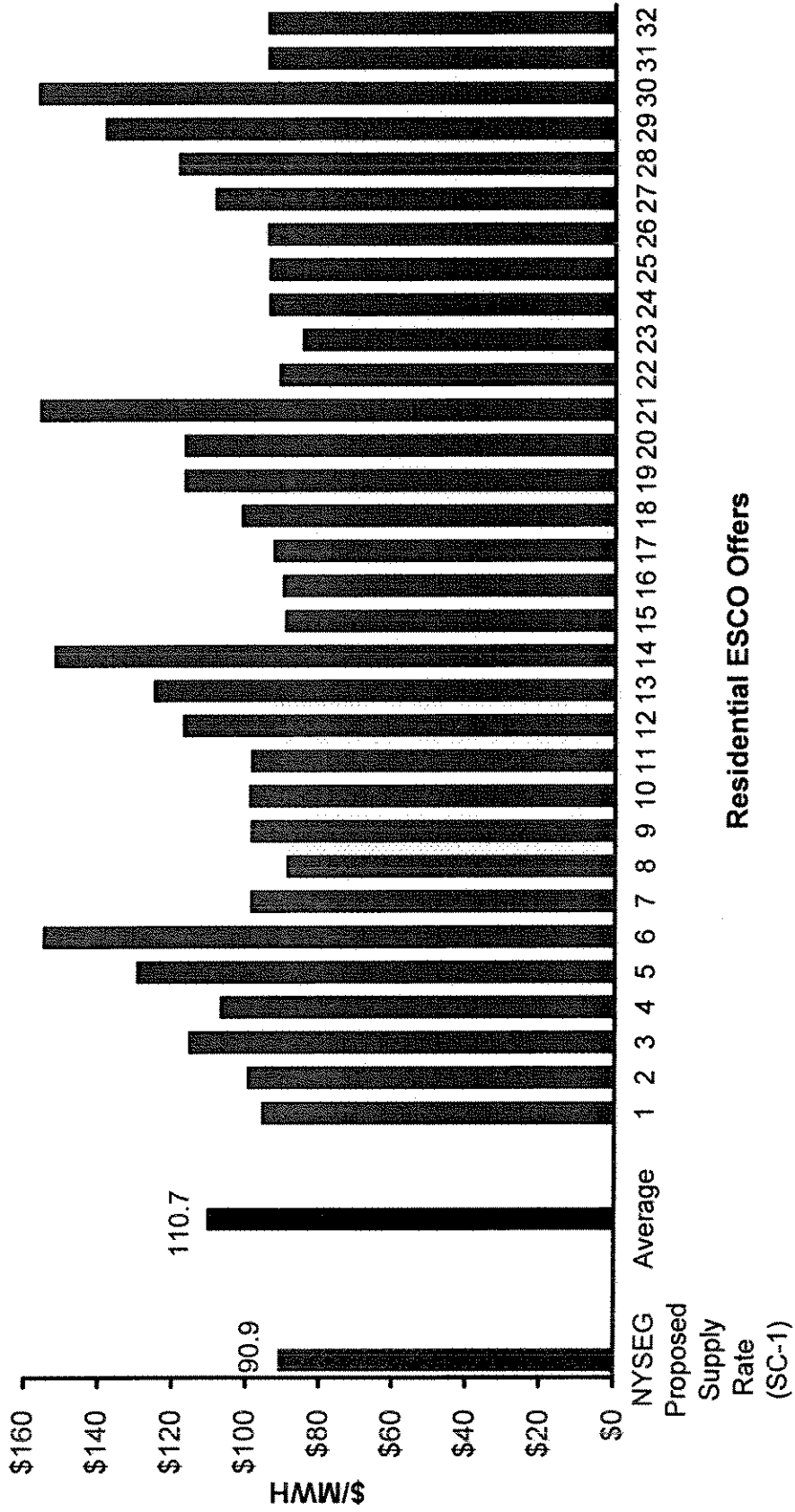
**NYSEG's 2008 Rate vs. Winning Bid Prices (Residential)  
Adjusted for Definitional, Locational and Timing Differences**



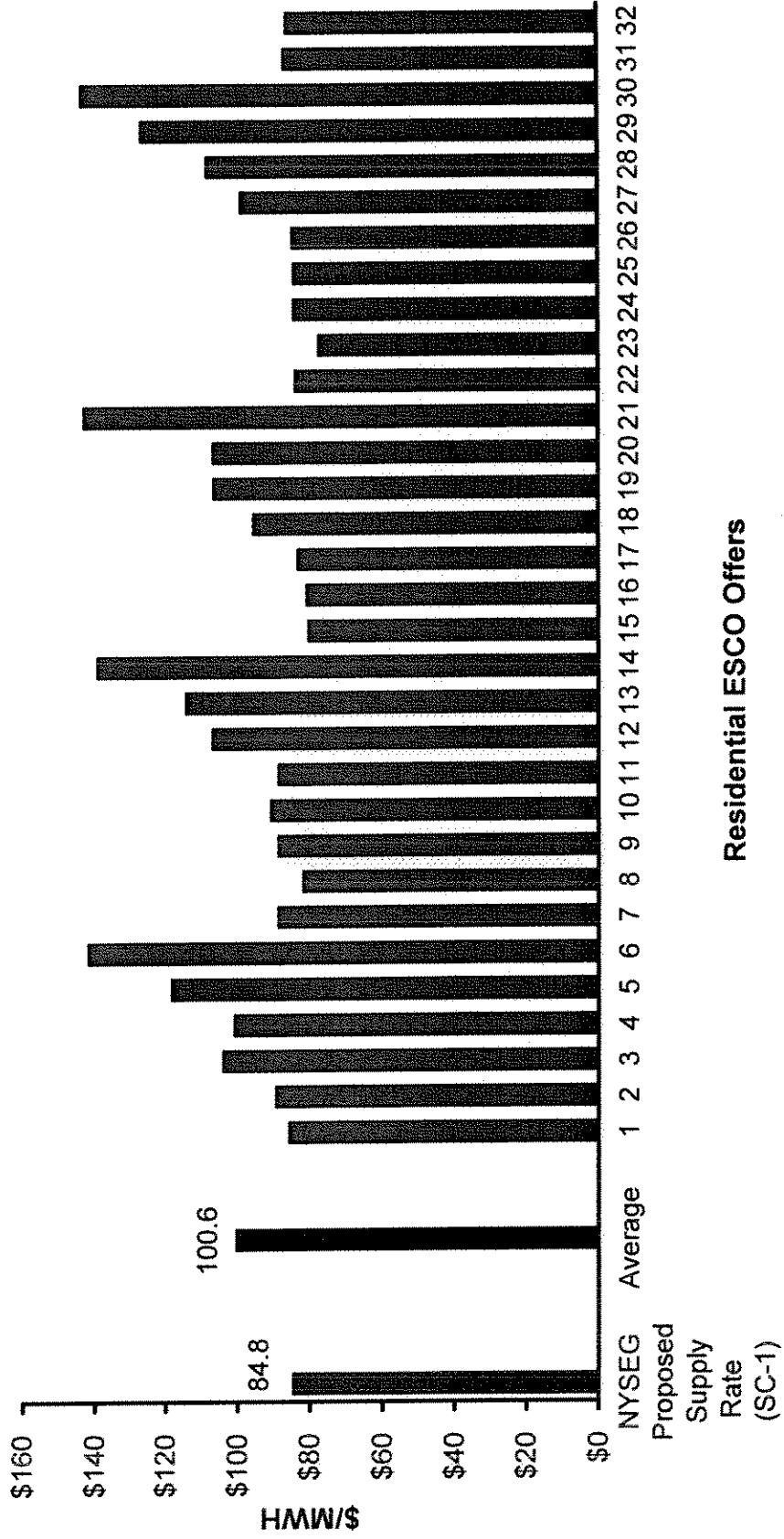
Note: Prices do not include transmission, ancillary services, line losses or taxes.

<b>Total Average Supply Rates</b>	
	(\$/MWH)
	<b>SC-1</b>
Average of Recent Solicitations, net of Line Losses	84.76 _a/
<i>Line Losses @ 7.28%</i>	<u>6.17</u>
<b>Total Average Supply Rate</b>	<b>90.93</b>
_a/ From Exhibit CP-6.	

**NYSEG's 2008 Rate vs. Residential ESCO Offers**



**NYSEG's 2008 Rate vs. Residential ESCO Offers  
Adjusted for Definitional Differences**

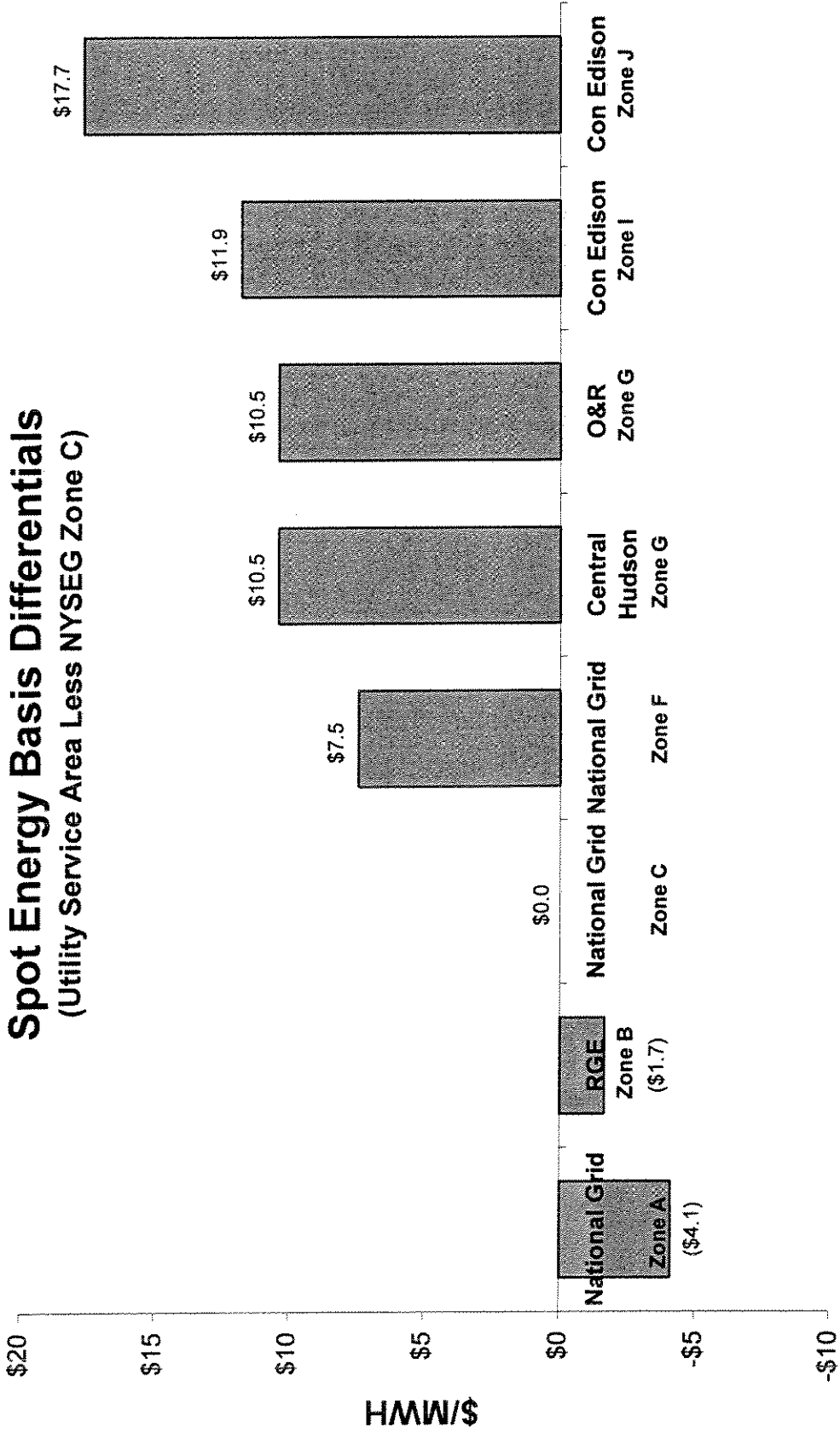


Note: Prices do not include ancillary services or line losses.

**NYSEG's 2008 Rate vs. Residential ESCO Offers  
Adjusted for Definitional, Locational and Timing Differences**



Note: Prices do not include ancillary services or line losses.



Note: Twelve months ending February 28, 2007.

### Annual Market Price Adjustment Methodology

In order to determine the final retail supply fixed rates for NYSEG's residential and small C&I customers, a "Market Price Multiplier" will be calculated and applied to the supply rates shown in Exhibit\_(NYSEG Panel-5). Separate Market Price Multipliers will be calculated for each calendar year that will be based on changes in wholesale electricity futures prices after March 9, 2007. NYSEG has calculated the wholesale electricity futures prices as of March 9, 2007 ("Base Index Price"). Market price changes from those Base Index Prices will be measured as of the first day in November prior to the start of the applicable calendar year. For example, on November 1, 2007, NYSEG will calculate a Market Price Multiplier for calendar year 2008, based on 2008 futures prices visible in the marketplace. The Market Price Multiplier for a given calendar year will be calculated as follows:

$$\text{Market Price Multiplier} = (\text{Index Price} / \text{Base Index Price})$$

The Index Price for calendar year 2008 will be calculated as follows:

1. NYSEG will calculate the simple average of the 12 monthly financially-settled on-peak New York ISO Zone A electricity futures contract prices reported by the New York Mercantile Exchange ("NYMEX") for January through December 2008 as of each of the 20 trading days immediately preceding November 1, 2007.
2. NYSEG will calculate the simple average of the 12 monthly financially-settled off-peak New York ISO Zone A electricity futures contract prices reported by NYMEX for January through December 2008 as of each of the 20 trading days immediately preceding November 1, 2007.
3. NYSEG will calculate the simple average of the 20 calendar year 2008 on-peak futures prices calculated in Step #1 above.
4. NYSEG will calculate the simple average of the 20 calendar year 2008 off-peak futures prices calculated in Step #2 above.
5. The resulting on-peak futures price calculated in Step #3 above, and the resulting off-peak futures price calculated in Step #4 above, will then each be adjusted by multiplying the price by the corresponding on-peak or off-peak basis differential factor as measured over the most recent 12 calendar months. For either the on-peak or off-peak period, the basis differential factor will be calculated as the simple average of the New York ISO Zone C locational marginal energy prices divided by the simple average of the New York ISO Zone A locational marginal energy prices. For the calculation of the on-peak basis differential factor, all day-ahead locational marginal energy prices during the on-peak period will be used. For the calculation of the off-peak basis differential factor, all day-ahead locational marginal energy prices during the off-peak period will be used.
6. The resulting on-peak and off-peak futures prices will then be weighted by the number of on-peak and off-peak hours during calendar year 2008 to obtain a single Index Price for calendar year 2008.

The same methodology will be used to determine the Market Price Multiplier in subsequent years. The Base Index Price and the methodology used to calculate these figures are shown in the attached pages to this exhibit.

The Market Price Multiplier for a given calendar year will be multiplied by the applicable supply rates for residential and small C&I customers shown in Exhibit\_(NYSEG Panel-5) to obtain the rates effective during that calendar year. Depending on market price movements, the retail supply rates could be higher or lower than those shown in that exhibit.

# Exhibit\_(NorthBridge Panel-9)

## Page 2 of 3

### Base Index Price Calculation

Step 1: Calculation of Calendar Year 2008 NY ISO Zone A On-Peak Futures Prices  
 \* For each trade date, calculated from averages of monthly NYMEX futures prices

Trade Date	NY ISO Zone A	\$/MWH
3/9/2007	71.04	
3/8/2007	71.71	
3/7/2007	71.88	
3/6/2007	71.94	
3/5/2007	71.14	
3/2/2007	71.18	
3/1/2007	71.25	
2/28/2007	71.07	
2/27/2007	72.03	
2/26/2007	72.08	
2/23/2007	71.73	
2/22/2007	71.63	
2/21/2007	71.70	
2/20/2007	71.18	
2/16/2007	71.69	
2/15/2007	71.68	
2/14/2007	71.63	
2/13/2007	71.78	
2/12/2007	71.56	
2/9/2007	72.53	
Average		71.62

Step 3: Calculation of Average Calendar Year 2008 Zone A On-Peak Futures Price

Average	71.62
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Step 2: Calculation of Calendar Year 2008 NY ISO Zone A Off-Peak Futures Prices  
 \* For each trade date, calculated from averages of monthly NYMEX futures prices

Trade Date	NY ISO Zone A
3/9/2007	48.46
3/8/2007	48.38
3/7/2007	48.46
3/6/2007	48.71
3/5/2007	48.18
3/2/2007	48.28
3/1/2007	48.20
2/28/2007	48.21
2/27/2007	48.50
2/26/2007	48.75
2/23/2007	48.40
2/22/2007	48.25
2/21/2007	48.33
2/20/2007	48.20
2/16/2007	48.42
2/15/2007	48.27
2/14/2007	48.52
2/13/2007	48.58
2/12/2007	47.95
2/9/2007	48.48
Average	48.38

Step 4: Calculation of Average Calendar Year 2008 Zone A Off-Peak Futures Price

Average	48.38
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**Base Index Price Calculation**  
**Steps 5 & 6: Calculation and Application of Basis Differential Factors, and Final Index Price Calculations**

	\$/MWH	
Calculations of Basis Differential Factors	On-Peak	Off-Peak
<u>Average 12-Month Historical Day-Ahead LMPs</u>		
NYSEG Zone C	63.49	45.53
NY ISO Zone A	58.75	41.97
Basis Differential Factor	1.0807	1.0847

Calculation of Index Price	On-Peak	Off-Peak	All Hours
NY ISO Zone A Futures Price	71.62	48.38	
Basis Differential Factor	1.0807	1.0847	
Resultant Futures Price	77.40	52.47	
Hours	4,096	4,664	
<b>Base Index Price</b>			<b>64.13</b>

from Step 3 and Step 4

Note: The same methodology using updated market price information will be used to calculate the 2009 Index Price as of November 1, 2008.