

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

At a session of the Public Service  
Commission held in the City of  
Albany on February 12, 2009

COMMISSIONERS PRESENT:

Garry A. Brown, Chairman  
Patricia L. Acampora  
Maureen F. Harris  
Robert E. Curry, Jr.  
James L. Larocca

CASE 09-M-0114 – Proceeding on Motion of the Commission to Examine the Prudence  
of Certain Capital Program and Operation and Maintenance  
Expenditures by Consolidated Edison Company of New York, Inc.

ORDER COMMENCING PRUDENCE  
PROCEEDING AND REQUIRING REPORT

(Issued and Effective February 12, 2009)

BY THE COMMISSION:

INTRODUCTION

On January 14, 2009, the United States Attorney for the Eastern District of New York (US Attorney) issued a press release to announce the arrest of 10 Consolidated Edison Company of New York, Inc. (Con Edison or the Company) supervisors and one retired supervisor. Based on the US Attorney's investigation, the Con Edison employees were charged with arranging for Con Edison to pay inflated claims by a contractor and with receiving from the contractor over \$1 million in bribes or kickbacks. This investigation and the investigative materials publicly available from it raise the specter of imprudence concerning the Company's expenditures associated with certain identified contracts. In the proceeding initiated by this order, we will examine the Company's

justification for these expenditures, and, if we find the expenditures unjustified, we will fashion an appropriate remedy.

The facts described in the publicly available investigative materials also justify a further investigation of the Company's conduct and behavior with respect to other contract expenditures incurred with respect to its capital projects and its operation and maintenance programs. As an initial step in this investigation, we will require the Company to prepare and submit a report which will include, at a minimum, the information described in the body of this Order. This proceeding may develop recommendations for changes in Con Edison's practices or procedures to reduce the risk of improper expenditures or administration of capital projects in the future. Further, the investigation will assist in developing recommendations concerning to what extent, if any, the scope of the prudence aspect of this case should be expanded beyond the payments made under the contracts identified in the US Attorney's investigation.

#### BACKGROUND

The US Attorney's investigation began with charges being brought against at least one contractor and at least two Con Edison employees in March 2007 and September 2008, who then agreed with the US Attorney to become cooperating witnesses for the ongoing investigation.<sup>1</sup> As the US Attorney's investigation proceeded, conversations were recorded with each of the Con Edison employees who were later arrested on January 14, 2009. In these recorded conversations arrangements were made for the submission of inflated vouchers by the contractor, for payments to be made by Con Edison to the contractor on these vouchers, and for the payment of kickbacks to the involved employees.

The arrests on January 14 were supported by affidavits from agents of the United States Immigration and Custom Enforcement (ICE) task force established to investigate instances of money laundering. Each affidavit provided an explanation of the

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<sup>1</sup> Together with the 11 individuals arrested on January 14, 2009, a total of 13 individual Con Edison employees have been identified in the US Attorney's investigation as recipients of bribes or kickbacks.

kickback scheme used by the Con Edison supervisor or supervisors who was the focus of that affidavit and included transcript excerpts of conversations with the accused employee as the scheme was being implemented. The individuals arrested were construction supervisors working in three of the five Con Edison regions.<sup>2</sup> The work underlying the arrests was undertaken pursuant to contracts for capital project and operation and maintenance work on the Company's electric, gas and steam transmission and distribution systems (the "indictment capital project contracts"). According to the affidavits, these schemes existed as early as 2000 and continued through the time of the arrests.

The Con Edison employees arrested were either managers or supervisors in construction management. The highest ranking individuals about whom a complaint was issued were Construction Managers who are described as overseeing all Con Edison construction projects in Manhattan (in the case of the defendant Rocco Fassacesia) or the Bronx (in the case of the defendant Paul Sanabria). The other individuals were Construction Representatives, Senior Specialists (who reported to Construction Representatives and who supervised Chief Construction Inspectors (CCIs)), and CCIs. All of these individuals could have been supervising work for Con Edison's Electric Division, the Gas Division, or, in Manhattan, the Steam Division.

While two of the named Con Edison employees were the Construction Managers for the Manhattan and Bronx regions, Con Edison employs others as Construction Managers for the Queens, Westchester and Brooklyn/Staten Island regions, and it also employs many others as Construction Representatives, Senior Specialists or CCIs in all of its regions. The US Attorney's disclosure of its arrests on January 14 and the accompanying affidavits did not associate any Con Edison employees other than the 13 specifically identified employees with the alleged bribes or kickbacks.

The US Attorney's efforts could result in some restitution from the contractor or the employees to Con Edison. Similarly, Con Edison has civil claims it

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<sup>2</sup> The Con Edison service territory is divided into five regions: Manhattan, Bronx, Westchester, Queens, and Brooklyn/Staten Island. The regions identified in the ICE affidavits are Manhattan, Bronx and Westchester.

could pursue against the contractor and the employees and may have some insurance coverage for some of these losses. These recoveries, however, may not provide reimbursement sufficient to offset the amount of overpayments Con Edison's ratepayers will have made for the work performed under the contracts.

### DISCUSSION

Pursuant to Public Service Law (“PSL”) sections 65 and 79, Con Edison, as an electric, gas and steam corporation, is charged with providing to its customers safe and adequate service at rates that are just and reasonable. By the same sections, and other provisions of the PSL, including PSL sections 66 and 80, the Commission is charged with ensuring that the Company complies with such requirements.

The conduct described by the ICE agents’ affidavits, unless disproved, has resulted in unwarranted payments by the Company to contractors to the detriment of the Company’s customers. Such unwarranted expenditures would have been included in the costs of the Company’s capital projects, as well as in its operation and maintenance expenses. Because such expenditures are an integral part of the Company’s rate case filings, such costs would have been, and continue to be, collected in end user electric, gas or steam rates. To the extent that Con Edison’s rates included charges for payments to contractors that were illegal and unwarranted, they would by definition be unjust and unreasonable.

Moreover, the Company’s conduct in connection with these contracts could be deemed imprudent. Under the aforementioned sections of the PSL, the Commission has the power to review past actions of the Company. If the Commission finds that Company actions were imprudent, it may order relief. The affidavits from these criminal cases detail actions by numerous Company managers and high-level employees that may be illegal and that included the creation and payment of unwarranted charges under the indictment capital project contracts. In light of these charges and the underlying affidavits, we must examine closely the prudence of the Company’s actions. In the absence of a persuasive justification by the Company, the inflated payments made by the company under these contracts would be imprudent.

Based on the foregoing, we initiate a prudence proceeding with respect to the indictment capital project contracts. In this proceeding, Con Edison must demonstrate that the Company's expenditures under the indictment capital project contracts were prudent, and, if that burden is not met, why the Company should not be required to restate its rate base so as to exclude from rate base all of the expenditures made under any of such contracts, and why a deferral should not be established for the benefit of ratepayers in an amount equal to the amount of return of and on rate base associated with such contracts in the period from January 2000 to January 2009.

At the time of our decision in Con Edison's last rate case, we voiced our concern that the Company's capital expenditures were far above estimates and that this warranted a closer examination of the Company's operational and accounting controls in this area. Case 07-E-0523, Consolidated Edison Company of New York, Inc. - Electric Rates, Order Establishing Rates for Electric Service, p. 105 (issued March 25, 2008). To protect ratepayer interests while a closer examination of these costs could be completed, we determined that approximately \$ 236 million of the rate increase established at that time would be implemented through an adjustment clause mechanism, which renders it subject to later adjustment and refund to customers, if the full amount of the capital costs cannot be justified. There are, however, no similar mechanisms such as temporary rates in effect for Con Edison gas or steam customers. Inasmuch as the ICE agents' affidavits strongly suggest that some of the overcharges associated with the indictment capital project contracts were charged to the gas or steam divisions, it may be necessary to make a portion of the permanent gas or steam rates temporary pending the outcome of this case, in order to fully protect customers. Such action with respect to gas and steam rates should therefore be addressed early on in this proceeding.

The affidavits made public by the US Attorney's investigation raise a concern that there may be deficiencies in the Company's oversight of its construction and bidding processes. While these affidavits justify the prudence case with respect to the indictment capital project contracts which we are beginning today, the affidavits also raise the possibility that the scope of our prudence inquiry should extend to other contracts or projects not identified in the affidavits filed thus far in connection with the

US Attorney's investigation. In particular, we note that the 13 Con Edison employees asserted to have engaged in illegal bribe taking and kickback conduct were in managerial and oversight positions for large portions of the Company's service territory. Moreover, there is some evidence in these affidavits that the scope of misconduct may have included bid rigging or other behaviors inimical to the best interests of Con Edison, its customers and other contractors. These facts raise serious questions as to whether Con Edison's internal controls were inadequate or were inadequately enforced to protect the Company from excessive payments and illegal conduct by its employees. Accordingly, this proceeding will include an investigation of the Company's internal controls and the consideration of appropriate remedies, including consideration of whether the scope of the prudence inquiry should be expanded to include capital or operation and maintenance project contracts or expenditures other than those addressed in the US Attorney's allegations.

As a first step in this investigatory phase of the case, we will require the Company to conduct an investigation and produce a report which, at a minimum:

- A. describes all Company controls in place in the period between January 2000 and January 2009 designed to protect the Company, and its customers, from overcharges for work done by contractors under capital and operation and maintenance project contracts, from kickbacks or other illegal payments to employees from capital project contractors, bid rigging or other practices which compromise the Company's ability to secure goods and services at the lowest price;
- B. describes all Company controls in place in the period between January 2000 and January 2009 with respect to the negotiation or administration of the Company's capital, operation and maintenance and service contracts, including but not limited to the bidding process, vendor selection process, evaluation process, and subsequent contract oversight and administration process, including Company verification, remittance, and review of contractor bill statements;
- C. identifies any auditors, attorneys, or other experts, internal or external to the Company's operations, who have been retained by the Company at any time from January 2000 to January 2009 to investigate and/or report on any aspect concerning the internal controls for capital project contracts and provide to the Commission all of their written findings to date;

D. provides any internal audit reviews and/or reports, and Company investigations of complaints regarding Company retained contractors and/or Company employees involved with capital and operation and maintenance contracts for the period from January 2000 to January 2009 referring to or involving bribes, kickbacks or any other illegal conduct or conduct which would otherwise compromise the Company's internal controls for the initiation, implementation or management of its construction programs;

E. describes all methods and procedures used by the Company from January 2000 to January 2009 to verify compliance with the Company's procedures and controls, as well as any remedial measures or procedures applicable when a provision of the Company's controls were not complied with, or were waived or otherwise compromised, and describes each instance when any of such remedial measures or procedures were used during such period and to what effect;

F. provides the total cost of contractor service and the number of contracts under which costs were incurred in each calendar year for the period January 2000 – December 2008 in each Con Edison region. These figures should be further separated among the Company's Electric, Gas and Steam Divisions, and each separate statement of costs and number of contracts should be further divided between capital and operation and maintenance expenditures and subdivided by specific contractor in cases where the Company has made payments of more than \$1 million to that contractor during the calendar year;

G. provides the total cost of contractor service associated with each of the Company's open contracts as of January 2009. The Company should also provide, for each calendar year, a breakdown of each project's contractor costs among each Con Edison region and, for each regional breakdown, a further breakdown between the electric, gas and steam divisions. Such costs should be further segregated between capital and operation and maintenance expenditures, and by specific contractor in cases where the contractor has received payments that exceed or are likely to exceed \$1 million in 2009; and

H. provides any plans that the Company has to pursue recovery of and/or damages that have resulted from the alleged illegal activity that is the subject of this Order or from further illegal activity that may be discovered through this investigation, as well as the total amounts, if any, that the Company is seeking or intending to seek from contract counterparties in damages, and the extent, if any, to which such claim may be covered by a surety, bond or other guarantee from the contract counterparty, or from any Company insurance policy.

The administrative law judge(s) will determine the schedule and procedures for addressing this report and otherwise conducting this investigation. Following and as a

consequence of this investigation, this case will consider the implications for expanding the prudence inquiry, setting temporary rate levels, or determining refund levels due under temporary rates, all as noted above, or for instituting corrective actions, as described further below.

The affidavit evidence also calls into question not only the entirety of Con Edison's construction spending in the past, but also looking forward. We note that the arrests did not result from any Company internal investigation or audit. Given the information contained in the affidavits, we cannot assume that the Company's own controls and oversight are sufficient to prevent this type of occurrence from happening in the future. Our ability to judge the reasonableness of the Company's future rate filings, particularly with regard to its construction budgets for capital spending and related operation and maintenance costs, may be significantly impaired. Accordingly, this proceeding should examine what actions the Company has taken or could take and what controls it will implement to establish that the Commission can, with confidence, set rates in the future based upon the Company's assertions regarding the need for and cost of capital projects.

### CONCLUSION

Based on our review of affidavits that formed the bases for the criminal complaint supporting the arrest warrants for eleven prior Con Edison employees for soliciting and accepting from a contractor improper payments in connection with construction projects in New York City and Westchester County, we find that sufficient questions are raised to warrant the commencement of this prudence review and that the bases for raising the specter of imprudence has been demonstrated such that Con Edison should be called upon to defend its practices. In this proceeding, we will examine the Company's justification for these expenditures, and, if we find these expenditures unjustified, we will fashion an appropriate remedy. Because the facts described in the publicly available investigative materials raise serious questions as to the adequacy of Con Edison's internal controls, we will also require an examination of the Company's



conduct and behavior with respect to other contract expenditures incurred with respect to its capital projects or its operation and maintenance programs.

An Administrative Law Judge will be assigned to oversee the conduct of this proceeding with a view towards ensuring that the issues set forth in this Order are fully and appropriately examined. We expect Con Edison to cooperate in full and good faith with all forms of discovery, including depositions, by staff and interested parties and to provide prompt access to all requested books and records and, as needed, utility personnel.

The Commission orders:

1. A proceeding is instituted to address the issues described in the body of this Order.
2. Con Edison is directed to preserve and maintain any and all documents and records relating to the events, contracts and employees underlying this Order or otherwise related to or within the scope of the inquiry established in this Order. Questions as to whether specific documents and records or categories of documents and records fall within the scope of this proceeding will be determined by the presiding officer.
3. This proceeding is continued.

By the Commission,

(SIGNED)

JACLYN A. BRILLING  
Secretary