**Exhibit PA-8**

**UNITED STATES OF AMERICA**
**BEFORE THE**
**FEDERAL ENERGY REGULATORY COMMISSION**

New York Power Authority ) Docket No. ER12-___-000

PREPARED DIRECT TESTIMONY OF
RICHARD L. ANSALDO

**Q. Please state your name and business address.**

A. Richard L. Ansaldo, P.O. Box 2542, Albany, NY 12220.

**Q. By whom are you employed and in what capacity?**

A. I am a self-employed financial utility consultant. In this proceeding I am working with Nexant, Inc. and representing the New York Power Authority ("NYPA"). My experience, background and qualifications are provided as Exhibit PA-9.

**Q. What is the purpose of your testimony?**

A. My testimony provides support for the 9.75% return on equity ("ROE"), the capital structure, cost of debt and overall rate of return ("ROR") that should be allowed in setting NYPA's transmission revenue requirement ("RR").

**Q. What is the capital structure, cost components and overall rate of return that should**

**be used to set NYPA's RR?**

A. The capital structure and its components are shown in Exhibit PA-2, Schedule E and supporting work papers sponsored by NYPA's Vice President of Financial Planning and Budgets, Thomas A. Davis. As can be seen, the cost of equity is 9.75%, cost of debt is 4.45%, and the debt-to-equity ratio is 29.3/70.7 and the resulting overall ROR is 8.19%.

**Q. Please discuss any factors that are particularly relevant to setting a reasonable ROE for NYPA's transmission system, compared to setting an ROE for an investor-owned utility ("IOU").**

A. NYPA is a special-purpose government entity whose mission is to provide clean, low-cost and reliable energy consistent with safety and a clean environment, while promoting economic and job development, energy efficiency, renewables and innovation for the benefit of its customers and all New Yorkers, without receiving tax revenues or "credits" from New York State. It finances its projects on its own with internally generated funds and bond sales to private investors. NYPA does not have traditional common stock and its "equity" is retained income stated on its financial statements as "net assets." NYPA has its own bond rating, which is currently AA- with Standard & Poor's ("S&P") and Aa2 with Moody's Investors Service ("Moody's") and its bonds are not guaranteed by the State. Accordingly, NYPA must provide its own financial integrity through its own revenues. NYPA needs to keep a safety margin over and above its interest costs, just like an IOU, in order to provide debt investors the assurance that they will be paid principal and interest on a timely basis. NYPA's ROE, or return on its net assets, as well as its equity ratio, provide that safety margin needed to maintain its financial integrity and bond rating. Unlike an IOU, NYPA pays neither income taxes to the Federal Government, nor

income taxes to New York State. Thus, its overall ROR is not "grossed up" for taxes, so the requested ROR of 8.19% in this filing provides the entire safety margin that debt investors and bond rating firms will see from the portion of NYPA's operations related to bulk power transmission. In the case of an IOU, part of the safety margin is provided by income taxes, which are not obvious in the stated ROR. Income taxes "cushion," in essence, the impact of unexpected expenses for IOUs.

**Q. Please summarize the basis for NYPA's overall ROR, capital structure and particularly the requested return on equity of 9.75%.**

A. NYPA's cost of debt was developed by calculating the effective cost of long-term debt, consistent with FERC's practice of excluding short-term debt as stated in *Central Telephone & Utilities Corp.*, 18 FERC ¶ 61,132 (1982)) where FERC determined that a company seeking inclusion of short-term debt must show "unique circumstances." I cannot show unique circumstances because in NYPA's situation, short-term debt not only finances construction, as is presumed in the FERC ruling involving Central Telephone, but it also finances its Energy Services programs, where the cost of that short-term debt is assigned to certain customers and recovered in a separate charge for that service. Since the cost of short-term debt which finances those facilities is assigned to customers of NYPA's Energy Service programs, facilities which NYPA does not own, it should not also be presumed that this same short-term debt also finances NYPA's own fixed assets and transmission plant. In other words, any cost benefit of short-term debt is assigned to the public in the pricing of NYPA's other services and cannot logically be assigned again to the inputs of the RR calculation. The debt/equity ratio is the result of forecast levels of

long-term debt and equity for 2012, starting with actual year end data from 2011. The cost of equity of 9.75%, which includes a 0.50% adder as an incentive for independent system operator ("ISO") participation, was arrived at using several different rationales and analyses.

**Q. Does the 50 basis point incentive proposed by NYPA conform to precedent established by FERC in other proceedings?**

A. Yes. Based on membership in an ISO or Regional Transmission Organization ("RTO"), FERC has generally granted utilities a 50 basis point upward adjustment to the base ROE in recognition of the region-wide benefits of turning operational control over transmission facilities to an ISO and for the utility's continued involvement with such organization. See, for example, *Niagara Mohawk Power Corporation*, 124 FERC ¶ 61,106 at P 35 (2008), *order on reh'g*, 126 FERC ¶ 61,173 (2009) ("Niagara Mohawk"). Also, the Commission has noted that the 50 basis point adder must fall within the zone of reasonableness as stated in the Niagara Mohawk case and in *ISO New England, Inc.*, 106 FERC ¶ 61,280 at P 246 (2004). As will be subsequently shown, application of a 50 basis point adder is appropriate here because it produces a rate of return that is within the range of results established from the proxy group.

**Q. Has FERC recognized that municipal or government-owned transmission systems have a similar investment risk as one owned by an IOU?**

A. Yes. In FERC Opinion No. 479, issued on April 19, 2005 and related orders involving the City of Vernon ("Vernon"), FERC stated that Vernon's ROE could be set by reference to the market-based return for similarly-rated entities. See generally the

discussion in *City of Vernon*, 111 FERC ¶ 61,092 at PP 84-103 (2005).

**Q. Have you reviewed FERC precedent on setting an ROE and ROR for IOUs and municipal utility entities like NYPA?**

A. Yes. I reviewed the Vernon order mentioned earlier, FERC's Southern California Edison Company order on rehearing and clarification issued October 6, 2011 (Docket Nos. ER08-375-004, *et al.*) ("SoCal Edison"), recent FERC Staff testimony filed on January 10, 2012 in Docket Nos. ER11-1915-002, *et al.*, as well as orders discussing proxy group selection criteria. I also reviewed FERC's proposed rulemaking entitled *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, Docket No. PL07-2-000, issued on July 19, 2007. The discussion in the gas and pipeline order is relevant here because FERC has recognized the problems in arriving at a reasonable cost of equity estimate if the proxy group was too small, and suggests, on a case by case basis, expanding the proxy group to include diversified utilities.

**Q. How did you determine that NYPA should request a base cost of equity of 9.25%?**

A. The 9.25% recommendation was based upon multiple considerations. First, the overall intent of an allowed ROE and ROR are to assure fairness to customers and at the same time maintain the entity's financial integrity. I believe that NYPA's AA- bond rating does not come at a cost to the public and its customers and the 9.25% return for the transmission system (9.75% with the ISO incentive) fits within the returns that NYPA has earned overall in the last two years which have produced a stable bond rating. For example, in 2010 and 2011, NYPA's net income before contributions to New York State (the contributions to the State are analogous to a dividend) was 11.3% and 9.5% on

average equity (net assets). Therefore, a base return of 9.25% and 9.75% after the ISO incentive adder would set the RR such that NYPA's transmission assets would provide similar support for the bond rating as NYPA's other operations. Second, other utilities in New York State have most recently been allowed 9.25% on equity by the New York State Public Service Commission and I did not want to request a higher equity return than the other New York utilities. Third, I reviewed FERC decisions and while there is no exact analog for NYPA due to its AA- bond rating, I felt the 9.25% was within the range that FERC would allow. For example, in the October 6, 2011 SoCal Edison order referenced above, FERC stated the following (at paragraph 7):

> On April 15, 2010, the Commission issued the above-noted order on the paper hearing and established a base ROE of 9.54 percent. This ROE determination was based upon a national proxy group, to which the Commission applied screening factors that it determined to be appropriate to the circumstances of this case and ensured that only companies of comparable risk were included. The Commission determined that the zone of reasonableness for SoCal Edison was between 7.80 percent and 16.19 percent. When the Commission applied the median to this calculation, it determined the base ROE for SoCal Edison to be 10.55 percent. Finally, the Commission updated the base ROE by adjusting for the yields on ten-year constant maturity U.S. Treasury bonds (ten-year bonds), resulting in an adjusted base ROE of 9.54 percent. Combined with the previous Commission-approved incentive adders of 125 basis points for Rancho Vista and 175 points for the DPV2 and Tehachapi Projects, the overall ROE for these projects will be 10.79 percent and 11.29 percent respectively. The Commission concluded that the overall ROEs were within the zone of reasonableness and were consistent with the just and reasonable requirements of section 205 of the FPA. (footnotes omitted).

My ROE recommendation for NYPA is within the reasonable range of FERC's well-established precedents and the recent decision in the SoCal Edison case. While NYPA's bond rating is higher than SoCal Edison's, the dramatically lower overall ROR for

NYPA, considering taxes (almost 11% for most IOUs vs. 8.19% for NYPA) and the need for a debt coverage safety margin to maintain NYPA's credit rating suggests the comparability between these two entities is relevant. Fourth, I considered the requested ROE to be within the parameters that FERC would deem reasonable using its proxy group criteria. Exhibit PA-10 shows my proxy group analysis. I performed several iterations of the proxy group, initially starting with nine utilities that had market traded common stocks and a bond rating of A- or better. This screen was performed starting with S&P's publication dated January 5, 2012 entitled "U.S. Regulated Electric Utilities, Strongest and Weakest." I have included that publication as Exhibit PA-10, pages 15-21. I then checked the ratings with current S&P information and made adjustments to the group based upon recent bond rating changes that have occurred. Pages 1 and 2 of Exhibit PA-10 discusses the selection process and an overview of the FERC DCF method used, and page 3 of Exhibit PA-10 shows the first FERC-based discounted cash flow ("DCF") iteration. My review of FERC decisions indicates a preference for median values. As can be seen, the range of DCF returns is 7.16% to 10.37% with a low median of 8.76% and a high median of 9.72%. The overall median of the High-Low returns is 9.10% and the average of the High-Low median values is 9.24%.

**Q. Please discuss your additional iterations of the proxy group analyses.**

A. In the second iteration, I removed Madison Gas & Electric due to its relatively small size in terms of revenue and capitalization. In this eight-company proxy group, the low median return is 8.81%, the high median return is 9.83%, the overall median of the High-Low returns is 9.12% and the average of the High-Low median is 9.32%. The absolute

range of the returns in this group is still 7.16% to 10.37% (Exhibit PA-10, p. 4). Finally, in the event that FERC may prefer a proxy group for NYPA which is comprised of utilities more narrowly classified as "electric" utilities, I presented an additional proxy group consisting solely of utilities classified as electric by Yahoo Finance, as opposed to the larger proxy groups which include a diversified electric and a gas utility. The third proxy group includes only six utilities. That group showed a low median return of 8.81%, a high median return of 9.49%, with the overall median of 9.10%. The average of the High-Low was 9.15%. The range of the returns here is 7.24% to 10.08% (Exhibit PA-10, p. 5).

**Q. What can you conclude from these proxy group analyses?**

A. The analyses all support the reasonableness of the requested base ROE of 9.25%, and the 9.75% ROE with the incentive for New York ISO participation is supported because it is in the range of the results from all of the proxy group analyses. While my research of FERC decisions did not yield any cases involving a AA- rated municipal entity, the overall ROR of 8.19% is relatively low compared to other "pre-tax" RORs allowed by FERC and by other jurisdictions across the country when taxes are considered. Also, on a simple after-tax basis, 8.19% is comparable.

**Q. Does comparative data show that the AA- bond rating for NYPA comes at a higher cost for ratepayers than a lower bond rating of A or BBB?**

A. No, it does not. Optimal "lower cost" capital structure decisions are heavily influenced by income taxes, and as already noted, NYPA does not pay income taxes. NYPA's lower cost of debt at 4.45% was very much a factor in its AA- or better bond rating. NYPA's higher bond rating is primarily the result of its conservative use of debt financing (low

leverage). Whereas IOUs must contend with the cost of a "tax on tax" grossed up cost of equity capital, which makes a 9.75% cost of equity actually cost about 15% at the Federal corporate income rate of 35%, the same 9.75% return for NYPA is simply 9.75%. IOUs have to balance the "cost" of a grossed up cost of equity which is needed to provide the safety margin for a higher bond rating, with the benefit that such a higher bond rating would produce in terms of a lower borrowing rate. This comparison comports with financial theory; the Modigliani-Miller Theorem tells us that in the absence of taxes, the cost of capital is a fixed amount based upon the risk of a project, and one cannot change the overall cost of capital (value of the firm) by shifting from debt to equity. However, when income taxes are added to the equation, the issue is more complicated and the use of debt leverage becomes an important consideration for tax paying entities like IOUs. Comparative data suggests that the AA- bond rating does not come at an increased cost compared to a lower bond rating, as may be the case with an IOU. As already noted, NYPA's requested ROR of 8.19% is the result of overall conservative financial management, yet its business risk is comparable to IOUs. Data from Regulatory Research Associates, attached as Exhibit PA-11 at page 3 shows that the overall after-tax ROR for "average" rated electric utilities in 2011 and 2012 was in the range of 7.95% to 8.00%. Also, in the pending FERC case in Docket No. ER11-1915-002 involving Public Service Company of New Mexico ("PNM"), a company rated only BB, FERC Staff recommended an overall after-tax ROR of 8.462%. Therefore, while the data shows that NYPA's AA- rating does not come at a net cost to its customers, attempts to make downward adjustments on the theory that a lower bond rating is more cost effective

would likely produce no downward adjustment in NYPA's situation.

**Q. Could you elaborate on why there would be no downward adjustment?**

A. Certainly. If one assumes the capital structure ratios and proposed cost of debt and equity should not be supported in rates, then one must propose a new capital structure and cost rate for both debt and equity as a surrogate. Data discussed earlier from Regulatory Research's national data shows no meaningful difference in total (*i.e.* 7.95% to 8.00% versus the proposed 8.19%). Data from the pending PNM case show, by comparison, that the company's BB rating for after tax cost of capital is actually higher. Therefore, one cannot simply take NYPA's capital structure and "impute" a lower equity ratio, or a lower cost of equity, without dramatically increasing its 4.45% cost of debt. Accordingly, the 4.45% cost of debt would need to be increased due to several factors: (1) the cost of the historical issuances would be higher, (2) the cost of credit support for shorter term issuances and interest rate swaps would be higher, and (3) the cost of "new debt" consistent with the proposed bond rating and capital structure needs to be added to embedded debt in order to model the proposed hypothetical capital structure. That is, if a lower-rated financial structure is imputed to NYPA, then one cannot assume the historical or prospective financing rates of an AA- rated entity. In the final analysis, comparative data shows no predictable downward result. NYPA's overall ROR is already about 33% less than the typical IOU considering taxes and the same if taxes are ignored.

**Q. Have you included credit rating reports for NYPA in your filing?**

A. Yes. Exhibit PA-12 show copies of the reports from both S&P's (AA-) and Moody's (Aa2) for reference.

**Q. Does this conclude your testimony?**

A. Yes, it does.

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## AFFIDAVIT OF RICHARD L. ANSALDO

**State of New York )**

**County of Albany )**

I, Richard L. Ansaldo, being duly sworn, depose and say that the statements contained in the Prepared Direct Testimony of Richard L. Ansaldo served on behalf of the New York Power Authority in these proceedings are true and correct to the best of my knowledge, information and belief, and I hereby adopt said testimony as if given by me in formal hearing, under oath.

Richard L. Ansaldo

SUBSCRIBED AND SWORN to before me
This 26th day of July, 2012

THOMAS KRAUPNER
Notary Public, State of New York
No. 01KR6148839
Qualified in Albany County
Commision Expires June 21, 2014