BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Consolidated Edison Company of New York, Inc.

Case 09-E-0428

August 2009

Prepared Testimony of:
Staff Policy Panel

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Office of Regulatory Economics

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Q. Would the members of the Staff Policy Panel please state your names, employer, and business addresses?

A. Andrew Harvey, Kevin Higgins and Marco Padula. We are employed by the New York State Department of Public Service (DPS or the Department). Our business address is Three Empire State Plaza, Albany, New York 12223.

Q. Mr. Harvey, what is your position in the Department?

A. I am a Principal Economist in the Office of Regulatory Economics. I joined the Department in 1974.

Q. Please summarize your educational and professional background.

A. I hold Bachelor of Arts and Master of Arts degrees in Economics from the State University of New York at Albany.

Q. Have you testified in any prior proceedings?

A. Yes. I have testified in about 50 proceedings before the New York State Board on Electric Generation Siting and the Environment and the New York State Public Service Commission (Commission) on a wide range of economic issues.

Q. Mr. Higgins, what is your position at the Department?

A. I am employed as a Supervisor in the Office of Accounting and Finance. I joined the Department in June 1987.

Q. Please briefly describe your educational background and professional experience.

A. I am a graduate of the State University College of New York at Oneonta with a Bachelor of Arts degree in Business Economics. I have also earned an Associates degree in Accounting from Morrisville State College.

Q. Please describe your responsibilities with the Department.

A. My work as a Supervisor includes the examination of accounts, records, documentation, policies and procedures of regulated utilities so as to develop issues for electric, gas, telecommunications and water rate proceedings, financing petitions, rate of return studies and other general accounting matters.

Q. Mr. Higgins, have you previously testified before the Commission?

A. Yes, I have testified in many proceedings, most recently in Consolidated Edison Company of New York's (Con Edison or the Company) last electric rate case (Case 08-E-0539).

Q. Mr. Padula, what is your position in the Department?

A. I am employed as a Utility Supervisor in the Rates and Tariffs Section of the Office of Electric, Gas and Water. I joined the Department in 1994.

Q. Mr. Padula, please briefly state your educational background and professional experience.

A. I received a Bachelor of Science Degree in Electrical Engineering from Northeastern University in 1990 and Master of Business Administration from Rensselaer Polytechnic Institute in 1998. From 1990 to 1994 I was employed by IBM as an Electrical Engineer responsible for the design and development of high performance power/thermal control systems for mainframe computers.

Q. Please briefly describe your current responsibilities with the Department.

A. My current responsibilities include electric and steam utility revenue allocation and rate design, computer simulation of electricity production, transmission and pricing, and wholesale electric market issues. I also serve as Staff co-leader on Con Edison electric and steam rate cases.

Q. Have you previously testified before the Commission?

A. Yes. I have testified on operating and maintenance expenses in Cases 94-G-0885 and 03-S-1672 and on embedded cost of service studies and rate design in Case 04-E-0572, Case 05-S-1376, Case 07-E-0523, Case 07-S-1315, and, the Stand-by Service proceedings.

Q. Panel, what is the purpose of your testimony?

A. We will discuss the austerity measures reflected by Con Edison in its rate request for the rate year ending March 31, 2011. Next, we will address the supplemental testimony of the Company's Property Tax Panel. We will also discuss the Company's proposal for a three-year rate plan, following which we present Staff's proposal for a three-year rate plan for the Company. Finally, we will discuss the impact of the Commission's recent Order in Case 08-M-0152 (Comprehensive Management Audit of Consolidated Edison Company of New York, Inc.), and what should be done in this proceeding.

Q. Is the Panel sponsoring any Exhibits?

A. Yes, we are sponsoring two exhibits.

Exhibit__(SPP-1) contains responses to DPS Staff Information Request (IR) that we refer to and have relied upon in our testimony.

Exhibit__(SPP-2) contains historical data of the Gross City Product of New York City (GCPNYC), as calculated by the City of New York, Office of Management and Budget (CNYOMB).

Austerity Program

Q. The Commission's Order in Case 08-E-0539, Con Edison - Electric Rates (2009 Rate Order), page 344, states that Con Edison should include in its next rate filing, or within not more than 30 days thereafter, testimony describing the Company's austerity program efforts it plans to continue beyond the rate year ended March 31, 2010, correct?

A. Yes.

Q. Did Con Edison submit testimony addressing this directive in its rate case filing?

A. At the time of its initial testimony, Con Edison had not yet finalized its response to the Commission with respect to its austerity budget. However, Con Edison reflected, as a placeholder, an adjustment of $30 million reducing its rate request pending the filing of supplemental testimony.

On June 8, 2009, Con Edison filed supplemental testimony presenting its austerity program for the rate year ending March 31, 2001. The Company identified cost reduction measures taken that reduce its rate request by $22.6 million, in place of the $30 million it originally reflected.

Q. Would you briefly explain Con Edison's rate year austerity program?

A. Yes. Con Edison's austerity program includes three categories of cost saving measures. The first category involves labor and labor-related costs and includes reductions of base salaries for executives, and senior and mid-level management, as well as 401(K) matching and discount stock purchase plan reductions that apply to management employees. The Company indicated that, except for the salary reductions applicable to executives, these four measures are only in effect for the first three months of the rate year (April 1 - June 31, 2010) and reduce its rate request by $1.7 million.

Q. Please continue.

A. The second category of cost saving measures are associated with corporate-wide initiatives and include restrictions on business travel, reductions in transportation and communications costs, suspension of some memberships in industry associations, reductions in consulting services, and reduction in vested vacation and employee health costs to be achieved by continued use of overtime work to delay some new hiring during the rate year. Except for the measures to reduce transportation and communication costs, which Con Edison states are permanent, the other corporate-wide measures are also only in effect for the first three months of the rate year and reduce the Company's rate request by $2.8 million.

Q. What is the last category?

A. The final category of cost saving measures relate to reductions in the Company's 2009 capital spending program. Con Edison indicates that this measure results in a reduction to its rate request of $18.1 million, representing the carrying charges associated with a capital spending reduction of approximately $139 million.

Q. Does Con Edison plan to update its rate year austerity program?

A. In his pre-filed supplemental testimony, Company witness Rasmussen states that when Con Edison establishes its fiscal year 2010 capital and O&M budgets, additional rate year cost reductions may be identified. Accordingly, an update is possible.

Q. Do you have any concerns or comments regarding Con Edison's proposed austerity program for the rate year?

A. Yes. Attachment B of the Company's filing submitted on March 26, 2009, which identifies austerity measures the Company planned to implement in the rate year ending March 31, 2010, include reductions to the Company's O&M

budget of $19 million. In that filing, the Company describes those reductions as being "associated with multi-year and low-priority projects and programs, and relatively modest on an individual project or program basis." Witness Rasmussen's supplemental testimony does not address the continuation of each of those specific O&M austerity measures, except to state that additional rate year cost reductions may be identified when the Company completes its 2010 O&M budgets.

Since the economy in Con Edison's service territory is showing little sign of improvement, we recommend that the Company's revenue requirement in this proceeding reflect the continuation of the category one (labor and labor-related) austerity measures, the category two (corporate-wide initiatives) austerity measures, and the O&M reductions identified in Attachment B of the Company's filing submitted on March 26, 2009, at least through the rate year and until the economy in the Company's service territory shows signs of improvement.

Q. How would you describe the present status of the

New York City (NYC) economy?

A. Prior national recessions, such as the recession that occurred during 1980-1982, pale in comparison with the present recession, which the National Bureau of Economic Research (NBER) declared began in December 2007. The basis for this conclusion can be found in Exhibit ___ (SPP-2). Exhibit___ (SPP-2) contains historical data of the Gross City Product of New York City (GCPNYC), as calculated by the City of New York, Office of Management and Budget (CNYOMB). This data shows the movement in the GCPNYC from 1979-2007 in both real ($2000) and nominal terms. It provides the forecast of GCPNYC in real dollars for the years 2008-2011.

Q. Since 1979, what has been the trend for real GCPNYC?

A. Despite the national recessions that occurred between 1980 and 1982, the economy of NYC continued to experience growth in real GCPNYC of 2.2% in 1980, 4.1% in 1981, and 2.0% 1982. The recession from July 1990 to March 1991 impacted the economy of NYC negatively, with a reduction in real GCPNYC of -2.7% in 1991. Growth in

GCPNYC subsequently turned positive and accelerated in the 1990s peaking in 2000 at 8.9%. The recession of 2001, along with the infamous September 11, 2001 terrorist attack, caused two years of sizable decreases in real GCPNYC of -5.0% in 2001 and -3.7% in 2002. Growth in GCPNYC then resumed in 2003 and continued through 2007. The national recession that began in December 2007, however, has precipitated a decline in prospective GCPNYC that is not only unprecedented, but also continuing.

Q. Please explain.

A. The CNYOMB foresees decreases in real GCPNYC of -4.5% in 2008, -12.0% in 2009, and -1.9% in 2010. These are truly staggering decreases in the economic activity of NYC that radiate well beyond the city limits and throughout the region, as well as New York State (NYS). The implications of this are generating budgetary challenges that are of tremendous magnitude.

Q. How is the present recession impacting NYC in comparison to the national economy?

A. Its impact on NYC is much more severe. The

August 2009 Blue Chip Economic Indicators states that real United States Gross Domestic Product (USGDP) increased by 0.4% in 2008. It predicts a decrease of -2.6% in 2009, and an increase of 2.3% in 2010, which is substantially better than described above for NYC.

Q. Please summarize the recent history and forecast of unemployment rates in NYC?

A. Unemployment rates have recently increased significantly. For example, the NYC unemployment rate experienced the largest increase in a single month on record in March 2009 to 8.1%, from 6.9% the previous month. That escalation in unemployment rates in NYC has continued, with the most recent unemployment rate at 9.5% for June 2009. The unemployment rate has almost doubled in 16 months. The CNYOMB projects that the average unemployment rate for 2010 in NYC will rise to 10.2%.

Q. What overarching economic uncertainties confront the national economy at this time?

A. With the Federal Funds rate close to 0%, the Federal Government is now primarily dependent on implementing fiscal policy to regenerate the economy back into a growth mode. Fiscal policy is inherently a slower policy tool than monetary policy, which makes forecasts of economic activity, as we go forward, fraught with uncertainty. Rising bankruptcies, commercial real estate uncertainties, and lagging increases in wages and incomes all pose further challenges. Economists argue whether this recession will look like the traditional "V" shape, where the economy exits the recession without returning to subsequent negative growth, a "W" shape, where the economy exits the recession only to return back to negative growth again (also known as a double-dip), or the dreaded "L" shape, where the economy falls into recession, and then stays in negative growth for an extended period of time. Consumer confidence, as measured by the Reuters/University of Michigan preliminary index of consumer sentiment decreased to 63.2% in August 2009. The consensus forecast by economists as determined by Bloomberg had been 69% for August 2009, with a range from 64% to 75%. The fact that this preliminary actual fell below the lowest forecast is a cautionary alarm regarding just how difficult it will be for the consumer to lead the U.S. economy out of this recession. The net effect of the confluence of these economic realities is that it may be a major challenge for the US economy to experience sustained economic growth over the next few years.

Q. What overarching economic uncertainties confront the NYC economy at this time?

A. The challenges that confront the US economy will continue to significantly impact NYC. Furthermore, the continued status of NYC as a global financial powerhouse, and its relative profitability, could be challenged, which could significantly contribute to the future economic vitality of NYC, the State and the US. We are presently facing great uncertainty that suggests firms navigate cautiously and engage in cost savings where possible.

Q. Returning to your discussion of Con Edison's austerity program, what would be the rate impact of your recommendation to extend the category one and two austerity measures an additional nine months (from June 30, 2010 to March 31, 2011), as well as the O&M austerity reductions identified in Attachment B of the Company's March 26, 2009 filing, to the end of the rate year?

A. It would further reduce Con Edison's rate request by $31.3 million.

Q. Are other Staff witnesses and Panels proposing austerity related adjustments?

A. Yes. The Staff Accounting Panel and Staff Witness Quackenbush, as discussed in their testimonies, are proposing austerity related adjustments of $2.242 million and $0.990 million, respectively.

Q. Please summarize the total level of austerity measures reflected in Staff's revenue requirement recommendation for the rate year ending March 31, 2011.

A. Staff's revenue requirement reflects total rate year austerity related savings of $57.132 million. This amount is comprised of the $22.6 million that Con Edison has proposed to date, $31.3 million attributable to continuing the austerity measures we are proposing, $2.242

million in adjustments that the Staff Accounting Panel is proposing, and a $0.990 million adjustment that Staff witness Quackenbush is proposing.

Q. Is the Company required to report on its efforts to achieve the austerity measures it has identified?

A. Yes. The 2009 Rate Order requires that the Company file reports on or about every 90 days concerning its progress in achieving all of the austerity cuts. In a letter confirmation submitted to the Commission's Secretary on August 27, 2009, the Company stated that it will file its first quarterly report by October 15, 2009. Therefore, to the extent necessary, we reserve the right to update our testimony on the Company's austerity program at the time of the hearings, if our review of that report has any impact on our recommendations.

Property Tax Panel Response

Q. In its 2009 Rate Order, the Commission directed Con Edison to include in its next electric rate filing, or not later than 30 calendar days after that filing, testimony explaining how its real property is defined and classified, the amount or value of its real property subject to taxation, the general uses of such real property, the history of the value of its property and tax rates over the last ten years, whether and to what extent its tax rates are consistent with those paid by other New York City and Westchester businesses. To the extent that there are inconsistencies in taxation, the Company was required to identify actions that have been and could be taken to address the situation, correct?

A. Yes.

Q. Did Con Edison submit testimony addressing these matters?

A. Yes. On June 8, 2009, the Company's Property Tax Panel (PTP) filed supplemental testimony in this proceeding addressing these matters.

Q. Do you have any concerns or comments regarding the supplemental testimony?

A. Yes. Our major concern is that within NYC, the Company's tax rates are established by a structure in which Con Edison, and therefore its customers, are required to bear a disproportionately large share of the overall property tax burden.

Q. In its supplemental testimony, did Con Edison's PTP explain how the Company's real property in NYC is defined and classified?

A. Yes. The Panel explains that, each year, the Mayor submits an executive budget for the upcoming fiscal year (July 1 to June 30) to the City Council (Council). After the Council adopts a budget, it fixes the annual property tax rates and authorizes the levy of real property taxes for the fiscal year (FY).

To determine the amount of the real property tax levy, the Council first determines the amount of the projected FY year spending and an estimate of FY non-property tax revenues. The Council then determines the amount to be raised by taxes on real property by subtracting the amount of projected FY non-property revenue from the amount of projected FY spending. The PTP states that "the property tax is unique in that it is the only tax over which the City has discretion to determine the rate without legislation from the State and therefore, property taxes may be used to balance the budget."

To ensure that the level of property tax revenue needed to balance the budget is achieved, the City makes allowances for a number of items including uncollectible property taxes, refunds and tax collections from prior years, together known as the property tax reserve. The real property tax levy is equal to the property tax revenue plus the property tax reserve.

After having determined the amount of the real property tax levy, the Council authorizes and fixes the real property tax rates. Three things determine the amount of tax applicable to property in NYC: the market appraisal for the property itself; the fraction of the assessed value on which taxes are to be paid; and, the tax rate for the property class.

Q. Please explain the classes of property in the City.

A. Counsel advises that the "class" system for property taxation in the City was established in the Real Property Tax Law. There are four classes of property in the City and consequently, four different tax rates. Class 1 is comprised primarily of one, two and three-family homes. Class 2 consists of all other residential property not in Class 1. Class 3 is comprised of utility real property owned by utility corporations, but excludes land and buildings. Class 4 contains all other real property. The PTP indicates that about 90% of the Company's property falls within Class 3 and the remainder within Class 4. Each class is responsible for a specific share of the property tax levy, known as the class share.

Class shares are determined each year according to a statutory formula. The PTP notes that the percentages of the tax levy represented by the class share that were in place in 1989 are known as the base proportions. Each year these base proportions are adjusted according to changes in market value determined by the New York State Office of Real Property Services (ORPS). The adjusted proportions become the current base proportions. The PTP indicates that this process was designed to ensure that each of the four classes pay roughly the same percentage share of the total property tax levy as they did in 1989. The base proportions are adjusted to reflect physical and other non-market changes that are reflected on the current assessment roll. The class share is measured by multiplying the total levy by the adjusted base proportion in each class. From that process, the tax rates for each class can be determined by dividing the class share by the total assessed value of the respective class.

Q. Are there any limitations on the tax levy and/or class shares?

A. Yes. According to the Company's PTP there are two limitations on the levy and/or class shares, a State constitutional operating limit provision and a 5% cap.

The operating limit condition, by and large, provides that the City is not permitted to levy taxes on real property in any fiscal year in excess of an amount equal to a combined total of 2.5% of the average full assessment of taxable real property for the current year and the prior four years. The Company notes that for NYC fiscal year 2008/09, the limitation was

$17.5 billion and the actual property tax levy falls below it.

The PTP states that the second condition, the rate cap, prevents the current base proportion of a class from being increased by more than the cap in any one year. The PTP maintains that this limitation has had a significant impact in the determination of the Class 3 and 4 tax rates over the years.

The PTP stresses that although the statute limits the growth of the current base proportion for any class share up to the cap annually, the City may seek State legislation to lower the legislative cap on the allowable growth of the current base proportion used to measure the adjusted base proportion of each of the four classes. The PTP notes that if the uncapped growth exceeds the statutory cap, the excess must be distributed among the other classes. If the legislative cap is reduced to less than the 5% statutory cap, then a greater excess must be shifted among the other classes. The PTP points out that since NYC's 2001/02 FY, the City has shifted the excess to Classes 3 and 4. The PTP states that the Company opposes this piece of legislation and lobbies the City in an attempt to mitigate the shift of the 5% overage to Class 3 taxpayers.

Q. What is the relationship between market value and the tax levy for each class?

A. In its supplemental testimony, the PTP illustrates the relationship between market value and the tax levy for each class based on FY 2007/08 information. This exercise clearly shows the discrepancy between the classes. Class 1 accounts for 54% of the city-wide market value but is only responsible for 15% of the property tax burden. The other classes pay disproportionately higher taxes since their shares of the tax burden are higher than their share of market value. In other words, since Class 1 pays only 15% of the tax levy, the residual 39% of its share gets passed through to the other classes, which together make up only 46% of the total market value. Thus, Classes 2, 3 and 4 shoulder a disproportionately large share of the overall property tax burden. Taxes in Class 3 are the highest relative to market value. Class 3 taxpayers account for just 2% of the market value, but are responsible for 7% of the tax levy.

Q. Did the PTP provide data showing the history of its electric property taxes in NYC over the last ten years as required by the 2009 Rate Order?

A. Yes. The Company submitted data showing that property taxes paid to the City rose from $411.2 million in FY 2000/01 to $945.9 million in FY 2009/20, or roughly 130% during that period. In contrast, increases in assessed and market values over that same period were smaller.

Q. Did the PTP explain the efforts Con Edison is making, or has made, in challenging the City's property tax class system?

A. Yes. The PTP discusses the Company's current efforts seeking to merge Class 3 with Class 4 which it contends would greatly benefit its customers. According to the PTP, the immediate benefit would be the end of the higher Class 3 tax rate, partially offset by an increase in the Class 4 tax rate. Based on current rates, the PTP estimates annual savings of roughly $120 million if Classes 3 and 4 merge.

The PTP also identifies other benefits of merging these two classes. Con Edison comprises approximately 77% of Class 3, so any cap legislation pursued by the City to shift the property tax burden away from homeowners has a significant impact on the Company. Merging Classes 3 and 4 would reduce this effect since the Company's property would be a smaller percentage of a larger class. Further, to the extent that the City increases the class tax rate to offset a reduction in assessments, Con Edison would realize a greater proportion of the reduced assessments it obtains, since it will pick up a smaller percentage of any increase in taxes aimed at offsetting the reduced assessments.

The PTP also explains that a transition assessment currently available to Class 4, but not Class 3 taxpayers, would be available to Con Edison, should Classes 3 and 4 be merged. A transition assessment phases in, over a five-year period, large assessment increases and the phase out of large assessment decreases caused by reasons other than physical plant increases.

The PTP indicates that large increases in the Company's recent assessments could have been mitigated via the five-year phase-in if the transition assessment had been available to Class 3 taxpayers.

Q. Did the PTP also explain the Company's prior efforts to change the class system of taxation in NYC?

A. Yes. The PTP refers to the Company's prior efforts as broad-based. The Panel claims that the Company contested the assessed values of specific properties, the availability of certain tax reduction benefits and credits and the legality of various City legislative actions. In addition, in its response to Staff IR DPS-222, included in Exhibit___(SPP-1), the Company identifies a few times in which it met with representatives from the City in which the Class system was discussed prior to its current efforts, which it claims is a concentrated effort.

Q. Why is the Company making a concentrated effort now to challenge the City's class system?

A. In its supplemental testimony, the PTP stated that "in 2008, it became increasingly apparent that the implementation of the class system in conjunction with allocation of the excess above the cap was unduly and unreasonably adverse to Class 3 property holders."

Q. Is the City supportive of the Company's current efforts to merge Classes 3 and 4?

A. The PTP indicates that the City is not supporting the efforts at this time. It notes, however, that the City may consider overall real property tax law reform next year. The PTP also states that the Company is "proceeding to seek introduction of our proposed change in the current legislation session." It should be noted that, while the state legislature has reclassified property in the City before, there has not been a case where an entire class was eliminated.

Q. Has the Company pursed any legal challenges within the last ten years regarding the class system?

A. No it has not. In its testimony, the PTP states "we have been advised by counsel that the classification system has been challenged in the past and upheld." The Panel indicates that in that case, the plaintiff argued in vain that the class system was unconstitutional.

Q. Has Con Edison, or any entity on its behalf, prepared any legal analysis of the litigation risks and the costs and benefits of pursuing legal challenges to the City class system?

A. In its response to Staff IR DPS-222.9R included in Exhibit___(SPP-1), the Company maintains that in December 2008, a legal analysis was performed on the Company's behalf by outside counsel regarding a challenge to the class system and is currently under consideration. The Company further states that "[a]ccordingly, the Company's analysis is not complete." It should be noted that the Company claimed in its response that the legal analysis conducted is subject to attorney/client privilege and, accordingly, did not provide a copy of the analysis.

Q. Has the Company used outside counsel or consultants to pursue property tax claims or challenges in NYC or other taxing jurisdictions?

A. In its response to Staff IR DPS-445 included in

Exhibit___(SPP-1), the Company indicates that it used outside counsel to purse tax claims and challenges in NYC, Westchester and Upstate counties over the past seven years.

Q. Does the Panel have final comments and recommendations?

A. Yes. First, we support Con Edison's current efforts to work with NYC to control or reduce the amount of NYC property taxes shouldered by the Company's customers and strongly encourage the Company to continue to work with the City to pursue property tax restructuring that will benefit its customers. Continual large increases in property taxes not only cause significant customer bill impacts, but also may discourage Commission authorization of funding for other initiatives that may benefit ratepayers in the long-term, such as energy efficiency, since such programs may also place untenable upward pressure on rates.

Second, although we recognize the past actions taken by the Company to control property taxes, we recommend that the Company be required to submit in each rate filing, testimony regarding the actions it has taken to control, or reduce, property taxes. Among other things, the filings should include: a summary of actions taken to challenge tax rates and/or assessments; information regarding its use of outside consultants and counsel to pursue tax claims or challenges; the extent to which outside counsel are employed on a contingency fee basis; and, its requests for available tax credits. In the absence of such a demonstration, the Company should be subject to a five basis point negative rate adjustment.

Finally, since property taxes are one of Con Edison's most significant expenses and because of the extraordinary upward pressure on delivery rates, we recommend that the Commission establish an aggressive incentive mechanism to encourage the Company to minimize these costs. The Commission should consider an incentive mechanism that will allow the Company to retain a greater share of any property tax savings it realizes as a result of its efforts. The Commission has in the past awarded utilities from 10% to 25% of refunds received as a result of successful property tax challenges, the higher percentages being based on extraordinary effort involved, the magnitude of the refund, a novel legal theory that produced the refund, the minimization of litigation costs, the potential for long-term benefits resulting from the successful challenge, and the potential for the successful challenge or basis for challenge to produce benefits for other utilities. Should Con Edison achieve substantial and ongoing property tax cost savings attributable to its efforts, as just discussed, related to correcting substantial over assessments to its Class 3 properties, the Commission should consider providing the Company with an award at or above the upper threshold of typical awards and/or consider whether such award should be allowed for a multi-year period.

Company's Proposal for a Three-Year Rate Plan

Q. Did Con Edison propose a three-year rate plan as an alternative to its one-year case?

A. Yes.

Q. Please briefly explain Con Edison's three-year rate plan proposal.

A. The Company proposes that rates established for the rate year ending March 31, 2011, become the base from which projections are made in order to set rates for the following two rate years. The Company also proposes that filings on capital expenditures in future years be made prior to the start of subsequent rate years to allow for review and, if necessary, Commission action.

Q. What are the projected increases in revenue requirement under the Company's three-year rate year plan?

A. Based on its preliminary update filing, the projected revenue requirement increases in Rate Year 1, Rate Year 2 and Rate Year 3 are $928.9 million $375.1 million and $381.2 million, respectively. In projecting these increases, the Company factored in a stay-out premium of 71 basis points to increase the return on equity from 10.9% to 11.6%. As an alternative to the three annual increases, the Company proposed levelized annual increases of $656.5 million, or 14.4% annually.

Q. What is driving the Company's projected increases in revenue requirement?

A. The primary causes of the Company's rate increase in Rate Year 1 are attributable to carrying costs on capital additions, property tax expense, pension & Other Post Employment Benefits (OPEB) costs and cost of capital. The major drivers of proposed rate increases in Rate Year 2 and Rate Year 3 are carrying costs on capital additions, property tax expense, and pension & OPEB costs. In fact, these three items account for approximately 88% ($332 million) and 83% ($315 million) of the Company's projected rate needs for Rate Year 2 and Rate Year 3.

Q. Does the Company's proposal include a request for various reconciliation, or true-up, mechanisms?

A. Yes. The Company's rate plan proposal includes the same reconciliation mechanisms currently provided for by the Commission. Specifically, true-ups would be provided for sales variances through continuation of the Revenue Decoupling Mechanism (RDM), energy efficiency program costs, pension & OPEB expense, property taxes, site investigation & remediation (SIR) program costs, World Trade Center (WTC) costs and recoveries, and certain interest costs. The Company would also continue reserve accounting for Category 2 and 3 Storm and East River Repowering project (ERRP) costs. In addition, the Company requests a mechanism that would allow it to defer costs should the economy experience unexpectedly high levels of inflation during the term of the rate plan. Moreover, the Company proposes to true-up and defer costs associated with new legislative and regulatory requirements. Finally, the Company proposes bilateral reconciliation of interference O&M expenses.

Q. As part of its multi-year rate proposal, did the Company recommend an excess earnings sharing mechanism?

A. No it did not.

Q. What comments or concerns do you have concerning the Company's proposed three-year rate plan?

A. During the period encompassed by its proposed three-year rate plan, the Company's electric delivery revenues would increase by over $3.9 billion. This would come on top of three consecutive annual delivery rate increases of $220 million (7.3% on delivery), $425 million (12.4% on delivery) and $523 million (14.1% on delivery) in 2007, 2008 and 2009, respectively. Cumulatively, delivery rates have increased approximately 40% over the past three years, and the Company has collected an additional $2 billion over that period. If the Company's rate increase proposal is approved without modification, Con Edison's delivery rates would increase approximately 83% over a six-year period.

Base rate increases of the magnitude proposed by the Company would be unreasonable because of concerns regarding the ability of most customers to bear such increases in rates. In addition, the Company's proposal does not contain a plan or strategy to control or reduce the upward pressure on delivery rates caused by its ongoing capital spending program, increasing property taxes, and increasing pension and OPEB costs. As noted previously, it is primarily these three items that drive the Company's revenue needs and its proposal fails to explain what actions, if any, it would take during the term of rate plan to manage these cost drivers.

Moreover, the Company's proposal does not include a plan to control or reduce its other operating costs including labor. The Company's proposal simply escalates the forecasted base rate year rate allowances by inflation. No cost control of any kind is discussed in the Company's proposal.

Finally, Con Edison's proposal does not consider other Company specific proceedings such as Case 07-E-0523, Capital Expenditure Deferral Review, Case 09-M-0114, Capital Expenditures Investigation and Case 08-M-0152, Con Edison Management Audit, which may have an impact its operations and rates during the term of the rate plan. Proposing to set rates for a three-year period without due consideration of these proceedings seems imprudent. Consequently, for all the above reasons the Commission should reject the Company's rate-plan proposal to lock in over $3.9 billion in additional delivery revenues over its three-year term.

Staff's Proposal for a Three-Year Rate Plan

Q. Did you explore the possibility of a multi-year rate plan for Con Edison as part of your examination of the Company's rate filing?

A. Yes.

Q. Are you proposing a multi-year rate plan as an alternative to Staff's one-year case?

A. Yes. As an alternative to Staff's one-year case, we are proposing a three-year rate plan for Con Edison.

Q. Would you please explain your proposal?

A. There were four primary causes of Con Edison's increase in base rates in its last electric rate case (Case 08-E-0539): carrying costs on capital additions; property taxes; pension & OPEBs costs; and, cost of capital. These are also the four major drivers of the Company's proposed rate increases in this proceeding.

Specifically, of the Company's rate request of $840 million (which excludes the 70 basis points stay-out premium) for the rate year ending March 31, 2011, about $540 million, or roughly 65%, is related to these four items. Furthermore, Con Edison's electric revenue requirement projections (Exhibit ___ (ERJ-1), July 10

Update), show that increases in carrying costs on capital additions, increases in property taxes and increases in pension & OPEB expense account for approximately 88% ($332 million), 83% ($315 million), 83% ($226 million) and 79% ($307 million) of the Company's projected rate needs for the rate years ending March 31, 2012, 2013, 2014 and 2015, respectively.

With this backdrop, we are proposing that the rates established for the rate year ending March 31, 2011, become the base from which the Commission provides for staged increases for the two subsequent rate years, limited to only three items: carrying costs on capital additions; property tax expense; and, pension & OPEB expense. There is little or no need for repeated annual rate case filings in the next two years involving the same cost drivers. Moreover, we are concerned that the public interest may not be served if Con Edison continues to file annual rate cases that primarily raise these same issues and cost drivers.

Q. Please continue.

A. The Staff Accounting Panel notes that Staff is recommending a base rate increase of $477.360 million for the rate year ending March 31, 2011. There is no stay-out premium in the one-year case. With a three-year rate plan, as discussed by the Staff Finance Panel, there would be a stay-out premium of 12 basis points to increase the recommended return on equity (ROE) from 10.1% to 10.22%. Accordingly, if a multi-year plan was adopted, the ROE increase would result in a Staff revenue requirement of $492.017 million for the rate year ending March 31, 2011. The increases in revenue requirement for the rate year ended March 31, 2012 and the rate year March 31, 2013 would be determined in fully supported staged filings that Con Edison would make related to capital additions, property tax expense and pension & OPEB expense.

Since the recommended delivery revenue increase is so significant in the first rate year, and the economy in the Company's service territory is expected to continue to be relatively weak, we recommend that the Commission, if it were to adopt our multi-year proposal, consider authorizing the Company to recover a portion of the rate year revenue requirement increase in Rate Years 2 and 3. This would tend to levelize the increases in each of the three years considering that Con Edison's current projections indicate that the three categories for which staged increases would be permitted would result in rate increases in the range of $300 million in Rate Years 2 and 3. In such event, the Company would be entitled carrying charges on any accrued revenue at the Company's pre-tax rate of return.

Q. What information would be included in the staged filings?

A. Con Edison would, among other things, submit its capital spending plan and the associated revenue requirement impact. The Company's capital spending plan should, among other things, reflect its implementation of the recommendations contained in the recent management audit report concerning its construction planning process. This should include the recognition of the resulting rate and bill impacts and the sustainability of the

Company's capital spending plans given the current state of the economy and the benefits that those plans are expected to provide. Con Edison's spending plan would also incorporate any Commission directives made in this case, or any other case, as they concern the Company's current and future construction activities.

In order to limit the potential rate impacts of increased infrastructure expenditures, the Commission should set a cap on the level of annual infrastructure expenditures for Rate Year 2 and Rate Year 3, equal to the level adopted for the first rate year. For example, if the Commission adopts the Staff Infrastructure Panel's proposed T&D capital expenditure forecast for Rate Year 1 of approximately $1 billion, the subsequent Rate Year 2 and Rate Year 3 spending in this category should be no more than that level. In addition, the existing downward reconciliation of carrying charges on capital expenditures in the categories of Transmission and Distribution, Shared Services, Production and Municipal Infrastructure should continue for all three rate years.

The staged filings would also include Con Edison's forecast of property tax expense based on latest known available information. As noted above, the Company would be required to demonstrate that it has taken actions to control or reduce its property taxes.

Con Edison would also present its forecast of pension and OPEB costs based on latest known actuarial information. Furthermore, under our proposal the Company would be required to continue to demonstrate that it has taken action to control or reduce its pension and OPEB benefit plan costs.

The annual staged filings would include forecasted sales using the sales forecasting methodology that the Commission adopts for Rate Year 1. Based on the updated sales forecast and the resulting revenue requirement ultimately approved for Rate Years 2 and 3, the Company would file updated RDM targets for each year. The RDM mechanism currently in place should remain in effect and be used for all three years.

Under our proposal, the staged filing would include a status report on all of the Company's other on-going relevant proceedings (i.e., Case 07-E-0523, Capital Expenditure Deferral Review and Case 09-M-0114, Capital Expenditures Investigation.

Q. Please explain your proposal regarding the remaining portion of Con Edison's revenue requirement.

A. As noted above, approximately 88% ($332 million) and 83% ($315 million) of the Company's projected rate needs for Rate Year 2 and Rate Year 3 are driven by three items for which staged filings would be permitted under our proposal. The Company would be required to manage the remaining difference in its projected revenue requirement without incremental rate relief.

Q. Does Con Edison have opportunities to manage that difference during the term of the rate plan?

A. Yes. For the last several years, Con Edison has experienced high attrition levels as its workforce ages and new employees opt not to remain with the Company. Between January 2004 and December 2008, the Company hired approximately 4,700 new utility employees as a result of this attrition.

In its response to Staff IR DPS-56, included in Exhibit___(SPP-1), Con Edison projects attrition of 700 employees in 2009, and states that it expects that attrition will increase beyond that level once the economy begins to improve. The Company also notes that it did not adjust its rate request for attrition because it generally needs to refill positions vacated through attrition.

Over that same time period, Con Edison has also been hiring new employees primarily to assist with its response to various emergencies and incidents, safety and upgrade programs, and other short-to medium term programs. Specifically, over the last five years (January 2004 through December 2008), the Company has hired approximately 1,650 new utility employees for its expanding programs. This new hiring equates to an approximate 13% increase of the Company's workforce. It should be noted that when asked to explain the productivity gains realized as a result this increased hiring, the Company, in its response to Staff IR DPS-291, included in Exhibit___(SPP-1), merely stated that adding employees does not in and of itself result in productivity savings.

Q. Please continue.

A. The recently released management audit report, among other things, notes that Con Edison typically operates in a reactive mode, and that external events, particularly incidents and accidents, are the primary drivers of its activities and that the Company lacks sufficient clarity in its long-term vision. As a result, the report recommends that Con Edison develop a comprehensive vision for its electric business.

As Con Edison engages in the process of a developing a successful comprehensive vision for the future, it may consider that its existing workforce is sufficient or excessive in number to address its needs and, as a result, it may not fill all positions vacated through attrition. This would yield considerable labor and labor-related cost savings during the three-year term of the rate plan and beyond.

In fact, based on recent data, it appears that the Company may be already putting this theory into practice. In its response to Staff IR DPS-14 Revised 2, included in Exhibit___(SPP-1), the Company shows employee headcount reductions in both June and July of 2009.

Q. Do other opportunities exist for the Company to manage the difference between its projected revenue requirements in Rate Year 2 and Rate Year 3 and the revenues allowed in Staff's proposed rate plan?

A. Yes. The Company forecasts an increase, albeit modest, in non-sales revenues in Rate Years 2 and 3. Such increased revenue, which is not subject to the RDM, is a source to offset possible cost increases in those rate years. The Company projects increases in miscellaneous service revenues, mandatory hourly pricing program revenues as well as other operating revenues. It's even possible that the Company's non-sales revenues will be even greater than it currently projects.

Additionally, the Company requests expense allowances for various short-term O&M programs in Rate Year 1. It does not, however, reflect the reduction in expense as the costs associated with these program changes decrease in Rate Year 2 and Rate Year 3.

Q. Will Con Edison be allowed to reconcile, or true-up, any of its costs under your multi-year rate plan?

A. Yes. Our proposed rate plan provides for the reconciliation of sales variances through continuation of the RDM, energy efficiency program costs, pension & OPEB expense, site investigation & remediation (SIR) program costs, WTC costs and recoveries, and certain interest costs. Also, the downward-only reconciliation for infrastructure capital expenditures would continue as described earlier. The Company would also continue reserve accounting for Category 2 and 3 Storm and ERRP costs. Further, Con Edison would continue to reconcile revenues related to SO2 allowance credits, transmission service charges (TSC) and transmission congestion credits.

It should be noted, that our plan would not allow for deferred accounting for the costs discussed above if the Company is earning in excess of the allowed return on equity established by the Commission.

Q. What about the cost of any regulatory, legislative or accounting change or any other new deferral item?

A. We propose to reconcile and defer, during the three-year rate plan, the entire costs of any regulatory, legislative or accounting change or any new deferral item whose impact exceeds 5% of the Company's actual utility net income. However, the Company can only defer the costs to the extent that its earnings do not exceed the Commission allowed return on equity. Cost savings associated with any regulatory, legislative or accounting change or any new deferral would not be subject to an earnings test and they would be captured entirely for customers.

Q. How are existing regulatory deferrals amortized within your rate plan proposal?

A. The regulatory deferrals subject to amortization are being reflected over the three-year rate plan.

Q. What are you proposing as the balance of regulatory deferrals increases or decreases during the rate plan period?

A. We propose that unless the cumulative deferral balance reaches $50 million, the Company should continue to defer the amounts until the end of the rate plan. If the balance exceeds that amount, Con Edison could request to recover from ratepayers or refund to ratepayers, as appropriate, the balance or a portion thereof, as part of its staged filing.

Q. How should your recommendations regarding the Company's austerity measures be reflected in your three-year plan proposal?

A. The reductions in capital expenditures would be shifted out in time so that the Company's annual capital budgets for the second and third rate years will not increase as a result of its reduction in capital expenditures. Therefore, the $18.1 million revenue requirement reduction associated with the Company's reduction of 2009 capital spending will carry beyond the first rate year, as will $0.4 million associated with the permanent transportation and communication cost reductions.

With respect to Staff's imputation of an additional $34.532 million in the rate year, we propose that it continue until the Company makes a showing in one of its staged filings that the economic conditions in its service territory have improved.

Q. Does Staff's rate plan include a provision for excess earnings?

A. Yes. Our rate plan includes an earnings sharing mechanism because we believe that this virtually universal feature of multi-year rate plans, is critical element. We believe that our earnings sharing mechanism will provide the Company with a strong incentive to minimize its costs and gain efficiencies.

Q. Please explain the design of your earnings sharing mechanism.

A. Given the Staff Finance Panel's recommended ROE and its stayout premium determination of 0.12%, we recommend an earnings sharing threshold of 10.9% over the duration of the rate plan. Further, on an annual basis the Company should be directed to report its achieved earnings and defer all earnings in excess of that rate. Under our proposal, at the end of the three year rate plan, earnings between 10.9% and 11.9% will be shared equally between the Company and customers, while customers will receive 65% of earnings in excess of 11.9% and up to 12.9%. For earnings above the 12.9% level, customers will receive 90% of any excess.

Q. What is the basis for the sharing mechanism structure you recommend?

A. We believe that our structure is appropriate because it reflects an allocation of benefits and risk that is largely consistent with such provisions that the Commission has found to be reasonable in recently-adopted joint proposals.

Q. What incentives are included in your multi-year proposal?

A. We recommend that the reliability performance incentive mechanism proposed by Staff witness Jones, and the customer service performance incentive mechanism proposed by Staff witness Insogna, continue for the duration of the three year rate and until modified by the Commission.

In addition, as noted above, we propose that the Commission consider establishing a new incentive to minimize property taxes.

Q. When would the Company make its staged increase filings?

A. Con Edison should be directed to submit a fully supported filling, no later than June 1, 2010 for the rate year beginning April 2011 and no later than June 1, 2011 for the rate year beginning April 2012. We believe that this will provide sufficient time for Staff and other interested parties to examine the Company's filing and report on it to the Commission for its consideration and eventual disposition.

Q. What do you propose in the event Con Edison files for new rates during the term of rate plan?

A. If Con Ed files for a rate increase to become effective before April 1, 2013, it should be required to return the stayout premium of 12 basis points to ratepayers starting from April 1, 2010 to the date of new rates.

Management Audit

Q. Are the impacts of the recently completed comprehensive management audit in Case 08-M-0152 reflected in Staff's revenue requirement recommendation for the rate year ending March 31, 2011 or its multi-year rate proposal?

A. No.

Q. Please comment on the procedures typically used by the Commission to incorporate the results of management audits in its rate decisions and what should be done in this proceeding.

A. The specific circumstances of this case indicate that procedures, in addition to those specified in the Public Service Law, may be appropriate to incorporate the results of the management audit into the Commission's rate order in this case, particularly if the Commission's decision results in a multi-year rate plan. As we have explained in detail, Con Edison's rates have increased substantially in recent years, the economy continues to be relatively weak, and Con Edison's customers are having difficulty paying their utility bills. In these circumstances, the Commission should consider all reasonable means to obviate upward pressure on Con Edison's rates. The recommendations resulting from this management audit are one such tool. As stated by the Commission in its August 21, 2009 Order, "If Con Edison can deliver on the recommendations in the Final Report, it bodes well not only for the corporation's future success, but also for customers in terms of better service and cost savings that help mitigate rate increases."

However, under the procedure typically used by the Commission to consider the results of management audits in rate proceedings, any resulting cost savings would not be considered until Con Edison's next rate case, in which new rates would be established effective no sooner than April 1, 2011. Further, if the Commission approves a multi-year rate plan in this proceeding, the results of the management audit may not be incorporated into rates for several years.

In these circumstances, we recommend that the procedure for reflecting the results of management audits that is typically used by the Commission, be enhanced to ensure that customers receive the benefits of the audit's recommendations as soon as possible.

Q. What specifically do you recommend?

A. We recommend that the Company identify, in its rebuttal testimony, the recommendations of the Final Report which can be implemented, in whole or in part, in time to help reduce Con Edison's costs in the rate year. The Company should also provide an estimate of the associated costs and benefits. The Commission should consider incorporating the net savings in its revenue requirement determination. Alternatively, the Commission could direct that the Company defer the net impact for future disposition.

In addition, any multi-year rate plan adopted in this proceeding should include a provision for the Company to submit information regarding the timing and associated costs and savings of implementing the audit's recommendations as part of the staged filings we discussed previously. The resulting net impact could then be reflected in the Commission's revenue requirement determination for the Company.

Q. Assuming the Company puts this cost/benefit analysis in its rebuttal filing, what process does the Panel propose concerning the review of that information?

A. We propose that, if necessary, Staff be allowed to file surrebuttal testimony in order to have an opportunity to change its current, or make further, recommendations as appropriate.

Q. Does this conclude your testimony at this time?

A. Yes.