

Position Paper IV:
**Casting a Long Shadow:
NY Rates of Return**

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In order to meet its stated goals of improved energy infrastructure, increased generation resources (especially renewable ones), and price stability, New York needs economically sound, financially solvent electric utilities with the type of robust investment profiles that attract the capital necessary to accomplish Statewide energy objectives. Its recent action regarding Rates of Return on Equity for these companies, however, belies that reality and threatens the financial health of the state’s utilities. This Position Paper was produced as part of a series to extend Central Hudson’s views on the necessary components of the critically important State Energy Plan now under development in Albany; in this installment: providing utilities with reasonable rates of return on their investment on behalf of New York’s energy system.

Background

Regulators are obligated to balance the interests of customers and investors, given the inherent structure of the regulatory compact. As cited in the 1923 Bluefield Water Works case,

“A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended the corresponding risks and uncertainties.... The return should be reasonable, sufficient to assure confidence in the financial soundness of the utility, and should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise money necessary for the proper discharge of its public duties.”

In the Federal Power Commission vs. Hope Natural Gas Company (1944), it was further expanded that the cost of capital shall receive the same regard, and that the return on equity "...should be sufficient to assure confidence in the financial integrity of the enterprise, so to maintain its credit and attract capital."

And yet, recent authorized return rates in New York State, in cases such as Orange & Rockland Utilities and National Fuels, are the lowest in the nation, and among the lowest returns awarded nationwide in more than three decades. These low rates are further exacerbated by a Commission tendency toward penalty mechanisms, true-ups and/or new and additional regulatory requirements that increasingly result in earned returns that are below the already too low authorized returns.

What Must Be Done

The deteriorating ROEs that have become the regulatory norm in New York State jeopardize the utilities' ability to finance the investments necessary to provide the level of service critical in an electronic age. The investment community is well aware of the damaging regulatory environment in New York. For example, Moody's, in its credit opinion on the Consolidated Edison Company of New York, took into account "...our more guarded view than we have had in the past about the extent to which the New York regulatory environment will be supportive in future rate case decisions... ." And later, citing the same Moody's report on ConEd: "Setting rates based on a very low ROE....seems to be a discouragement instead of incentive to invest in utility infrastructure to ensure reliability of service against a backdrop of solid economic and customer growth in the utility service territories."

In adopting this approach, New York is clearly sending signals that it is *not* open for business. In the case of the nation's lowest utility ROEs, the result will be a worsening of the disparity between New Yorkers' electric bills and those of other states, for when utility credit ratings drop, the companies pay more to finance the debt necessary to maintain and expand their system. Those higher financing costs will be reflected in higher energy bills -- an outcome that places New York at a further competitive disadvantage in retaining and attracting residents and businesses.

Robust, reliable energy delivery systems require robust, reliable utilities to make the significant capital investments necessary to support and expand such systems. Simply put, such companies require returns on equity that will attract investors. Investors have choices. In a global

economy they have an increasing array of choices. New York State must offer competitive rates of return or be stranded.

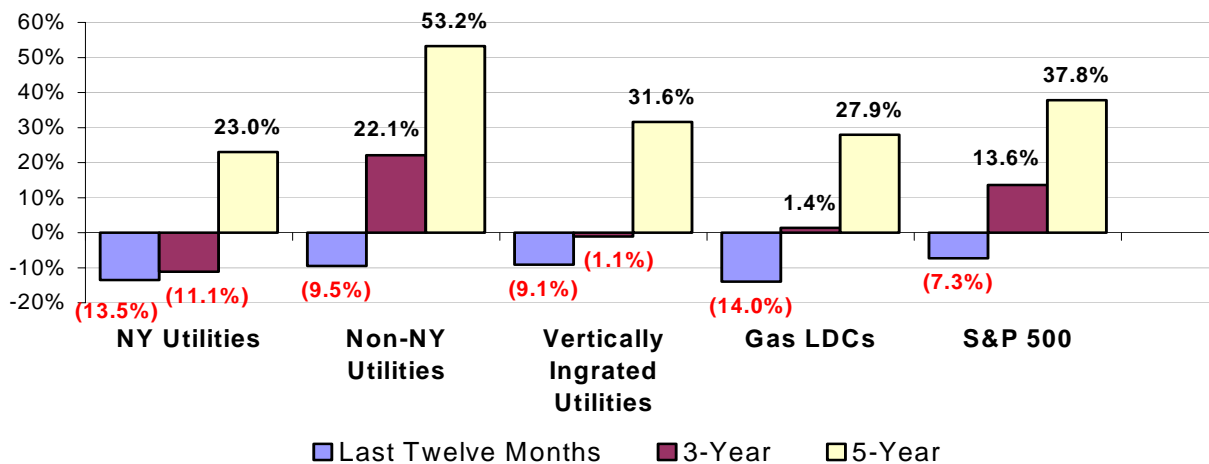
Action Plan

The New York Public Service Commission must recognize the harmful outcome of its recent ROE practices, and accept its responsibility to ensure that utility investors receive a fair and reasonable return. Many of these investors are New York residents who depend upon the security of a utility dividend to finance their retirement; many utility stocks are held within their investment portfolios by New Yorkers who want to not only live but also invest in our state (and their region). They deserve the right to a fair return.

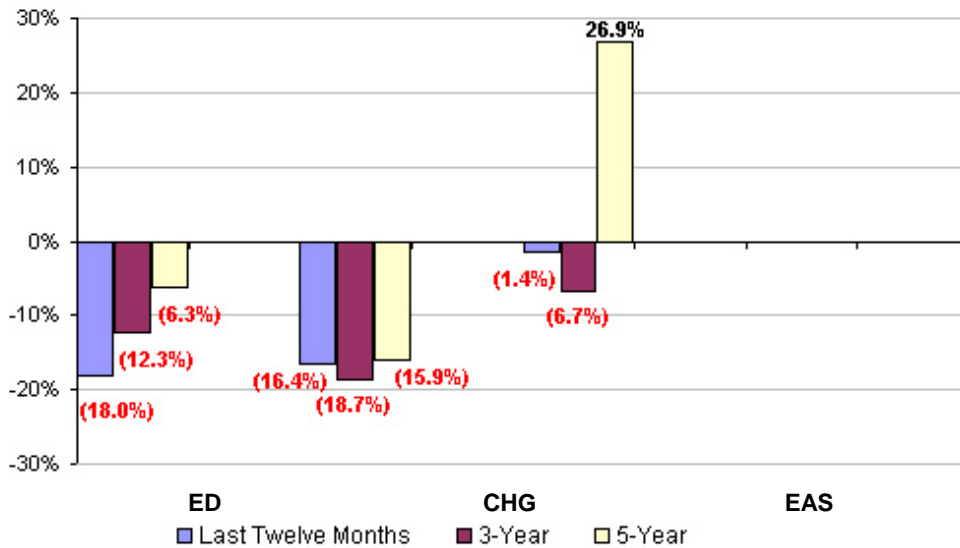
A National Perspective

A decade of the Commission’s regulatory practices have damaged the investment profile of New York utilities, once considered stable, sound dependable companies. One need only consider the following to recognize that our ability to attract investment (and with it, jobs and prosperity for New York residents) has been diminished in recent years:

Stock Price Performance



NY Utility Stock Price Performance



Source: Bank of America - FactSet

Customer Impacts

Although reduced ROEs may appear to initially reduce the cost of electricity, they have the opposite long-term impact by reducing the utility's access to capital and introducing doubts about its credit worthiness, which affects how suppliers, employees and others view the company. With hundreds of millions of dollars in imminent infrastructure investment necessary in order to update and expand New York's electric system in the decades ahead, the Public Service Commission's approach of lowering returns and raising penalties has placed the financial integrity of the utilities at risk, and with them, the affordability of this indispensable commodity.

Summary

Clearly, New York faces enormous challenges as it prepares a blueprint for the future in its State Energy Plan. Decades of misguided public policies and the neglect of the utilities' financial strength have left the companies in a difficult position: key to the solution but unwelcome as a partner.

Public policy makers must recognize that New York's utilities offer the best solution to 1) construct requisite infrastructure improvements 2) invest in renewable energy, and 3) administer energy efficiency services; and, that earning a reasonable rate of return on these value-added strengths is the necessary thing to do for the benefit of all New Yorkers.