STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 07-E-0523 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Electric Service.

NOTICE OF SCHEDULE FOR FILING EXCEPTIONS

(Issued January 8, 2008)

Attached is the Recommended Decision of Administrative Law Judges William Bouteiller, Michelle L. Phillips and Rudy Stegemoeller together with a copy of the Commission's rules governing the procedures to be followed. Briefs on exceptions (an original and 25 copies) will be due in hand to the undersigned and all active parties on Monday, January 28, 2008. Briefs opposing exceptions will be due in hand to the undersigned by noon (and may be mailed to all active parties) on Tuesday, February 12, 2008.

The parties' briefs should adhere to the requirements of 16 NYCRR 4.10, 3.5 and 4.8 which address page limitations, font size, spacing, margins and other requirements that will be enforced in this case.

JACLYN A. BRILLING
Secretary

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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RECOMMENDED DECISION

BY

ADMINISTRATIVE LAW JUDGES

William Bouteiller
Michelle L. Phillips
Rudy Stegemoeller

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RECOMMENDED DECISION

William Bouteiller, Michelle L. Phillips, Rudy Stegemoeller, Administrative Law Judges:

INTRODUCTION

On May 4, 2007, Consolidated Edison Company of New York, Inc. (Con Edison or the Company) filed tariff revisions to change its rates, charges, rules and regulations for electric service. Most significantly, the Company has proposed to increase its electric service rates and charges by about $1.2 billion during the 12-month period ending March 31, 2009. The Commission has suspended Con Edison's rate filing and it initiated this proceeding to examine the merits of the Company's proposals. The suspension period extends to March 30, 2008. Thereafter, new rates will go into effect on April 1, 2008 pursuant to the current rate plan.

Department of Public Service (DPS) Staff began its audit and investigation of the rate filing soon after it was submitted and an initial conference of the active parties was held on June 18, 2007. The schedule for this case was set at the conference and Con Edison provided an overview of the rate filing.

Various parties have responded to the Company's rate and tariff proposals in pre-filed testimony submitted in September 2007. Con Edison, among others, responded to the parties' opposition to the filing and the competing proposals. During this proceeding, Con Edison updated the rate filing with information that became available after May 2007. A preliminary update was provided in August 2007 and an update was included with the rebuttal testimony the Company filed on September 28, 2007.

The evidentiary hearings in this case were held in New York City between October 17 and 31, 2007. During the hearings, the administrative law judges were joined by Commissioner Robert E. Curry, Jr. Public statement hearings are scheduled to be held in New York City and Westchester starting in January 2008. Initial and reply briefs have been filed in this case by the parties whose positions are briefly summarized below.

The Parties' Positions

1. Con Edison

Con Edison seeks to increase electric rates by $1.2 billion. This increase consists of two amounts. The first is the $515 million that remains to be recovered from the three-year rate plan that began in April 2005 and ends in March 2008.[1] In the last three years, Con Edison's electric rates were increased twice, by $105 million in April 2005 and by $220 million in April 2007. During this period, the Company was able to keep the amount of the two rate increases to a minimum by using funds available from the sale of various assets and other sources. In 2007 alone, Con Edison used $250 million of customer credits to cover its costs. No longer does Con Edison have a sufficient amount of customer credits to cover any such amount of revenue requirements in 2008 and thereafter.

Con Edison's revenue requirements are also increasing substantially and rapidly due to the infrastructure improvements and modernization it has begun to implement. In the past year,

[1] Case 04-E-0572, Consolidated Edison of New York, Inc. – Electric Rates, Order Adopting Three-Year Rate Plan, issued March 24, 2005 (the 2005-08 Rate Plan).

during the upcoming rate year and for years to come, Con Edison plans to invest billions of dollars in the electric distribution and transmission network to serve New York City and Westchester. The Company’s past, current and future infrastructure investments are contributing substantially to the revenue requirements that have been presented in this case. The Company’s plans to replace and upgrade electric distribution and transmission system plant in 2008-09 are largely responsible for the $685 million delivery rate increase that it is seeking for this period. Previous investments in the transmission and distribution systems are responsible for $245 million of the $515 million that the Company is seeking for the period related to the 2005-08 rate plan.

Beyond the upcoming rate year, Con Edison expects that electric rates will have to be increased in each of the next two years, 2009-2011. The Company currently estimates that it will need $323 million starting in April 2009 and $334 million in April 2010.

2. DPS Staff

From its investigation of the Con Edison rate filing, DPS Staff supports up to a $642 million rate increase starting in April 2008. Staff has not taken a position on the Company’s assertion that additional rate increases will be necessary in 2009 and 2010. Staff would await the submission of detailed rate filings for these years before stating its position on the need to increase rates by any such amounts.

DPS Staff supports Con Edison’s plans to make distribution and transmission system improvements. Staff has proposed that the infrastructure upgrades undertaken by the Company be closely monitored to ensure that this construction is completed in a timely and cost-effective manner. Should any of the funds provided for the infrastructure initiatives not be expended, DPS Staff believes that they should be preserved for customers. Similarly, Staff believes that any funds provided but not spent for new operation and maintenance (O&M) programs, and for new positions, should be preserved for ratepayers.

3. Other Parties

The City of New York, the Metropolitan Transportation Authority and the Port Authority of New York (collectively referred to as the NYC Government Customers) are three of the largest energy users on the Con Edison electric system. They state that the amount of the proposed electric rate increase is unprecedented and it must be reduced to a more reasonable level. After the Commission examines and adopts the parties' reasonable adjustments to the rate filing, the NYC Government Customers believe it still may be necessary for the Commission to constrain the total amount of capital and spending that Con Edison would include in rates for the upcoming year. The NYC Government Customers have submitted testimony in this case addressing revenue requirement issues, the cost of service study, revenue allocations, rate design, energy efficiency, revenue decoupling, system planning and street lighting matters.

Westchester County urges the Commission to keep to its primary responsibility to set just and reasonable rates while maintaining safe facilities and adequate service. In contrast to the 12% increase that Con Edison implemented during the last three years, Westchester County observes that the Company has proposed to increase delivery rates by about 64% in the next three years. The County considers this to be a radical departure from the balanced approach that was achieved in previous rate proceedings. According to it, the rate filing contains excessive amounts and expenditures that would overburden customers. Westchester County believes that a proper balance can be maintained by constraining the proposed spending levels, deferring recovery of certain costs, and allowing the Company only a fair rate of return on equity capital. It proposes that the rate increase in 2008 be limited to about $177 million.

The New York Power Authority (the Authority or NYPA) considers the amount of the Con Edison rate filing to be enormous and staggering. The Authority recognizes that the New York City service area is unique and presents challenges for Con

Edison to address; however, it questions whether the proposed rate increase is appropriate given the Company’s successful financial performance, the amount of system reliability it has achieved, and the high prices for electricity that currently prevail in the City. NYPA believes that customers may not be able to afford the Company’s large capital expenditure program and the operation and maintenance expenditures. According to NYPA, the Con Edison rate filing warrants close scrutiny and downward adjustments.

The State Consumer Protection Board (CPB) provided three witnesses who have proposed adjustments to the Company’s projected expenses, cost of equity capital, and capital expenditures. CPB believes that the proposed rate increase must be mitigated and proceedings should be initiated to address several policy issues, including the revenue decoupling mechanism the Company has proposed and a long-term demand side management program.

The New York State Energy Research and Development Authority (NYSERDA) participated in this rate proceeding on matters related to the demand side management. Energy efficiency matters have also been addressed jointly by the Natural Resources Defense Council and Pace Energy Project.

Retail access matters have been addressed by the Retail Energy Supply Association and the Small Customer Marketer Coalition. The Joint Supporters, a group of companies and associations that actively pursue or use energy services in the Company’s service area, participate in the demand resource program managed by Con Edison and NYSERDA.

The New York Energy Consumers Council (NYECC) represented the interests of various commercial property owners in New York City and several hospitals, colleges, governmental agencies, cultural and financial institutions, industrial customers, housing cooperatives and real estate organizations.[2] Several universities and medical centers are represented in this case by the Consumer Power Advocates.

The ARE-East River Science Park LLC has participated in this case and addressed Con Edison's Business Incentive Rate as it applies to the biotechnology/life science research and development campus near Bellevue Hospital. The Astoria Generating Company, LLP has addressed a transmission system project located at East 13th Street and the Company's proposal to hire a meteorologist.

The Utility Workers Union of America, AFL-CIO, Local 1-2 (Local 1-2 or the Union) has addressed matters of concern to the union membership. The Union supports the total amount of the rate filing and the Company's plans to improve the transmission and distribution facilities to provide reliable electric service and to keep up with system growth.

The New York City Housing Authority (NYCHA) states that its budget is unable to accommodate Con Edison's proposed rate increase.

REVENUES

Revenue Decoupling

On April 20, 2007 the Commission issued its Order Requiring Proposals for Revenue Decoupling Mechanisms in Cases 03-E-0640 and 06-G-0746. In compliance with this order the Company included in its rate filing a revenue decoupling mechanism (RDM) which the Company refers to as a "revenue accounting and rate incentive mechanism" (RARIM).

The Company's proposed RDM would work as follows: at the end of each rate year, the Company would reconcile by service class the actual weather normalized delivery revenues to

[2] NYECC, a not-for-profit corporation, succeeds two groups who previously participated in Commission proceedings, the Owners' Committee on Electric Rates and the New York Energy Buyers Forum.

the allowed delivery revenues established in the sales forecast in the most recent rate proceeding. The Company would make refunds to customers if the actual delivery revenues are more than the allowed revenues, and surcharge customers if the actual delivery revenues are less then the allowed revenues. The shortfall or excess in each service class would be surcharged or refunded to customers on a volumetric basis over the following 12 months. The Company would track the reconciliation figures on a monthly basis. Should the cumulative actual reconciliation for the combined service classes equal or exceed $10 million at any point in the rate year, the Company would implement interim surcharges or credits. The Company also proposes to use the RARIM to reconcile costs, including interference expense and property taxes.

1. Weather Normalization

As part of its RARIM, Con Edison proposes a “weather normalization” provision. At the outset, it is important to note that in this context, the words “weather normalization” are somewhat confusing. The effect of a simple RDM is to remove the variability of weather-related sales from a company’s annual revenues. The “normalization” proposed by the Company would re-introduce weather variability and weather-related sales into the Company’s revenues.

Staff has numerous objections to the Company’s weather normalization provision. Staff asserts that an RDM should not be designed to segregate factors over which the Company has no control. Staff argues that the proposed normalization procedure is overly complex. Staff states that Con Edison’s weather impact calculation starts with a sophisticated statistical methodology and follows with multiple stages involving allocations between sales and sendout, calendar days and billing days, days and months and quarters, as well as service classes.[3] According to Staff, the complexity of the normalization method

[3] The Company’s methodology for normalizing weather is articulated in detail in Ex. 161.

would require an unreasonable amount of oversight. Staff also states that without the weather normalization provision, the incentive to use weather to game a sales forecast in the rate case is greatly reduced or eliminated.

Staff points to data from the past two years indicating that the Company's hot weather revenues exceed its hot weather expenses to a great extent. During the summers of 2005 and 2006, estimated incremental costs associated with above-normal weather were roughly $10 million, while the estimated incremental revenues total more than $68 million. The relationship between hot weather and increased sales is amplified by Con Edison's estimate regarding increased use of room air conditioners.[4]

The Natural Resources Defense Council and Pace Energy Project (NRDC/PACE) propose a detailed set of principles to govern decoupling mechanisms which generally are as follows:

- Decoupling must break the link between profits and sales.
- Allowed revenues should be adjusted for desirable or unexpected and unavoidable factors at increased or decreased costs.
- Adjustments to revenues, actual revenues and true ups should be calculated in a transparent way.
- Deferrals of rebates or surcharges should be avoided to the greatest extent possible.

NRDC/PACE agrees with Staff that the Company's proposed weather normalization mechanism is overly complex and lacks transparency. They also notes that the Company's weather proposal would link profits to high sales during abnormally hot summers, which would potentially conflict with the goals of increasing energy efficiency and reducing peak demand during those times.

City of New York and NYPA also oppose the weather adjustment on grounds that it is complicated, almost impossible

[4] Exhibit 265.

to verify, and would likely result in over-collection of revenues due to the difference between heat-related costs and heat-related revenues. NYPA states that it is unclear why Con Edison's delivery rates do not already recover costs properly and why this weather carve-out is necessary.

CPB states that weather fluctuations should not inherently advantage or disadvantage either consumers or the utility because rates are established based on projections of normal weather.

The Company defends its weather normalization proposal by stating that it should be at risk for weather variations. This would retain the *status quo* for the Company.

NYPA states that it knows of no other electric decoupling mechanisms with a weather normalization clause. The Company responds that Idaho Power Company's decoupling mechanism is based on weather normalized sales.

Con Edison rejects Staff's concerns regarding gaming of sales forecasts in rate proceedings and argues that sales forecasts are carefully litigated. Con Edison states that Staff seems to be questioning the ratemaking process, rather than the implementation of revenue decoupling. The Company argues that there would be no need for on-going regulatory oversight because this proposed methodology is not unduly complex. The Company compares its weather normalization to more complex procedures that have been adopted by the Commission, for example, unbundling. The Company explains that many of the factors used in determining the weather impact will be set in advance once a year and need only be reviewed once a year. Con Edison states that "while simplicity is a noble goal, it must remain secondary to accuracy."[5] The Company proposes, as an alternative, to limit the weather normalization to the months of June through September.

Staff sees no reason to allow Con Edison to retain the extra revenue associated with warmer than normal weather when

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[5] Con Edison Initial Brief at 452.

its revenue requirement has already factored in the expenses associated with high temperatures.

The Company argues that eliminating the Company's opportunity for additional earnings from hot weather will have an adverse effect on investor expectations. Staff observes that the Company did not perform any study to support this claim. The Company responds that a formal study is not needed to reach a reasonable conclusion that the Company will become a less attractive investment to the extent that opportunities for additional earnings are diminished. The Company finance witness, on cross-examination, stated that investors view volatility of weather as a symmetrical factor, but that investors would prefer symmetrical volatility to stability at a lower earnings rate.[6]

The questions of how complex the weather mechanism would be, and how serious the potential for gaming of forecasts is, are only relevant to the extent they are balanced against a competing concern. The Company has identified no substantial reason for its weather normalization proposal except that it would maintain the status quo and that the Company earns money from hotter-than-normal weather.[7] If the Company has historically earned money from weather fluctuations, at the expense of ratepayers, then correction of that flaw in the ratemaking process is justification enough for establishing an RDM that removes weather variations from the Company's revenues.

Even if the Company were indifferent to this issue from a revenue standpoint, the weather normalization proposal

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[6] Tr. 2953, 2918.

[7] Consumer Power Advocates cite a customer-oriented point in support of Con Edison's position, arguing that rate volatility would increase if the risk of weather variability is removed from the Company onto ratepayers. The RDM would be structured to reduce volatility because reconciliation would be triggered any time the account reached $10 million. Moreover, because the Company's weather-related benefits have outweighed its risks, transferring this risk to customers will result in a net customer benefit.

should be rejected. The complexity of the mechanism is self-evident[8] and customer interests would suffer from requiring Staff to monitor the mechanism.

2. Revenue per Customer Reconciliation

Under the revenue-per-customer model, an increase in customers would result in increased revenues that would be retained by the Company; conversely, a decrease in customers would result in a decrease in revenues, for which the Company would remain at risk.

Staff opposes the Company's per customer RDM model and instead recommends that total delivery revenues be trued up on a class-specific basis. Staff believes that there is strong potential for gaming the estimated number of customers when a per-customer RDM model is used. The City is also critical of Con Edison's revenue-per-customer approach, arguing that it should be considered along with other economic indicators such as non-manufacturing employment in developing revenue targets.

NRDC/PACE and CPB support the Company's revenue per customer method on the grounds that it will give the Company an incentive to encourage and facilitate economic development.

The Company argues that its per customer reconciliation mechanism is necessary to provide the Company an incentive to promote economic development on its system. The Company also points out that it incurs incremental costs when new customers are added.

Staff responds that the customers whose retention or expansion is most directly affected by Con Edison are contract and negotiated rate customers and that these are excluded from the RDM in any event. Staff also asserts that there is a strong potential for gaming the estimated number of customers on a per-customer RDM model. This gaming would occur, according to Staff, if multiple metered customers are encouraged to convert

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[8] Exhibit 161.

to individually metered accounts, thus increasing the actual number of customers.

Con Edison argues that Staff has not established a reasonable basis for this concern. The Commission must approve the customer forecast, and the Company has many years of historical customer counts by service class that can be used as a basis for reasonableness. The Company observes that the example of a master-metered SC 4 customer being re-metered so that each unit becomes a separate SC 1 customer would likely result in a loss of revenue to the Company under an RPC mechanism, not an increase. The Company also observes that the Commission recently approved a revenue-per-customer mechanism for gas rates in the Con Edison territory.

Unlike the weather normalization issue, the revenue-per-customer issue casts two legitimate concerns against each other – reducing the impact of gaming and uncertainty in forecasting, versus encouraging the company to promote economic development.

Both concerns remain theoretical, however. Staff has provided only general concerns regarding gaming of customer counts, and the Company has not identified any economic development programs that it would not pursue. Even in the absence of specific economic development programs, however, there is an intangible benefit in having the Company’s interests aligned with the economic interests of the service territory. The Commission has approved revenue-per-customer mechanisms in other recent cases and we recommend that the Company’s proposal be adopted here. The Company should be ordered to produce for Staff any reports on customer account activity that Staff deems necessary for monitoring its gaming concerns.

3. Other Issues

Con Edison also proposes to capture 100% of additional revenue load growth attributed to “environmentally sound programs” that it might promote, such as plugged-in vehicles. NYPA opposes Con Edison’s suggestion that it retain revenues from environmentally-sound programs because Con Edison has not provided a definition of such programs.

We find Con Edison's proposal is theoretically sound but unworkable in the absence of specific definitions, it should be rejected. If the Company has an environmental program that may warrant exemption, the Company should bring a specific petition to the Commission.

NYPA claims that its DSM programs would be adversely affected by the Company's RDM proposal, because NYPA is treated as a single service class and any energy efficiency measures that NYPA's customers choose to undertake that result in a lowered delivery charge would result in a delivery surcharge equal to the revenue savings they might experience.

The Company disputes NYPA's assertion that the RDM will eliminate any incentive for NYPA customers to pursue DSM. NYPA customers will still have a significant opportunity to save through a reduction in supply costs. Moreover, assuming NYPA passes any RDM adjustments to all NYPA customers and not only to those who pursue DSM, NYPA customers will still be able to reduce their delivery costs due to reduced usage. The Company is correct.

The Retail Energy Supply Association (RESA) argues that the RDM should not be considered in this proceeding. RESA states that the Commission should defer consideration of RDM proposals pending the outcome of the EPS proceeding[9] and that the Company has not identified any energy efficiency measures that it would not implement due to the existence of a perceived disincentive. The Commission has clearly ordered that RDM mechanisms be considered in the context of individual rate cases.[10] RESA's proposal should be rejected.

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[9] Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standards, Order Instituting Proceeding (issued May 16, 2007).

[10] Cases 03-E-0640 and 06-G-0746, Order Requiring Proposals for Revenue Decoupling Mechanisms (issued April 20, 2007).

CPA proposes that the RDM should not apply to mandatory hourly pricing customers. CPA argues that mandatory hourly pricing gives these customers enough incentive to pursue efficiency measures and that there is no further need to tamper with ordinary market incentives. The RDM is not a mechanism for changing market incentives; it is a mechanism to remove a disincentive from the Company. Hourly pricing, moreover, is often more an incentive to load shifting than to energy efficiency. CPA's proposal should be rejected.

NRDC/PACE also proposes that the RDM should include quarterly updates of allowed revenues based on the Company's sales forecasting models. The Company argues that this would be expensive and complex to implement, and there are a range of independent variables in the sales forecasting models that would need to be updated on a quarterly basis. The Company observes that the allowed target under a revenue decoupling mechanism is not an allowed sales target, but rather an allowed delivery revenue target. The Company is correct; the difficulty of quarterly updates to sales forecasts would outweigh any benefits.

Staff proposes that reconciliation be performed every 6 months versus every 12 months as proposed by the Company. The Company is not opposed to a 6-month true up period. In the absence of any objection from the Company, and in order to further reduce volatility, Staff's proposal should be adopted.

Late Payment Charges

Con Edison has estimated the amount of late payment charge revenues expected during the rate year by using a recent three-year average. DPS Staff believes it would be better to use a three-year average of the ratio of the late payment charges to the total amount of revenue the Company collects. According to Staff, the use of this ratio avoids an underestimate of the late payment charges given the size of the rate increase that is being considered. Staff's proposal is not opposed by the Company.

Fuel Management Program

Con Edison estimated the amount of Fuel Management Program revenues expected during the rate year by using the historic base period amount, $98,000. DPS Staff prefers a recent three-year average. Staff's proposal is not opposed by the Company.

ADR Deferred Tax Benefits

Con Edison is holding $51.25 million of ratepayer funds associated with a correction the Company has made to its accounting for Asset Depreciation Range (ADR) Deferred Tax Benefits. The Company proposes to return these funds to ratepayers over three years and DPS Staff concurs.

Direct Current Incentive Program

Con Edison has $9 million of funds that were provided to it for the conversion of certain direct current electric facilities. The Company has not spent the funds and DPS Staff has proposed that they be used during the rate year to offset a portion of the rate request. Con Edison proposed to return them to ratepayers over a three-year period. In general, the Company believes that a three-year period better manages the rate impacts and it would be consistent with the Company's practice to use a three-year amortization period for such items.

While it is important to manage the size of the rate increase that Con Edison will be allowed to implement in 2008, it is also important that good ratemaking practices be employed to avoid excessive reliance on one-time revenue sources to pay for recurring costs. The Company's accounting practice to amortize revenues such as these over three years helps to level the impact of one-time occurrences. It should also be followed for ratemaking purposes here to avoid large swings that could ultimately be adverse to the ratepayers' best interests. We recommend that the Company's proposal be adopted.

Excess Deferred State Income Taxes

In January 2007, the New York State Corporate Income Tax rate was reduced from 7.5% to 7.1%. Consequently, Con

Edison has $12.5 million of excess deferred tax credits and an excess deferred tax debit of $1.4 million. The Company proposes to return the tax credits to customers over three years; Staff has proposed that they be passed back to customers during the rate year. The Company would treat this item the same as the funds available from the direct current incentive program and the ADR deferred tax benefits.

As discussed above, we are recommending that the one-time revenues be amortized over three years. This approach provides an amount of mitigation for the rate year that will continue thereafter. Thus, it avoids a drop in the amount of one-time revenues in the year following the rate year and thereby does not create pressure to increase rates immediately following the conclusion of the rate year.

Transmission Congestion Credits

Con Edison obtains revenues from the sale of transmission congestion credits (TCCs) auctioned by the New York State Independent System Operator. The credits allow market participants to hedge their costs when there is congestion on the transmission lines in and about New York City. In the Con Edison 2005-08 electric rate plan, $60 million of annual transmission congestion credits were estimated. Amounts in excess of this level were flowed to customers through the Monthly Adjustment Clause (MAC). In the last three years, Con Edison has received an average of $150 million per year.

In this case, the New York Power Authority and Westchester County propose that the amount of transmission congestion credits be increased. Westchester believes that the TCCs should be used to mitigate the amount of the rate increase that Con Edison has requested. NYPA would obtain a greater share of the TCCs if a greater amount is estimated and used to offset the base rate increase. Only full service customers received the credits that flow through the Monthly Adjustment Clause. NYPA does not pay the charges or receive the amounts that pass through the MAC.

Con Edison believes that the rate year estimate of TCCs should remain at $60 million. The Company has some doubts that the $150 million level can be reached in the rate year. It notes that there is a Federal Energy Regulatory Commission (FERC) proceeding considering the potential sale of TCCs on a long-term basis. Consequently, it believes the future level of TCC revenues is uncertain. Con Edison states that there is substantial risk associated with estimating a greater amount of revenues; it sees no harm and less risk in maintaining the current approach.

On the other hand, NYPA considers the $60 million revenue estimate for the rate year to be arbitrary and inconsistent with the historic information. NYPA also asserts that it should share in the full amount of TCC revenues and not be excluded from receiving any portion of the TCC revenues.

We find that Con Edison has not provided any estimate of the amount of TCCs that may be reasonably expected during the rate year. Instead, it has acknowledged that the TCCs have averaged $150 million and that they could be less if FERC determines that the TCCs can be sold on a long-term basis. We also find that the Company has not provided any convincing reasons for believing that the recent, three-year average is not likely to continue.

Accordingly, we believe that the best estimate on the record of the amount of TCCs that can be expected during the rate year is the three-year average of $150 million. This figure should be used for ratemaking purposes. Further, Con Edison has not explained why NYPA should enjoy the benefit of the first $60 million of the TCCs but should be excluded from receiving any addition TCC amounts that might flow through the MAC. Absent any persuasive reasons for limiting NYPA’s receipt of TCCs, we find that there is no basis for excluding all of the TCC revenue that can reasonably be forecast for the upcoming rate year in the revenue requirement.

Sales Forecast

The Company presented forecasts for its sales volume, delivery revenues, and sendout. Its sales volume forecasts for the three rate years are 58,541 GWhs; 58,980 GWhs; and 59,501 GWhs, respectively. Its forecasts of the franchise area sendout for the same periods are 62,825 GWhs; 63,570 GWhs; and 64,359 GWhs, respectively. Staff and NYC propose adjustments to the Company's sales forecast. Staff's adjustments in total result in an upward revision of 220 GWhs to the Company's sales forecast (equivalent to an increase of $12.2 million in delivery revenues). NYC proposes that the sales forecast be increased as a result of eliminating the Company's DSM adjustment. We discuss NYC's adjustment and Staff's adjustments, in turn, below.

1. DSM adjustment

NYC argues that the Company's adjustment to its forecast to reflect the effect of DSM is insupportably selective and redundant. NYC states that the historic impact of DSM over the past 35 years has been extensive. It continues that the historic levels of sales, which reflect actual DSM investment, are used in the model that forecasts sales. As a result, it concludes that the effect of DSM is already reflected and should not be the subject of a separate adjustment.

Moreover, NYC argues that the Company has not sustained its burden of proving that a specific DSM adjustment is necessary. It states that the Company failed to point to any analysis that supported its conclusions that recent amounts of DSM spending (including that by NYPA and NYSERDA) had been "relatively small" and therefore of "negligible" impact.[11]

The Company disagrees with NYC's proposed adjustment, stating that it is based on hypothetical data that do not reflect the actual DSM impact of prior DSM programs and it used the incorrect assumption that the DSM impact grew throughout the

[11] NYC Initial Brief at 16-19; Reply Brief at 19-20.

estimation period. The Company argues that, in reality, its DSM programs do not have a continuously growing impact. The Company adds that NYC's simplified regression model ignores the ARIMA terms that are an important part of the Company's sales forecasting models, in that they capture the collective impact of factors that are not implicitly included in the Company's model. According to the Company, the exclusion of these terms may lead to biased standard errors in the model, and as such, the results of NYC's analysis are inaccurate and unrealistic. Finally, the Company explains that its DSM adjustments reflected incremental savings (i.e., savings from new DSM programs proposed by the Company in this filing) and discounted the savings attributable to the one program that had savings in the historical period that was reflected in the model forecast).[12]

We find the Company's explanations persuasive and note that they provide a rational basis for its DSM adjustment as proposed. We therefore recommend that NYC's proposed DSM adjustment not be adopted.

2. Personal Income Variable

Both the Company and Staff agree that use of a real disposable income variable in the residential model is "theoretically sound." However, the Company notes that such data are available only on an annual basis and with up to a two-year lag. It states that these realities lead to estimating errors that flow from the method used to convert annual figures into quarterly data and the need to estimate the data for all of 2006 in order to place them on a comparable basis to the other data used in the econometric model. The Company states that it chose not to use personal income due to these estimation errors

[12] Con Edison Initial Brief at 307-309; Reply Brief at 119-120. The Company does not include results of its own proposed DSM program in the demand forecast used by its Infrastructure Panel.

and argues that Staff has not demonstrated how these issues may be overcome.[13]

Staff states that a residential forecasting model generally includes a personal income variable. It contends that "most" of the New York State electric utilities have done so in their rate cases. Staff argues that it used a conversion methodology that was used by the Company to develop its sales forecast and that is "fairly standard and among the few widely used in the forecasting industry." Staff also claims that because the quarterly personal income data that it used for 2006 and beyond was estimated by Economy.com and provided by Con Edison, the Company should have the same confidence level in the estimates of personal income as in the other economic variables provided by Economy.com. Finally, Staff argues that a key economic variable should not be rejected because of alleged data estimation errors.[14]

The Company's justifications for declining to use a personal income variable along with its intimation that estimation errors may be insurmountable are not persuasive. Given that the Company used "economic" variables for its other service classifications (e.g., SC 2, SC 4, and SC 9), forecasted in some instances by Moody's Economy.com, and given that both the Company and Staff agree that use of a real disposable income variable in the residential model is "theoretically sound,"[15] we recommend that a personal income variable be used to forecast residential sales.

3. 2005-06 Dummy Variable and Appliance Saturation Levels

The Company and Staff disagree on whether the residential sales forecast model should make use of the 2005-2006 dummy variable and appliance saturation data. The Company contends that its use of a dummy variable was intended to

[13] Con Edison Initial Brief at 298-299; Reply Brief at 110-113.

[14] Staff Initial Brief at 91-93; Reply Brief at 41-42.

[15] Tr. 533-534, 538-539, 576.

capture the effects on SC 1 sales of the unusually warm summer of 2005 and the unusually hot days during August 2006. The Company offered an analysis of daily weekly sendout against the daily number of cooling degree days (CDDs) to show the "exceptional" correlation that it contends exists between sendout to CDD when high CDD days were present in the third quarters of 2005 and 2006.

The Company argues that Staff's opposition to its inclusion of a dummy variable is grounded in its misinterpretation of the relationship between sales volume and weather. The Company adds that Staff's own analysis show that SC 1 customers are more responsive to changes in weather than are commercial customers, thus warranting inclusion of a dummy variable in the forecasts for SC 1 but not for commercial customers. According to the Company, Staff's re-estimation of the SC 1 sales forecasting model on a shortened sample demonstrates that the Company's approach (i.e., using a dummy variable) produced the best forecast.[16]

The Company asserts that Staff incorrectly assumes that if customers have more appliances in place, the level of responsiveness will not go down when weather returns to normal. The Company argues that Staff has provided insufficient evidence for its position.[17] The Company argues that its use of the growth rate of sales per customer per billing day in its sales forecast captures, among other things, the impact of changes in appliance saturation over the estimation period. The Company also adds that Staff ignores the distinction between appliance

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[16] Con Edison Initial Brief at 299-301; Reply Brief at 113-114.

[17] In short, the Company is arguing that Exhibits 265 (a Company response to NYISO showing how the Company developed its peak load forecast), 33 (a Company presentation stating that the use of air conditioners has increased by 900,000 between 2002-2006), and 34 (a discovery response showing the increase in saturation levels based on Company surveys) should not be given any weight in making determinations regarding the Company's sales forecast.

saturation and usage rate of appliances, and refers to its testimony that not all households that have the appliances listed in Exhibit 34 will use them during normal weather. The Company argues that during unusually hot summers like those of 2005 and 2006, the percentage of households using the appliances and the usage of each household may differ so drastically from normal that weather variables do not adequately account for the sales impact and a dummy variable has to be used to pick up the exceptional sales impact.[18]

Staff contends that the Company's analysis does not support its dummy variable methodology because the sendout and sales data are measured on different bases and their responses to weather variations do not match. In addition, Staff states that since the SC 1 model already contains weather variables, any weather variation impact should be explained thereby. Finally, Staff asserts that by using the same dummy variable for an above normal summer and for a below normal summer, it is difficult, perhaps impossible, to relate the dummy-captured impact to weather in the summers of 2005 and 2006.[19]

Staff states that if the dummy variable is of any use at all, it may be useful in capturing the permanent impact of appliance additions on sales forecasts. Staff argues that the Company's forecast is understated because it does not contain a variable to reflect appliance saturation. Staff contends that the absence of such a variable is in contradiction to the Company's use of such data to justify its proposed infrastructure investments. Staff adds that its projected growth in appliance saturation levels is in line with its belief that higher responsiveness in sales to weather will not decrease.[20]

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[18] Con Edison Initial Brief at 302-304; Reply Brief at 114-118.

[19] Staff Initial Brief at 93-96.

[20] Staff Initial Brief at 96-101; Reply Brief at 43-46.

We are not persuaded that a use of a dummy variable is required. Since the SC 1 model already contains weather variables,[21] the additional inclusion of a dummy variable to capture "exceptional" weather could be redundant and therefore unnecessary. For this reason, we recommend that the dummy variable not be included.

4. Number of Customers

The Company argues for the rejection of Staff's adjustments to its forecast for the number of customers in service classifications 1, 2 and 7, claiming that the record evidence does not support assertions that the Staff forecasts are superior to the Company forecasts. The Company asserts that record evidence points to its models as having a better "fit" and as predicting forecasts that are closer to actual numbers.[22]

Staff argues that the Company's assertion that its models have a better "fit" is unfounded. Staff points to its ex post forecast evaluation as evidence that its forecasts produced more accurate results when compared to actual data for 2007. Staff responds that if the Company's assertion that it is not valid to use R-squared to measure goodness-of-fit is correct, then the other statistics cited by the Company are also invalid measures. Staff also argues that two years is the conventional time frame for ex post evaluation for quarterly or monthly sales forecasting models (not the three years relied upon by the Company). Staff adds that an ex post evaluation that goes further back into history is less valid as it is more distant from the current situation.[23]

We note at the outset that while both the Company and Staff are attempting to establish the superior "fit" of their respective models, neither has established that the statistical measures upon which they rely are valid or widely accepted

[21] Tr. 533.

[22] Con Edison Initial Brief at 304-305.

[23] Staff Initial Brief at 103-105; Reply Brief at 40-41.

criteria for comparing different models. Therefore, based primarily on the two year ex post evaluation (Exhibit 264), we recommend that Staff's proposed adjustment to the number of customers in SCs 1, 2 and 7 be adopted.

5. Cooling Degree Days in non-Summer Months

Staff argues that the Company's forecast of CDDs is incorrect, does not match its 30-year historical average as defined for normal weather, and is not based, contrary to the Company's assertion, on a method that is consistent with the National Weather Service Bureau's practice. Staff states that these inconsistencies resulted in a below normal forecast of CDD per year that leads to an upward revision of all SCs that have CDD as an input.[24]

The Company states that it is using CDDs as a measurement to capture the impact of weather on customers' use of air conditioning appliances, normally in the period May through October. It notes its testimony explaining why it did not use CDDs that might fall in March, April, November and December.[25]

The Company's explanation for its calculation of CDDs for use in the sales forecast has a rational record basis. It therefore is recommended that the Staff adjustment be rejected.

6. Price Deflators

The Company agreed to Staff's proposal.[26]

Summary

The overall impact of our sales forecast recommendations result in an upward adjustment of 145 GWhs or $9.3 million.

[24] Staff Initial Brief at 101-103; Reply Brief at 46-47.

[25] Con Edison Initial Brief at 305-307; Reply Brief at 118-119.

[26] Tr. 586.

EXPENSES

World Trade Center Costs

Con Edison is currently receiving $14 million in rates to cover some of the costs it has incurred to restore the electric facilities in lower Manhattan that were damaged by the attack on and the collapse of the World Trade Center (WTC). In this case, the Company has proposed to recover $37.3 million of WTC costs during the rate year. However, DPS believes it is premature to provide the additional amount. Staff proposes that the current rate treatment be maintained for now and until all the WTC costs are known and Con Edison has obtained all the reimbursements that it is entitled to receive. CPB and Westchester County have also addressed this matter. They believe that Con Edison should defer its WTC costs until all avenues of recovery are exhausted.

According to Con Edison, it has obtained most, if not all, of the insurance payments it expects to receive from insurance carriers and it has received the bulk of the federal funds it expects to obtain for the costs incurred for the restoration, rebuilding and interference expenses at the World Trade Center. For these reasons, it proposes to recover its remaining expenses over 36 months and its capital costs over 30 years. It also plans to treat its ongoing costs for the World Trade Center as normal operating and capital expenses.

We find that the time has arrived to build into rates proper amounts for the Company to recover the outstanding costs that have been incurred to restore the electric facilities in the vicinity of the World Trade Center. While the Company may still recover some other funds either from the federal government or from pending litigation, there is a reasonable basis on the record of this case to allow the Company to recover its costs at the higher rate that is supported by the available information. Any other recoveries that the Company may obtain can be used either to pay WTC costs or they can be preserved and provided to ratepayers. Rate base should be calculated consistent with the amount of costs the Company has claimed and with the treatment of expenses that we recommend. However, if the Company has provided any updates that Staff has not fully audited, they should await a complete review by Staff.

Meteorologist Position

Con Edison has sought to include $150,000 in rates to hire a meteorologist to evaluate the weather information the Company obtains from the weather services to which it subscribes. DPS Staff notes that, in the 2004 electric rate case, the Company also expressed interest in establishing this position but has not done so. In this proceeding, Staff asserts that the Company has not adequately supported its claim that a meteorologist would provide it better information to react to emerging weather conditions. Staff also believes that the weather subscription services provide Con Edison ample and adequate information for its purposes. Were the Company to hire a meteorologist, Staff would expect Con Edison to obtain operational savings to offset the cost of a meteorologist.

According to the Company, an in-house meteorologist can more accurately forecast the local weather conditions for electric system purposes. It insists that a meteorologist would provide Con Edison the capability to react proactively to severe weather conditions.

It is difficult to believe that the currently available public weather reports, the Company's subscription to various weather services, and the knowledge and expertise of its current staff of professionals is insufficient for Con Edison to be able to properly operate the electric system at all times, including during periods of inclement and severe weather. We find that Con Edison has not presented sufficient justification to provide an additional $150,000 in rates for a meteorologist given the resources and capabilities that it already has.

Finance & Auditing Department Personnel

Con Edison has proposed to include in rates twelve positions in its Finance and Audit Department. Seven of the positions, including a Vice President, would be in the Tax Department and three positions would be in the Treasury Department. The Company also proposes to add a financial reports accounting position and a regulatory filings accounting position. DPS Staff proposes to disallow the twelve positions because it considers them to be unnecessary.

DPS Staff acknowledges that a consulting firm, KPMG, provided Con Edison a report which indicated that other firms with similar tax responsibilities operate with more staff than the Company. However, Staff considers the KPMG study results unreliable. According to Staff, the study compared Con Edison to manufacturing firms and it used data from 2002. Instead, Staff believes that more recent data should have been used and that Con Edison should have been compared to other electric companies. Staff also notes that delay in filling these positions is a further reason for not providing a rate allowance.

Addressing the financial reports accountant, Con Edison has requested the new position to assist in the production of “plain English” financial reports. Staff states that it has reviewed the current format for the reports and it considers them sufficiently clear and user friendly. Concerning the request for a regulatory filings accountant, Staff asserts that the Company has not provided adequate support for its claim that there has been an increase in regulatory filings to warrant this position.

As to the three Treasury Department positions, Staff is not convinced that the Company needs them to allow the unit to develop and for employee rotations and turnover as the Company has asserted. With respect to the lease administrator position, Staff doubts that another administrator is needed absent an increase in the number of real estate transactions the unit handles. Moreover, if another lease administrator were needed to handle wireless telecommunication carriers’ requests for antenna attachments, Staff asserts that the revenues from the attachments would cover the cost of another lease administrator and the position need not receive any other funding.

In response, Con Edison maintains that the KPMG report recommendations should be implemented. It defends the comparison group that KPMG used and asserts that it includes utility companies and is large enough to provide representative results across industry lines. The Company also asserts that it surveyed electric industry companies.

Con Edison states that it has filled many of the positions that Staff has challenged and that only three of them remain vacant. According to the Company, the rate plan that the Commission recently approved for Con Edison's gas operations provides for the positions that Staff has challenged in this case.

We find that the Commission's actions in this case should be consistent with the actions taken in the 2007 gas rate plan absent any clear reasons for why the Commission's actions in the gas and electric rate proceedings should differ. Moreover, on the basis of the Commission's action in the 2007 gas rate case, the Company has taken steps to fill the positions that were recommended in the KPMG report with which Staff has only of recent taken issue. We believe that the Commission should allow in rates the positions that the Company has filled. At most, the Commission should advise the Company not to fill any of the positions that remain open if it has any serious reservations about the KPMG recommendations or the quality of the report that the consulting firm provided.

Shared Services Organization

In 2006, Con Edison began a Shared Service Unit that is responsible for finding and obtaining greater efficiency and effectiveness throughout the Company's operations. In addition to setup, training and employee benefit costs for this unit, the Company will incur about $2.3 million of labor costs before the start of the rate year. During the rate year, Con Edison estimates labor costs of about $1.5 million and that it would expect about 25% of this amount to be offset by the savings the unit will obtain.

Staff is opposed to providing a rate allowance for the Shared Services Unit. According to Staff, all the costs for the unit can be offset by achieved savings. Con Edison has estimated that the savings achieved by the unit are expected to meet its costs by the year 2011.

In response, Con Edison complains that Staff used extra-record information for its position that there are no current expectations that the unit will obtain cost savings during the rate year. In any event, the Company has admitted this point.[27] More significantly, there is no dispute between the parties that the unit is expected to pay for itself within five years.

We find that this unit was purposefully formed to find operating efficiencies with a clear expectation that it will be able to achieve its objective. We do not believe that it is necessary to include in rates the cost for this unit in its start-up years when all such costs can reasonably be expected to be recovered by the results that should be accomplished. We recommend that Staff's adjustment be adopted and that Con Edison plan to recover all the costs of this unit from the cost savings it will produce.

Executive Compensation

DPS Staff adjusted the Company's amount for executive compensation to exclude the salaries and benefits for two recently retired officers. Con Edison accepts the Staff adjustment.

Stock-Based Deferred Compensation Plan

Con Edison provides its officers and management employees deferred compensation in the form of stock options. The Company considers the stock plan a legitimate cost that should be recovered in rates. Staff considers the stock options

[27] Con Edison's Initial Brief at 200.

comparable to the incentive compensation that the Commission disallowed in a 2002-03 rate case.[28] If it is viewed as incentive compensation, apparently the compensation should be self-supporting with the productivity the Company expects to obtain. Staff has proposed that about $14 million for the plan be disallowed.

According to the Company, the stock plan is an integral part of the annual compensation package offered to officers and management employees to compete with other firms and to attract talented persons to work for it in New York City where the cost of living is high. The Company points out that a similar adjustment was proposed in the 1991-92 Con Edison electric rate case and the Commission rejected it and recognized the compensation plan as a legitimate business expense.[29] Con Edison also states that it is not seeking to recover in rates the cost of the annual bonuses that are paid to executives which is another element of the total compensation package that the Company considers to be a legitimate business expense.

It appears that the Commission has previously ruled on this element of the Company’s compensation package for officers and management employees and has determined that it is generally permissible and can be recovered in rates. DPS Staff has not made a clear showing that the Commission effectively reversed its determination when it considered the RG&E incentive compensation and ruled on it. Moreover, Con Edison claims that the stock option deferred compensation is not necessarily incentive compensation but rather it is an essential feature of the total compensation package used to attract and adequately compensate officers and employees. We recommend that Con Edison

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[28] Case 02-E-0198 and 02-G-0199, Rochester Gas & Electric Corporation – Electric and Gas Rates, Order Adopting the Recommended Decision with Modifications (issued March 7, 2003).

[29] Case 910E-0462, Consolidated Edison Company of New York, Inc. – Electric Rates, Opinion No. 92-8, (issued April 14, 1992), 32 NY PSC 441, 488.

be allowed to recover in rates the costs of its stock-based deferred compensation plan.

Variable Pay Plan

Con Edison provides variable pay to eligible management employees to reward good performance. The Company also uses variable pay to compete for and to retain talented professionals. According to the Company, if it did not provide employees variable pay, the level of the merit increases paid to employees would be higher. It also states that when the variable pay plan was first adopted the merit pay percentage was decreased.

CPB proposes that the costs of the variable pay plan, about $11 million, be disallowed. CPB states that it requested support for the program and the Company did not provide it. CPB asserts that only a general response and no documents were provided. CPB also claims that there is no proof that this plan benefits ratepayers.

CPB believes that variable pay is a bonus that should only be awarded for performances that are over and above the norm. It also believes that such performances should produce increased benefits for ratepayers and stockholders.

Con Edison states that, during the discovery phase of the proceeding, it provided CPB a description of the variable pay plan that fully responded to the request for information. Moreover, the Company states that it stood ready to provide additional information but CPB never requested anything further.

The Company also states that its managers have discretion to award variable pay to encourage employees to perform at a higher level. It insists that the plan benefits ratepayers by improving the performance of management employees. According to the Company, it would be arbitrary to preclude the recovery of these costs while retaining for ratepayers the benefits it achieves. Con Edison states that other utility companies provide their employees variable pay.

The record does not demonstrate clearly that Con Edison purposefully refused to provide CPB the information it needed to examine and evaluate the rate filing submitted in this case. Had CPB believed at the time that it was conducting its discovery that the Company was avoiding or evading its legitimate inquiries, it could have sought formal enforcement of its discovery requests but no such action was taken. Accordingly, this issue cannot be decided on the basis of whether or not Con Edison was forthcoming with all the information that CPB is entitled to obtain in a rate proceeding.

Addressing the merits of the parties' respective assertions, it is unclear whether the variable pay plan is designed and intended to provide any specific and measurable cost saving and efficiencies that inure to the benefit of ratepayers. If this program is primarily intended to compensate employees for superior performances, there has not been any demonstration provided by Con Edison to show that the amounts paid were, in fact, related to any specific results. However, the Company appears to support the plan, in part, as a cost-effective substitute for the merit pay that employees would normally expect to receive.

We find that the status of the variable pay plan has not been adequately developed on the record in this case to support the cost disallowance that CPB has proposed.

Payroll Taxes

Con Edison has used a payroll effective tax rate of 9.79% that Staff accepts and would apply to all labor expense adjustments.

Labor Escalation

Con Edison used a labor escalation rate of 6.39% that Staff accepts and would apply to any labor adjustments made in this case.

Duplicate Miscellaneous Charges

Con Edison projects for the rate year the same amount of Duplicate Miscellaneous Charges that were incurred during the historic test period. According to Staff, the amount for the rate year should be increased by the general escalation rate. The Company accepts Staff's position.

Pension and OPEBs

DPS Staff accepts the Company's most recent statement of its pension and other post retirement benefits (OPEBs) costs for the rate year.

Health Insurance Costs

Con Edison has proposed to increase the historic test period medical plan costs by 8% and prescription drug costs by 9.5% to arrive at the amounts projected for the upcoming rate year.[30] DPS Staff points out that this approach contravenes the Commission established ratemaking practice that applies the general inflation factor to these and various other expenses. Staff proposes to adhere to the Commission's established practice by applying the general inflation rate to the Company's latest known health care costs.

The Company believes that the Commission's established practice can no longer be justified and it should not be applied to the current health care costs. Con Edison states that these costs are rising at about four times greater than the general inflation rate and it believes this trend will continue. The Company does not believe that its health insurance costs should be understated. It proposes that different escalation factors be used for the different types of employee welfare expenses.

Con Edison also states that it did not apply a general inflation factor to many of the costs that it could have handled this way. Instead, it has proposed specific increases and decreases for various costs. Only 38% of the Company's costs, excluding purchased power costs, were escalated using a general

[30] According to Con Edison, the increases are supported by numerous studies and surveys including the 12th Annual National Business Group on Health/Watson Wyatt Survey Report 2007 and national surveys prepared by Towers Perrin, Buck consultants, Kaiser Family Foundation and others.

inflation factor. For this reason, it believes that the health care costs should be considered separately.

In response, Staff points out that the Commission has adhered to the standard approach in recent times. Staff also observes that the total amount of Con Edison’s operation and maintenance expenses is increasing substantially and by an amount that greatly exceeds the general rate of inflation. According to Staff, the Commission’s established approach continues to make good sense and the Company should not be allowed to remove from the group any items that may exceed the group average.

We find that Con Edison has not provided a sufficient basis for departing from the established ratemaking practice. In recent times, the Commission has adhered to its approach, and the logic for the approach remains sound.

<u>Group Life Insurance Costs</u>

Con Edison provides its management employees group term life insurance equal to their base annual salary. It also provides $30,000 of group term life insurance to the members of Locals 1-2 and 3.

DPS Staff criticizes Con Edison’s forecast of the group life insurance expenses for not including the dividends that the Company receives from its insurance provider. Staff points out that, in 2005, the Company received dividends that were nearly half the amount of the premiums it paid. Staff also notes that the Company has received such dividends in four of the last five years. It therefore recommends that a five-year average ratio of the dividends to the premiums (46%) be used to reduce the group life insurance premiums the Company has claimed in this case. From the $1.8 million that the Company claimed, Staff would allow $990,000.

In response, Con Edison states that dividends are not a certainty and it could be required, in any given year, to make additional payments to the insurance carrier depending upon the amount of claims that are paid. According to the Company, it is inappropriate to include either a dividend refund or an additional payment in the projected expense amount.

Given the Company’s experience in this expense category, we find that it is reasonable to use the five-year ratio of dividends to premium payments to arrive at a representative figure for the rate year. Con Edison’s proposal is unreasonable because it ignores the available information and suggests that no such premium payments may occur during the rate year. The historical information indicates otherwise and suggests a pattern of dividend payments that should be used to reduce the premium payment that the Company has claimed.

East River Repowering Project

Con Edison is performing major maintenance at the East River Units 1 and 2. The work includes the inspection of the combustion and hot gas path, and the repair and replacement of various parts. The three-year rate plan that applies to Con Edison from 2005 to early 2008 allows the Company to collect $7.5 million annually for major maintenance expenses at its East River facility. At the end of the three-year rate plan, the Company will have about $8.7 million of unexpended revenues that is still needed for this maintenance project.

The Company proposes to continue to collect in rates $7.5 million for the East River Repowering Project. It would also have the Commission establish a permanent reserve account for this expense. DPS Staff supports the Company’s proposal to continue to collect $7.5 million in rates; however, it is opposed to any permanent reserve account and it believes that the Company should return to customers the $8.7 million previously collected but not spent to date. Staff believes the Company should estimate its costs properly and control the timing of its work. Con Edison expects to spend about $24 million over the next three years on major maintenance at the East River facility.

In its brief, Con Edison claims that it needs reserve accounting, and the funds accumulated from the last rate proceeding, to pay for this maintenance project and to meet its schedule. According to the Company, Staff does not understand the timing of this project and the Company's ability to control the operation of these units to meet system demands and weather conditions.

We recommend that the Company be allowed to retain the $8.7 million that was collected pursuant to the 2005-08 rate plan but only if the funds are committed to and used for the major maintenance work on the East River facility. If the Company is unwilling to commit these funds to this specific purpose, we do not believe that Con Edison should be allowed to retain them.

For purposes of the calculation of the rate year revenue requirements, we recommend that the calculated rates include $7.5 million for the East River Repowering Project. The Company has provided a multi-year estimate for this project which indicates that the $8.7 million remaining on the Company's books, with a $7.5 million rate allowance, should cover a large portion of the expected costs of this project.

Finally, Staff is opposed to the establishment of reserve accounting for this project and we find that the Company has no entitlement to any such accounting for this project. Traditional means of accounting, and routine ratemaking practices, can be used to adequately address the effects that the East River Repowering Project can have on the Company's rate levels.

Vehicle Fuel Costs

Con Edison claims to have estimated its gasoline and diesel fuel costs using a weighted average of $2.60 a gallon. However, DPS Staff believes this figure is incorrect. It asserts that a weighted average of $2.77 a gallon was used by the Company in the rate filing. This disagreement arises in the context of the Company seeking to revise its weighted average to $2.80 a gallon using more current information. Con Edison would also increase the amount of fuel it expects to use during the rate year.

Staff does not believe that the Company should be allowed to update this expense item because fuel cost increases were anticipatable at the time that the Company filed and a cost estimate was included in the rate filing. In support of its position, Staff relies on the Commission's Forecast Test Year Policy Statement.[31] Instead of merely providing its internal budget of future operations, Staff asserts that the Company should have provided an estimate of its vehicle fuel costs for the upcoming rate year. Staff also states that the Company provided no support for the fuel consumption estimate provided with its update.

In response, the Company states that the merits of its fuel expense update should be considered because the presiding officers ruled at the hearings that they would permit consideration of the update notwithstanding Staff's objections to it on the basis of the Forecast Test Year Policy Statement.

As to the merits of the Company's updated information, Con Edison states that it has provided its gasoline and diesel costs from 2001 to 2007 and the amounts of fuel it has used for this period.[32] From the historical information, the Company asserts that there is no question that its fuel costs are increasing and fuel consumption is increasing at a rate of about six percent. The Company considers its estimates of fuel prices and consumption to be conservative given the amount of construction and maintenance activity planned for the rate year and the most recent prices for gasoline and diesel fuel.

During the hearings in this case, the presiding officers were asked to rule on the application of the Commission's Forecast Test Year Policy Statement but only with respect to the Company's updated vehicle fuel cost estimates.

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[31] Case 26821, Statement of Policy on Test Periods in Major Rate Proceedings (issued November 23, 1977) 17 NYPSC 25-R.

[32] Exhibit 363.

We allowed this update not so much on technical grounds but for practical and pragmatic reasons believing that it was better to permit all the facts concerning the Company's current vehicle fuel costs in the record. As stated elsewhere in this recommended decision, we have serious reservations about the updating process the Company has used in this case which appears to be contrary to the practices that the Commission intended in major rate proceedings.

Turning to the facts concerning the vehicle fuel costs, the Company's update is worth only $300,000 if its assertions are accepted or, $900,000 if Staff's understanding of the issue is correct.[33] In either event, the amount in dispute for this item is relatively small and it does not appear to have a material impact on the size of the rate increase that the Company will be permitted to implement. This update will be allowed but only because this matter was considered and addressed during the hearings.

Information Advertising – Public Affairs

During the historic test period, Con Edison spent $10.5 million to inform customers and the public about important utility system matters, including energy conservation and emergency preparedness. The Company proposes to increase its informational spending by $8.5 million during the rate year.[34] Among other things, it would provide customers more information about their ability to control energy usage and reduce bills.

According to Staff, insufficient justification exists for the additional funds the Company has sought in this case. Staff also believes that the Company's informational advertising is controversial and self-serving. It disagrees with the focus of the Company's previous advertisements and it believes that

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[33] Con Edison Initial Brief, pp. 205-06; Staff's Initial Brief at 39.

[34] The $8.5 million is a total company figure; $6.9 million would be allocated to the electric department.

they should be addressing matters of more importance, such as energy conservation.

Staff asserts the Commission should only provide the Company a small amount for permissible informational and institutional advertising in keeping with the policy statement on this matter.[35] According to Staff, the maximum allowance pursuant to the policy statement is $4.47 million or 0.06% of operating revenues. On this basis, Staff proposes that $17.6 million of the Company's request for informational advertising be disallowed.

In support of the amount of information advertising planned for the rate year, Con Edison states that it will conduct an "Energy Education" program and a "Working for You" program. These programs will inform customers and the public about the need to maintain the electric infrastructure, enhance energy conservation, emergency services and other programs. According to the Company, its plans for these informational programs respond to Commission pronouncements, in several reports addressing system outages, that more constant and better communication is needed. According to the Company, the amount requested is needed to provide recurring messages that lead to greater customer recall and awareness. It is also needed to use various media outlets, including print publications, radio spots and outdoor advertising. Further, the Company states that the additional funding is needed to reach customers in diverse ethnic communities.

We find, as a general matter, that the Company should keep to the requirements of the Commission's informational advertising policy statement. Con Edison has not presented on the record sufficient information for us to recommend to the Commission that an informational advertising allowance in excess of 0.06% of operating revenues be provided to fund any expanded informational programs. Neither the content of the

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[35] Statement of Policy on Advertising and Promotional Practices of Public Utilities (issued February 25, 1977) 17 NY PSC 1-R.

informational advertising programs has been presented here in sufficient detail nor has the design of the program been adequately addressed for us to recommend that the established limit on informational advertising be waived in this instance for any specific purpose.

Insurance Expense

Con Edison is projecting higher property and liability insurance costs for the rate year, about $5.3 million or 22% more than the costs incurred during the historic test period. The proposed increase is due to a forecast of a 10% per annum increase in insurance premiums. Staff considers the 10% estimate to be overstated and contrary to past experience and recent results. Staff points to a modest decline in insurance expenses over the three-year period from 2004 to 2006.

The Company is also projecting a 17% increase in excess liability insurance premiums, a category which represents one-third of the Company’s total annual insurance expense. However, the actual premium incurred for 2007 is only 2.9% greater than the 2006 amount. Using this percentage as its measure of annual growth in insurance expense, Staff has proposed that the Company’s estimate be reduced by about $3.75 million.

Con Edison is amenable to only a $1.2 million reduction and it is opposed to anything further. According to the Company, its estimate is based on the best available information and it is superior to the adjustments suggested by the other parties. In response to Staff, it states that every year presents different risks for insurers. Therefore, it does not believe that Staff’s reliance on historic information is dependable.

CPB also proposed that the insurance costs be reduced. Like Staff, CPB believes that the Company’s forecast is not supported by the historical trends. CPB would eliminate the entire increase the Company has requested.

CPB has also addressed director and officer liability insurance and proposes that this cost be excluded from rates and be made the responsibility of the Company’s shareholders. This insurance protects the directors and officers from inappropriate activity and decisions that are adverse to shareholder interests. According to CPB, the insurance coverage is unrelated to ratepayers who do not select the officers and directors, and do not subject them to potential liability. In CPB’s view, the Company’s directors and officers receive adequate compensation for their expertise and competence, and they need not be insulated from personal responsibility for inappropriate decisions. CPB proposes that the $5.44 million the Company is claiming for this insurance be disallowed.

Con Edison considers CPB’s proposed adjustments arbitrary, inherently unreasonable and contrary to the increases that it has experienced in insurance costs. With respect to director and officer liability insurance, Con Edison states that the insurance is a necessary and a reasonable cost of providing service. It states that such costs are outside of its control and determined by events that are not the fault of management. It points out that other large firms obtain this type of insurance and the Company believes it would have to pay officers or directors for it even if they were to pay for the insurance on their own.

We recommend that Staff’s estimate and modest increase be used for property and liability insurance costs given the historic trend that has not shown any increase in this cost category for a recent three-year period. The Company has not demonstrated sufficient upward pressure in this category of costs or volatility to support the increased amount it proposed.

On the other hand, we recommend against CPB’s proposed adjustment to director and officer liability insurance. The standard practice is to allow such costs for ratemaking purposes and the Commission has not had a policy to the contrary.

Site Investigation and Remediation

Con Edison accepts Staff’s adjustments to the amount of expenses being projected for site investigation and remediation (SIR) work. The disputes on this cost item are among the Company, CPB and NYPA.

CPB claims that its efforts to examine the cost estimates were frustrated by the Company’s failure to provide the supporting information it requested. According to CPB, the Company was not responsive to its request for all the workpapers and documents that supported the cost estimate.

CPB also states that DPS Staff’s evaluation of the SIR expenses is insufficient to protect ratepayer interests. Staff examined the timing of the SIR projects and adjusted them for delays and slippage. Among the additional matters CPB believes should be examined are the Company’s procedures for bidding SIR work, the competitiveness of the bidding process, the adequacy of the Company’s management of the SIR projects, and the accuracy of the cost estimates. According to CPB, the Commission should order a management audit of the SIR programs and the recovery of these costs should be subject to a reconciliation that reflects the audit results. If the audit reveals that Con Edison did not manage the SIR projects in a cost effective manner, CPB believes that the Commission should have the ability to adjust the amounts recovered from ratepayers.[36]

In response, Con Edison states that it provided extensive supporting information for its SIR program and that CPB never followed up on its original request after the Company

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[36] CPB also proposes that a longer amortization period be used for SIR costs than the three-year amortization that the Company initially proposed. DPS Staff has supported a five-year amortization that the Company has agreed to which appears to serve CPB’s interest in the use of a longer period than the one proposed by Con Edison. NYPA has proposed that these costs be amortized over 20 years which appears to us to be far too long a period.

responded to it. To demonstrate its willingness to cooperate with discovery and provide the parties information, Con Edison points to Staff's discovery concerning SIR expenses and the detailed information provided to it. The Company notes that all the SIR information requested by DPS Staff was also provided to CPB.

We find that confusion about the discovery process permeates the presentation in this case made by the out-of-state accounting witness that CPB hired who was unfamiliar with how rate cases are processed in New York. Discovery problems of this sort have never occurred in the past with CPB's presentation in rate proceedings before the Commission. It is somewhat surprising that CPB did not approach the presiding officers early in the case to bring to our attention any of the difficulties it was experiencing in conducting its audit and examination. In any event, CPB's proposal for a management audit of the SIR program and a reconciliation mechanism for these costs do not suffer from any inadequate discovery results.

On this score, Con Edison asserts that there is no need, or record basis, to make the recovery of the SIR costs subject to refund pending a management audit of the program. The Company states that the record does not contain any indication that its cost estimates are unreasonable, that its bidding procedures and management practices are inadequate, or that it has failed to minimize the SIR costs.

We recommend that the Commission provide the Company a reasonable expense allowance for SIR costs at the level supported by Staff's evaluation of the program. We find that the cost estimate developed by Staff from examining the timing of the projects, and by using a five-year amortization period, provide a reasonable cost estimate for this item. Also, we believe, as a general matter, that reconciliation mechanisms are generally undesirable for expense items in the context of a one-year rate plan. As to whether or not a management audit of the SIR program should be performed, we find that the proper scope of a management audit could include such matters but it is not necessary to hold up the ratemaking allowance for this item pending the results of any such audit.

Another SIR-related matter has been raised by NYPA. The Authority proposes that the SIR cost be recovered only from gas customers and not from Con Edison's electric customers. According to it, the site investigation and remediation costs for manufactured gas plants are unrelated to the delivery of electric service. NYPA disagrees with any longstanding Commission practice that permits an artifact of the natural gas business to be imposed on electricity customers.

NYPA's proposal is opposed by the Company, CPB and the NYC Government Customers. Con Edison points out that the manufactured gas plants provided energy that was used for street lighting and in homes and businesses for lighting, cooking and heating. It supports the continued allocation of these costs to electric, natural gas and steam customers and it states that customers now rely on electricity, rather than manufactured gas, for light, heat and cooking.

The NYC Government Customers state that the remediation of manufactured gas plant sites is an important environmental initiative for the residents of New York City and they consider NYPA's proposal a serious threat to the remediation program. They believe that natural gas customers cannot afford to bear the SIR costs alone and a transfer of all the costs to them would threaten the funding of the remediation efforts and present environmental harm. They support the continuation of the established policy.

We recommend that NYPA's proposal be rejected and that the Commission continue to allow proper and reasonable amounts of SIR costs to be allocated to all customers of public utility services to spread this responsibly over a broad base and to minimize its impact on any one group of customers.

Postage

Con Edison has proposed to increase the historic test period amount for postage by 7.6% to reflect the increase in postage rates that went into effect on May 14, 2007. It also proposed to increase the postage rate by the general rate of inflation. DPS Staff has opposed the latter increase because it expects the May 2007 increase to remain in effect throughout the upcoming rate year. Staff also points out that some electric customers are beginning to receive and pay their bills electronically. This emerging practice will tend to reduce the amount of postage that the Company incurs. Con Edison does not appear to challenge or oppose the Staff-proposed adjustment and we recommend that it be accepted.

Interference Expense

Interference work occurs when a municipality requires Con Edison to move or protect its electric facilities when a municipal agency is installing or repairing water mains, sewers or drainage facilities and when roads, sidewalks and curbs are reconstructed. Con Edison has estimated about $105 million of interference work and expense for the rate year, almost double the amount experienced during the historic test period. In the 2005-08 electric rate plan, the Company was allowed to reconcile this expense item for variances that were 2.5% above or below the rate allowance. In this case, Con Edison has proposed that any and all variances from the amount allowed in rates be reconciled.

Staff has proposed to reduce the rate allowance for interference work to $92 million by Staff's calculation or $93 million by the Company's. There is only a $1 million discrepancy between these parties and the Company is willing to accept Staff's adjustment properly calculated.[37] Staff proposes that amounts below the rate allowance be reconciled; however,

[37] The discrepancy appears to be related to the parties' views about interference labor. They should attempt to reconcile this difference. We note that while the Company has agreed to Staff's adjustments it has not agreed to Staff's methodology and it reserves the right to depart from the Staff approach in future cases.

Staff proposes no reconciliation for any amounts spent in excess of the rate allowance.

CPB has proposed that the rate year estimate be set at $78 million. It believes that New York City's projection of planned capital expenditures is uncharacteristically high in comparison to the historical levels and a recent five-year average. It proposes that the ratio of actual expenditures to budgeted amounts in 2006 be used to reduce the Company's estimate.

In response, Con Edison claims that the 2006 ratio departs substantially from the ratios suggested by other years and it does not believe that the 2006 ratio should be used. Addressing the large difference in interference costs from the last rate case to now, the Company explains that the historic figures do not include the interference expenses incurred in lower Manhattan. They were treated separately because of the federal funds that were available. Now that the federal program is about to expire, the Company has included in its forecast all interference costs at all locations.

With respect to the New York City estimate of planned capital expenditures, Con Edison states that it works closely with the City and it has no basis for believing that the City will not undertake the planned construction during the upcoming rate year. As to the Company's proposal to reconcile all differences between the rate allowance and the actual costs, Con Edison states that these costs are beyond its control and they depend upon the actions of governmental entities.

The Company disagrees with Staff's partial reconciliation proposal. Con Edison believes that the magnitude of the rate increase in this case has no bearing on whether a full reconciliation should be provided for interference work. It states that a full reconciliation will protect customers and the Company to the same extent and that its use would be fair and equitable. By accepting Staff's adjustment to this cost category, Con Edison believes it would be inequitable to use an expense amount that is at the low end of a reasonable range that exposes the Company to the risk of costs above the forecast amount.

If the Commission decides in this case to set rates for only one year, with only the forecast test year in mind, we believe that there is no need to provide the Company any true-up or reconciliation for interference work. Instead, the Commission should provide the Company a reasonable cost allowance based upon the information of record and should avoid the use of any more elaborate mechanism. The reasonable range for this expense is between the $78 million proposed by CPB and the $93 million that the Company and Staff support. If CPB's use of the 2006 ratio of actual-to-budgeted expenditures is out of line with the ratio for previous years, its proposal may indeed be too low. On the other hand, we do not accept Con Edison's characterization that the Staff/Company estimate is at the "low end of a reasonable range." It appears to us that this estimate is the best that the two parties can support and it is not the lowest reasonable estimate that could be used for ratemaking purposes. Absent a demonstration by CPB that its estimate is more reasonable, we recommend that the Staff/Company estimate be used.

PSC Assessment

The Company and Staff agree that the latest known assessment provided by the Department of Public Service for the costs of the regulatory agency should be used to estimate the rate year expense amount. In its calculation of this item, Staff would reflect the average amount of the refund that is provided to Con Edison which has been 5.25% over a recent four-year period. It does not appear that the Company opposes Staff's calculation of the PSC assessment amount for the rate year and we recommend that it be adopted.

Rents – ERRP Carrying Charges

Con Edison's East River facility is a combined steam and electric generation plant and the costs of the facility are shared between the electric and steam departments. Staff accepts the Company's statement of the amount of rent that the steam department charges the electric department for the facility to cover depreciation, taxes, carrying charges and return requirements. Staff points out that the rent does not affect electric delivery rates because it is collected through the Monthly Adjustment Clause (MAC).

Shared Services

Staff accepts the Company's statement of the billings between Con Edison and its affiliated companies, including Orange and Rockland Utilities, Inc. and the holding company parent, Con Edison, Inc. The billings cover the shared services that the affiliated companies use.

Uncollectibles

Staff accepts the Company's statement of its uncollectibles expense. Staff also accepts Con Edison's unbundling of the portion of the uncollectible expense that should be collected in the Monthly Adjustment Clause (MAC) and the Market Supply Charge (MSC). The final projected rate year MAC and MSC amounts for fuel and purchased power costs will determine the amount of uncollectibles removed from base rates.

Property Taxes

Staff has proposed about a $1.8 million downward adjustment to Con Edison's estimate of the amount of property taxes to be paid during the rate year. Both parties use an average tax growth rate to arrive at the amount for the rate year. The Company started with data from 2001-02 and it excluded from its figures an atypical, mid-year increase that the City of New York imposed during the 2002-03 tax year. Staff also excludes consideration of the mid-year tax increase, but did so by using historic data subsequent to the mid-year tax increase. Staff believes that its method is better because it is less complicated and does not rely on the 2001-02 data that Staff considers to be stale.

In support of its average tax growth rate, Con Edison states that Staff used a very high tax rate for the 2002-03 fiscal year that has the effect of decreasing the percentage change for the next year. It believes that Staff's method produces an artificially low percentage change in the five-year average.

Con Edison claims that Staff has "cherry-picked" its starting point to produce a lower five-year average growth rate for property taxes; however, we do not see any evidence to support this allegation. Moreover, the use of Staff's five-year average does not appear to be distorted either by its starting point or by the data that was gathered and averaged. Accordingly, we recommend that Staff's growth rate be used rather than the Company's which required an adjustment to provide useful results.

Another property tax issue between the Con Edison and Staff concerns the Company's proposal to use a reconciliation mechanism. Con Edison proposes that all differences between the estimated and actual amount be reconciled. Staff proposes that there not be any reconciliation of property taxes because they can be reasonably forecasted.

According to Con Edison, New York City could impose a special, mid-year increase like the one implemented in 2002-03 and it would not be covered for any such event absent a reconciliation mechanism. The Company believes that the mechanism used in the multi-year rate plan should also be used in a one-year rate case. Con Edison fears that a taxing authority may take advantage of it and impose higher taxes if there is no reconciliation mechanism in place.

In support of its position, Staff explains that true-ups are typically avoided in one-year rate proceedings because it is not likely that significant variances from the forecast levels will occur. Staff points out that the tax assessments for 2008 are known and so are the tax rates for 2007-08. Thus, it sees very little reason to provide the Company a reconciliation mechanism.

We agree with DPS Staff that there is no need to provide Con Edison a reconciliation mechanism for property taxes in order to develop and implement just and reasonable rates for the upcoming rate year. We do not believe that the taxing authorities will perceive any difference that will encourage them to impose on Con Edison any taxes that they would not otherwise impose on all taxpayers.

Customer Service

1. Call Center Enhancements

Due to the large rate increase that is needed for Con Edison to invest in its aging infrastructure, DPS Staff does not support the Company's proposal to increase its call center staffing which would add to the rate increase. According to Staff, Con Edison has been able to respond adequately in the recent outage situations with the equipment and personnel it has. Consequently, Staff does not believe there is a need to increase the staff levels at the call centers or to begin to introduce remote agent technology.

According to the Company, the call center staffing should be increased to 36 customer service representatives and two supervisors. It also believes that the call centers should be able to operate at remote locations and have speech recognition functionality, additional outbound telephone lines, and an uninterrupted power supply.

Con Edison states that the routine operations require additional staff and that a high rate of attrition in these positions requires it to provide continuous training for new employees. The remote agent technology is an ingredient of the Company's business continuity strategy that is expected to facilitate the handling of customer calls during emergencies and at other times when customer calling is high. This technology would allow customer service representatives to work in the field and be deployed to remote locations.

Speech recognition, and an interactive voice response system, would allow the Company to improve customer interactions and, according to Con Edison, it is not very costly. Also, the Company asserts that more outbound telephone lines are needed to contact customers about system outages. The Company would use the additional lines to inform customers of service restoration times and to verify that service has been restored. The Company has sought to include in rates the cost of 48 additional outbound telephone lines but Staff has proposed that only 24 additional lines be allowed. The Company states that its figure is supported by a study of the number and duration of calls which indicates the number of telephone lines that may be needed at any given time.

We recommend that Con Edison be allowed a portion, but not all, of the additional customer representative positions it has proposed in this case. The thrust of Staff's position appears to be that the Company can get by with the number of customer representatives it currently has and that the service provided at the call centers has not been unacceptable. The Company, on the other hand, asserts that the additional customer representative positions are needed for the call centers to operate properly and Staff has not demonstrated that the Company need not improve its performance at the call centers or that the Company's statement of its requirements is inaccurate. In this context, we recommend that a rate allowance be provided for half the number of positions that Con Edison has proposed and, in the Company's next major rate filing, this matter should be re-examined to determine whether any additional positions are needed. This approach is consistent with Staff's having supported half of the additional outbound telephone lines the Company has requested and it provides the Company resources to develop the call centers properly. In all other respects, we recommend Staff's position to the Commission.

2. Outreach and Education

Con Edison has been operating with a $3.5 million budget for outreach and education. In this case, the Company has proposed to increase its outreach and education spending by about $6.6 million. Staff believes that only a $360,000 increase is needed.

Staff believes that the existing outreach and education program has effectively delivered the Company’s messages. It provides information about the rights and responsibilities of utility customers; informs customers about the programs and services available to them; and, it tells them how to contact the Company and the means available for paying their bills. The outreach and education program also addresses emergency situations and distributes energy and safety information to school children. Given its comprehensive nature, Staff is unaware of any need to add to the program. Staff states that the Company has not demonstrated that an additional $6.3 million is required to continue to satisfy these needs.

Like Staff, CPB believes that Con Edison has provided insufficient justification for the outreach and education funding it has sought. It believes that the Company should use less costly methods to communicate with customers; that direct mailings should be limited; and, the greater use of the Company website should be explored.

According to the Company, it is challenging for it to deliver its key messages to a diverse customer base with a wide range of ages, native languages and cultural differences. To reach such a heterogeneous customer base, it must use a wide range of media that is familiar to them. Con Edison states that its outreach and education proposal responds to the recommendations contained in the 2006 Long Island City and Westchester storm outage reports issued by the Department of Public Service. It plans to expand the delivery of electric system information and to increase customer awareness of issues related to electric service.

Con Edison states that the merits of the programs it has presented in this case have not been critically assessed by Staff and that the need for electric department outreach and education is not directly related to the amount required by the natural gas department. The Company also asserts that it operates in one of the most expensive media markets and has many customers who speak languages other than English. For these reasons, it does not consider the amount it has requested to be excessive.

We agree with DPS Staff and CPB that Con Edison, for the time being, should live within the bounds of its established outreach and education budget to satisfy the information needs in the service area. The Company has examined its communications with customers following the recent storms that inconvenienced many and disabled electric service. The Company should improve upon its performance as has been recommended. Nonetheless, Con Edison has an established budget for information and education which has not been shown to be inadequate for its intended purposes. The Company has not been able to convince the Staff and CPB that additional resources are needed to improve upon the delivery of the Company’s messages to its customers. For these reasons, we recommend only the small budget increase proposed by DPS Staff.

Further, as Staff has proposed, Con Edison should continue to provide the DPS Director of Customer Services its annual public awareness outreach and education plans at least 90 days before the plans are implemented. This practice, and the collaborative efforts that take place in this context, are useful to ensure that the Company’s goals, objectives, messages and strategies are coordinated with government efforts. According to the Company, it has provided such plans to the Director at the beginning of its summer and winter seasons and the process has worked well.

3. Field Operations

Con Edison proposes to add 15 customer field representatives to its ranks. Eight representatives would read demand-metered accounts that can be difficult to access and sometimes require multiple visits. Also, the number of demand meters is rising.

Seven additional representatives would visit meters where consumption is reported on inactive accounts. In such instances, new customers of record are identified; the usage on the old and new accounts is determined; and, liability for service is established. According to the Company, there are increasing numbers of customers who begin to use electric service without properly notifying it.

Staff claims that no rate allowance need be provided for the 15 positions because the representatives should be able to generate sufficient revenues to pay for the cost of these positions. Con Edison would not speculate on the amount of additional revenues that any of these customer field representatives may provide and it states that it is difficult to establish customer responsibility for past usage.

We find that there has not been provided on the record any demonstration that the customer field representatives are not needed for the purposes for which Con Edison has presented. Staff has asserted that these positions can be funded by the additional revenues that they may yield; however, it is not clear that the field representative who will read demand-metered accounts will provide any new sources of revenue or that the representatives who are dispatched when consumption occurs on inactive accounts will be able to obtain any substantial amounts of revenue for past due accounts. We do not recommend that Staff’s proposed adjustment be adopted.

Research and Development

Con Edison has proposed to increase its spending for research and development by $11 million. Staff is concerned about the amount of the research and development costs in the rate year and observed that the expenditures have been less than the budgeted amount due to the credits provided when projects are successful and they are booked to operations. Staff proposes that only $19 million be allowed for research and development.

We find that Staff has calculated a proper amount for research and development using the assumption that some of the projects will prove successful and their costs will be transferred to the Company’s accounts for operations. We therefore recommend Staff's adjustment. We also recommend that Con Edison's proposal to reconcile the rate allowance for research and development costs be denied if in this case the Commission sets rates for the upcoming year.

Facilities Expense

Con Edison has proposed to increase, by about $16.7 million, the amount to be spent to maintain and improve its buildings and structures. CPB has proposed that the increase be limited to about $3.3 million. To begin, it does not believe that the Company provided sufficient support for the proposed increase. It states that the rate filing and workpapers were incomplete and inconsistent. It also asserts that no support was provided for about $11.9 million of program changes. In general, CPB believes many of these expenses can be capitalized because the improvements to the buildings and structures will be used over an extended period.

With respect to Con Edison's building infrastructure restoration expense, CPB believes that the renovation costs should be capitalized. It also observes that, in a recent two year period, this expense averaged about $1.1 million and the Company proposes to increase it by an additional $3.6 million. CPB suggests that the additional amount should be recovered over five years to reduce the expense amount for the rate year.

As to the costs for the Company's master planning process that determines the facility improvements to be made, CPB proposes that about $913,000 be disallowed because the benefits for ratepayers have not been shown and because the costs in this category are not known and measurable.

In response, Con Edison states that in the next four years it will perform about 300 projects to upgrade its buildings and structures in the service area to meet the Company's needs. Con Edison states that it responded fully to CPB's discovery about the projects and it clarified the responses when asked to do so. It therefore opposes CPB's assertion that inadequate information was provided.

As to the building infrastructure restoration expense challenged by CPB, Con Edison explains that it is installing water sprinklers in its corporate headquarters at 4 Irving Place to comply with Local Law 26. Four floors have been renovated and 24 remain. One and a half floors will be completed each year between now and the year 2019. According to the Company, it adequately explained this project on the record and its accounting system controls the expense and capital treatment that the project expenditures receive. It states that the employee relocation costs and improvements made to the temporary site where they will work are properly considered expense items.

Concerning two other building infrastructure restoration projects, Con Edison states that it is inspecting, in accordance with Local Law 11, the exterior facades of its buildings in New York City that are over six stories tall. It is also restoring the cooling tower components, and relocating associated structural steel and piping, on the roof of 4 Irving Place. The Company believes that its compliance with Local Law 11 is necessary to promote public safety and to restore City architecture. The cooling tower work will combat airborne diseases that could affect building occupants. Con Edison asserts that the amounts estimated for the rate year are necessary for these purposes and the proper accounting for sporadic repairs (as opposed to complete replacements) calls for them to be expensed.

Finally, with respect to the costs for the master planning process, Con Edison states that this process is necessary and it will provide substantial benefits. Con Edison points out that building space and leases are needed for employees at various locations and its staff levels are increasing due to the electric infrastructure improvement programs. A full scale study and analysis of the available facilities, organization functions and employee levels will be performed to optimize the use of the facilities and to avoid construction and maintenance of new offices and buildings. A request for proposals will be issued and a consulting firm will be hired in mid-2008.

On the basis of the presentation made by CPB, we do not find adequate support to recommend to the Commission that Con Edison’s expenses for building infrastructure restoration work be reduced by about $13.4 million. To begin, if CPB’s consultant wanted more or better information from the Company when he was performing his audit and investigation, we could have applied the Commission’s discovery rules to provide such assistance. However, by the time that the witness prefiled his testimony and attended the hearing, it was too late to provide additional discovery. Moreover, the Company disputes CPB assertion and states that it cooperated fully with the consultant’s examination. In these circumstances, no adjustment is supported by the parties’ conduct during the discovery phase of the proceeding.

Next, there has not been provided any demonstration that the Company has applied improper expense or capital accounting to the building restoration costs that it is incurring. There has not been provided any specific demonstration of any cost misclassifications that must be corrected.

Finally, the Company has defended the merits of these projects and there is no question concerning whether the work should be done on the schedule that Con Edison has provided. Some of the work is required to comply with local ordinances and it appears to be prudent for Con Edison to devise a master plan to address its need for buildings and space.

Emergency Preparedness

Con Edison has proposed to improve its emergency response organizations and to provide additional planning for emergencies. It plans to consolidate its emergency preparedness command and control, and replace some of the equipment used during coastal storms. Further, it would add resources to better understand the scope of the incidents that require an emergency response.

The operational and maintenance costs for the planned programs are about $4 million and the programs would require about $8.4 million per year for capital expenditures in 2008 and 2009. DPS Staff has proposed to disallow the costs for the emergency management programs.

Staff states that the Company needs to take steps to improve its emergency preparedness and the proposed programs could help to improve its communications, storm preparations, and emergency response. However, Staff believes that a larger issue must first be addressed by the Company. According to Staff, Con Edison lacks cohesion and accountability in its emergency preparedness program from its corporate ranks to the field operations. With respect to the business plan provided in this case for the electric operations emergency management program, Staff states that it does not clearly define how the emergency organizations will be coordinated. Staff is not convinced that the strategies stated in the business plan are consistently applied throughout the Company and that the work will be performed well and be verified.

Staff recommends that the Company provide a modified emergency preparedness program proposal that addresses the findings contained in the audit report of the July 2006 outage of the Long Island City network.

In response, Con Edison states that it needs the programs presented in this case regardless of the organizational structure that is used for emergency planning. It believes that the complete elimination of the requested funds is contrary to Staff's overall position that improvements are needed. If the funds are not provided, the Company believes that it should be allowed to defer any incremental costs for the emergency preparedness initiatives that the Commission directs.

To demonstrate that these funds are needed, Con Edison points to the proposed coastal storm mitigation program and the need to replace transformer vaults to protect against a coastal storm with a significant storm surge. The Company states that there is no dispute that the vault replacements should be made. Similarly, Con Edison states that it needs an incident command center and a control center screening group no matter the organizational structure that is ultimately employed. According to the Company, the outage audit report does not contain any specific recommendations concerning these items. For these reasons, Con Edison believes that it should not be required to provide an entirely new program proposal to obtain the funds needed to make these improvements.

The Company also believes that the schedule for the submission and review of any revised emergency preparedness plan should be established in conjunction with the process for the review of the outage audit rather than the schedule for this rate case. In mid-January 2008, Con Edison plans to provide an interim progress report on the comprehensive emergency preparedness plan it is developing and, in March 2008, it believes the plan will be ready for submission.

We believe that the Company has made a case for providing funds in this rate case for emergency preparedness improvements. While the overall program design for the improvements is not certain at this time, there has been established some elements and features that are known to be necessary, such as vault replacements, a command center and the control center screen group to which the Company points. It also appears that as long as the overall program design remains uncertain, there could be a delay in the implementation of the complete program. Moreover, it appears to be inconsistent for Staff to have found all of the capital projects proposed by the Company’s Infrastructure Panel to be necessary, while they recommend against this capital project which appears to be no less important. For these reasons, we recommend that the three items specifically supported by the Company be allowed and the other costs it claimed not be provided until the comprehensive emergency preparedness plan is known and determined to be acceptable by the Commission. At that time, the Commission can determine whether any deferred cost treatment should be provided for any of the program costs.

Productivity Adjustment

The Commission's standard practice is to apply a 1% productivity adjustment in major rate cases like this one to encourage the utility company to obtain efficiency throughout its operations. In this case, the Company has applied the standard, productivity adjustment from the historic test period and for the periods before and during the forecast test period. Staff has accepted the Company's productivity adjustment. Local 1-2 opposes it and the NYC Government Customers believe that the standard adjustment should be tripled.

According to Local 1-2 the adjustment is misplaced and counterproductive. It asserts that the productivity adjustment threatens the provision of safe and reliable service. Local 1-2 believes that the adjustment can force a reduction in the historic level of internal workers and increase Con Edison's reliance on outside contractors who do not have as much experience with the underground electric network and who may add to the Company's costs.

Local 1-2's arguments against the standard productivity adjustment are not new. They have been considered in previous Con Edison rate proceedings and they have not been accepted. The productivity adjustment does not target the Company's workforce as Local 1-2 seems to believe, nor does it encourage the Company to operate less efficiently or to compromise safe and adequate service. The adjustment is used as a standard regulatory convention to discourage a "flow-through" or a "cost-plus" approach to ratemaking. It ensures that the utility company will explore all available and reasonable means for maintaining efficient operations before it attempts to obtain increased rates to cover a growing body of costs. We recommend that Local 1-2's position on the productivity adjustment be rejected.

The NYC Government Customers reviewed Con Edison’s new capital projects and its operations and maintenance expense programs. They believes that the Company can achieve greater amounts of productivity that has been obtained in the past. The following are a few examples of the programs that the NYC Government Customers believe will produce sizable savings: the Remote Monitoring System, the Edison Program, the Electric Mobile Dispatch Program and the Equipment Modernization Program.

Also, according to the NYC Government Customers, the large amounts that Con Edison plans to spend on capital projects and operation and maintenance (O&M) programs supports an expectation that increased productivity will be achieved by the expenditures. However, Con Edison states that not much of its capital spending has the potential to increase productivity. According to it, only $200 million of the $1.3 billion capital program can produce productivity gains. The remainder is for substations and facilities that have become old, less reliable and need to be replaced.

The Company also criticizes the NYC Government Customers for not comparing the programs presented in this rate filing with the programs included in the last rate case. According to Con Edison, the City’s analysis of potential productivity savings may have had more merit if such comparisons were made. And, with respect to the capital and O&M projects that will not be in service during the rate year, Con Edison believes that it is premature to use any productivity savings they may produce for ratemaking purposes here.

Finally, Con Edison points out that it will be hiring over 1000 new employees annually to replace workers who are retiring or leaving the Company for other opportunities. At this rate of replacement, more than one-half of the workforce by 2010 will have less than ten years of experience in their respective positions. According to the Company, the training it must provide the new employees, and the performance of less experienced workers, will not contribute to its productivity performance. For this reason, it does not believe that the proposed tripling of the standard productivity adjustment is warranted.

To begin, we note that the rates being established in this proceeding will only remain in effect for one year, from 2008 to 2009, unless the Commission takes steps to anticipate the costs and programs that the Company plans to implement in mid-2009 and thereafter. In this case, DPS Staff has focused only on the upcoming rate year and it has not anticipated any of the requirements for any subsequent periods.

We find that a sufficient amount of productivity has been assumed and quantified for the upcoming rate year and it is not necessary to factor any greater amounts of productivity in the calculations used in this case as has been suggested by the NYC Government Customers. The best estimate of the Company's operating and capital expenditures have been developed in this case are they are being used for the upcoming twelve-month period.

Nonetheless, we agree with the NYC Government Customers that the scale and scope of the Company's efforts should provide new and greater opportunities to produce operating efficiencies and such improvements should become apparent as the programs are implemented. In our opinion, the objective that the NYC Government Customers seek can best be achieved by examining Con Edison's operations in succeeding years when it files again to increase rates. At that time, the results that the NYC Government Customers are looking for should have materialized and they should be demonstrated in the costs that Con Edison submits when it seeks to increase its rates by as much as $335 million in 2009-10 and by $390 million in 2010-11.

Advanced Metering Infrastructure (AMI)

The Company proposes to implement its AMI plan in this rate proceeding rather than await Commission action in the AMI proceeding.[38] Given that the Company's rate plan AMI proposal is identical to its pending proposal in the AMI proceeding, Staff and CPB assert that it should be decided there, not here. NYC does not support the Staff and CPB, citing the potential delay in the installation of AMI metering, as well as its arguments that the roll-out of AMI is critical to the expansion of real-time pricing, and that both these efforts are central to Mayor Bloomberg's PlaNYC.

We find that the recent Commission decision in the AMI proceeding[39] moots the parties' arguments regarding AMI in this proceeding because it definitively establishes that AMI implementation and the treatment of related costs will be addressed in the AMI proceeding. We therefore recommend that any rate year AMI costs be removed from this rate case and, if the Commission authorizes AMI implementation and recovery of its related costs prior to its consideration of this case, the rate case could be updated, if appropriate, to reflect the outcome.

Depreciation and Amortization

The Company proposes to update the average service lives of twelve of its primary plant accounts or sub-accounts, so that eight accounts would change toward shorter lives and four would change toward longer lives. In addition, it proposes changing the majority of its primary plant accounts or sub-accounts toward higher negative net salvage factors. The Company states that the changes were developed based on current

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[38] The Company states that its proposal is consistent with its filing in Case No. 04-E-0952, In the Matter of Competitive Opportunities Regarding Electric Service, Case No. 00-E-0165, In the Matter of Competitive Metering, and Case No. 02-M-0514, Proceeding on Motion of the Commission to Investigate Competitive Metering for Gas Service (collectively, the "AMI Proceeding").

[39] Order Requiring Filing of Supplemental Plan (issued December 19, 2007).

plant mortality studies (Exhibit 41) and are intended to reflect the Company's recent removal cost experience.[40]

With respect to the contested average service life selections, Staff agrees that a shorter average service life is appropriate for two accounts, but contends that the Company has lowered the lives too far; for two different accounts, Staff would leave the service lives unchanged and on two other accounts, Staff would increase the service lives. With respect to the contested net salvage factors, while both Staff and the Company agree that the net salvage factors should be increased, Staff argues that the Company's increases are overstated.
The following chart illustrates the differences between the Company and Staff on these contested issues:

Account	Current Service Life	Company Proposal	Staff Proposal
9514 – Structures and Improvements	65	40	55
9526 – Misc. Power Plant Equipment	50	40	45
9534 - Station Equipment	50	45	50
9565 – Line Transformers	35	30	35
9567 – Underground Services	70	70	75
9576 – Underground Street Lighting and Signal Systems	65	65	70

Account	Current Net Salvage Factor	Company Proposal	Staff Proposal
9534 - Station Equipment	-20%	-30%	-25%
9554 – Station Equipment	-20%	-30%	-25%

Staff's recommendations would decrease the Company's proposed increase of $48.2 million (annual) depreciation to $38.0 million and use of its recommended depreciation factors

[40] Con Edison Initial Brief at 286-287.

would result in a deficiency in the theoretical depreciation reserve for Electric Plant of $533.9 million or minus 14.38% as compared to the Company's proposed $626.7 million or minus 16.46%. Staff also recommends the $533.9 million deficiency be amortized and recovered over fifteen years, as proposed by the Company, thus equating to an annual increase in depreciation expense of $35.6 million rather than the Company's proposed annual increase of $41.8 million.[41] Staff bases its recommendations on its review of Company's summarized property mortality study (Exhibit 41), workpapers that were based on 2005 Mortality supplied by Company Witness Hutcheson, the results of the Company's 2002 Electric and Common Utility Plant Mortality Study provided in the Company’s last electric rate case, and two addition sets of studies that were provided in Exhibit 41. Staff states that it used many more factors to develop its proposed depreciation parameters, and it asserts that the resulting parameters fully support its proposed service lives and net salvage factors.[42]

In contrast to both the Company and Staff, the City and Westchester propose to modify the approach to recovery of net salvage. The Company currently recovers net salvage on an ongoing basis. The City recommends that the Company amortize the actual cost of negative net salvage over a 10 year period after it is incurred. The City argues that the Company’s method of recovering net salvage from customers is unduly burdensome for customers and cannot be justified. It states that the current system is inequitable because it almost always results in the installation of a new asset to serve a new generation of customers and the prior generation being required to fund the siting of such assets through negative net salvage.[43] The City also argues that the current practice is impractical, requiring

[41] Tr. 3921.

[42] Tr. 3925-3928; Staff Reply Brief at 58-66.

[43] The County also makes this argument. County Initial Brief at 18-19.

decisions based on projections that are so far in the future that the projections become meaningless. In addition, the City argues that the Company's approach penalizes those customers who contribute to the assets in early years because they pay more for the asset by virtue of being required to provide a return on the nearly un-depreciated asset. The City asserts that its proposed approach eliminates the guesswork regarding which assets will result in negative net salvage and what the amount will be. The County argues that the extraordinary amount of the requested rate increase should prompt the consideration of all alternatives to aggressively reduce rates, one of which is funding negative net salvage by expensing current costs. It, along with the City, argue that their proposals would not (financially) harm the Company or jeopardize safety or reliability and that they fully accord with principles set forth by NARUC. It characterizes Con Edison's objections to its proposal as either untrue or incorrect.[44]

CPB recommends that Con Edison's proposed depreciation changes not be adopted. CPB states that the Commission has considerable discretion regarding the calculation and timing of the recovery of the utilities' depreciation expense. Based on its assertions that (1) denial of the Company's proposed changes would result in an accumulated depreciation reserve deficiency of less than 8% of the total reserve for depreciation, (2) the extremely large requested rate increase would have significant rate impacts, and (3) there is a lack of a capital recovery crisis or other compelling need to increase depreciation expense now, CPB argues that the Commission can and should reject the Company's proposed increase thereby decreasing projected depreciation expense by approximately $87 million.[45]

NYPA argues that the requested increase in depreciation expense is unjustified and the removal costs are

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[44] NYC Initial Brief at 7-12 and Reply Brief at 16-19; County Initial Brief at 15-19.

[45] CPB Initial Brief at 90-91.

uncertain. NYPA proposes that the removal costs be capitalized when incurred, so that they will be known and verifiable. It adds that most of the removals are being coupled with and are sometimes driven by needed replacements or upgrades and therefore can be considered cost of the new equipment. In recognition of these factors, NYPA asserts that the recovery of negative net salvage in the manner that Con Edison has previously used and proposes to continue is not compulsory, and should be rejected here, especially when coupled with its “outsized” request for a rate increase.[46]

The Company argues that Staff’s proposals must be rejected. The Company states that its recommendations were guided by its interpretations of the current plant mortality study, adjusted to remove the actual historical retirement experience, while Staff relied on the unadjusted current plant mortality studies, as well as two other outdated plant mortality studies. By doing so, the Company asserts that Staff erred because such studies are inherently inaccurate as they fail to exclude the major retirement history related to the transfer of production plant from the Company’s electric department to its steam department. With respect to Accounts 9567 – Underground Services, and 9576 - Underground Street Lighting and Signal Systems, the Company proposes to leave the existing service lives unchanged because it reasoned that infrastructure work being performed on the underground system will result in retirements in the near future that will tend to decrease lives going forward and, given the already very long lives for these accounts, it is not appropriate to continue to increase them.

The Company urges the rejection of the City’s and Westchester’s net salvage proposal, stating that they are transparently results-oriented recommendations that will create intergenerational inequities and will result in levels that are inadequate to cover the amounts the Company has recently expended on net salvage. The Company argues that by failing to

[46] NYPA Initial Brief at 20-21.

allow the Company at least current recovery, the City and Westchester proposals serve to increase depreciation related costs that will need to be recovered in the Company’s next electric base rate case and well beyond. In contrast, the Company argues that its proposals will avoid intergenerational inequities by fairly providing for payment by current customers of a small portion of the negative net salvage each year over the life of the plant, while that plant is providing service and benefits to those same customers today. In addition, the Company notes that the City’s witness acknowledged that the Company’s current treatment of net salvage “is widely used in the utility industry” and further stated that he is not suggesting that the Commission ought to change its practice with respect to net salvage for utilities other than Con Edison.

With respect to the CPB and NYPA proposals, the Company argues that neither party has based its proposal on any methodological disagreement with the Company. The Company states that CPB is apparently motivated by its view that the Company’s need for depreciation-related changes proposed in this case is not sufficient to justify the resulting rate increase for consumers. It states that NYPA’s proposal would exacerbate intergenerational inequity and violate the Uniform System of Accounts. In any event, the Company argues that neither party’s proposals can stand against the Company’s proposals which are based on the plant mortality studies which support a finding that current service lives and net salvage factors are not adequately providing for the proper levels of depreciation expense and provide a sound and reasonable basis for the Commission to approve the Company’s proposed depreciation changes.[47]

We find that Staff’s consideration of additional historical data and studies provides a preferable basis to use for setting the service lives and negative net salvage for the contested accounts here at issue. Accordingly, we recommend

[47] Con Edison Initial Brief at 287-293; Reply Brief at 107-110.

that the Company's proposed changes be implemented for the uncontested accounts and that Staff's proposed changes be implemented for the contested accounts.

Normalizing and Other Adjustments

LIC Capital Costs

The Company includes in its capital expenditures, depreciation amounts and carrying costs, the costs associated with the repair, replacement, restoration and planned work for Long Island City after the outage that occurred in July 2006 in portions of that network. Staff objects to the inclusion of these costs in the rate year because they are the subject of a pending Commission prudence proceeding. Staff therefore recommends that Con Edison (1) remove all costs related to the Long Island City events from this rate case and (2) reverse the application of credits on Long Island City related carrying costs pending resolution of the prudence review. Staff also recommends that the Company be allowed to defer (1) carrying charges on the $53.59 million net plant balance at the authorized cost of capital rate that is determined appropriate by the Commission in this case, and (2) depreciation accruals of $1.05 million annually on Long Island City investments.[48] The Company does not object to Staff's proposed rate treatment. We recommend that the Staff proposal be adopted.

Program Change for Employee Payroll

CPB proposes a $2.45 million adjustment to the Company's total program change request of $49 million, stating that the Company was not clear regarding the number of employees being requested to fulfill the various proposed program changes and that the Company-provided exhibits contained detail that was

[48] Staff proposes that the deferrals continue until such time as the prudence determination regarding the investments is made by the Commission but notes that, if the prudence review is concluded prior to Commission consideration of this case, it would support an update to reflect the outcome.

insufficient to reconcile and/or link the additions to the program change or normalization.

The Company argues that the CPB adjustment is improper. It asserts that it provided comprehensive support for its program changes and normalizations and these changes cannot be rejected based upon “belated and unfounded” claims by CPB that it did not receive adequate information or improperly formatted information. The Company contends that its workpapers explained the program and the number of employees associated with the program change and fully documented the need for additional employees.

We find that there is a rational record basis for the Company’s proposed expenditures and therefore we recommend that the CPB’s adjustments to employee payroll not be adopted.

Overtime

The CPB proposes two adjustments to the Company’s level of overtime, reducing the escalation applied to electric operations overtime and removing 10% of the payroll to reflect the Company’s expected workforce additions and to eliminate some overtime for unusual storms. CPB argues that the Company did not justify the increase in compensatory time and overtime, and that management needs to analyze the cause of overtime. The Company notes its testimony that employees receive annual increases and overtime therefore increases at the same rate of salary increase and that much of the overtime associated with storm costs were normalized out of the rate year. In response to CPB’s suggestion that the additional work force will decrease the level of overtime, the Company cites its testimony that (1) overtime and compensatory pay will be required at some level, (2) the additional personnel proposed in this rate filing are intended to address new initiatives and programs, not to decrease overtime levels, (3) compensatory overtime was a necessary cost of doing business and that it places entry or low level management employees “on par” with weekly employees, and (4) the Company is replacing significant numbers of long-term employees with people who have very little experience and who need time to "get up to speed." The Company argues that overtime level is not expected to decrease in the rate year and that CPB conceded that it made its adjustment to overtime without determining what steps the Company takes to analyze overtime.

We find that there is a rational record basis for the Company's proposed expenditures and therefore we recommend that the CPB's adjustments to overtime not be adopted.

Reserve Accounting For Storms

The Company proposes that $8 million be included in the rate year to cover storm costs ($2.4 million in storm mobilization costs and $5.6 million to fund a storm reserve for significant storm activity of Category 2 or higher storm events). The Company proposes to true-up these costs at the end of either a one-year or a three-year plan, stating that, if the spending level does not reach the $8 million amount, a regulatory asset would be created, and a regulatory liability would be created if the spending were greater than $8 million. The Company notes that the number and level of storms is completely out of its control and that the Commission has authorized storm reserves for other New York State utilities, including National Grid, New York State Electric and Gas, and Orange and Rockland Utilities. No party suggests that the storm reserve not be established, however, CPB proposes that the reserve be funded at $5 million instead of $8 million. CPB bases its adjustment on information provided to it by the Company, testifying that the information revealed that, once the usual storm costs of 2006 were excluded, storm costs exceeded $5 million only two other times in the last 15 years. CPB adds that the Company's estimate of $2.4 million for storm mobilization costs is not supported by historical data and appears overstated. CPB questions the $4.1 million portion of the reserve allocated for "level 3" storms, stating 60% of them were "level 3A" and resulted in an average cost of $2.2 million and the remaining “level 3” storms occurred approximately once every three years and could be addressed in a deferral request rather than being built into rates.

We find the CPB’s arguments persuasive. The appropriate amount for the storm reserve may have been overstated as a result of reliance on storm events experienced in 2006, which both the Company and CPB acknowledge was an extraordinary year for storm costs. Accordingly, we recommend that the Company be permitted to establish a storm reserve in the amount of $5.6 million dollars, and subject to true-up, and to accrue interest.

Infrastructure

The Company’s Transmission and Delivery projects increased O&M expenditures, excluding interference work, by nearly $100 million in the rate year. Substation Operations projects will support new substation facilities and a structural integrity/station betterment program. System and Transmission Operations increase expenditures over a wide range of programs, notably improving overhead transmission restoration capability, manhole inspection and refurbishment, and several advanced technology programs, including maintaining the Company’s alternate energy control center.

The bulk of the increased O&M programs are in Electric Operations. Notable are unit substation repairs and inspection, maintenance of remote monitoring systems, underground structure inspection program, overhead inspection program, stray voltage testing, network transformer vault cleaning, line clearance, removal of double wood poles, additional line clearance made necessary by the Greenburgh Tree Law,[49] and maintenance associated with capital work.

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[49] Expenses of $6.1 million were submitted in an update, to comply with a law passed in the Town of Greenburgh in June 2007. Because the passage of a law is an event over which the Company has no control, the update will be accepted under the Statement of Policy on Test Periods.

The Company’s proposal includes 44 new programs in which the Company spent zero dollars in 2006. These new programs total $36.4 million in cost.[50]

Staff recommends no reduction to the funding for the Company’s infrastructure programs. Staff expresses reservation regarding the large increases in inspection programs and stray voltage testing. Staff reserves a recommendation, however, explaining that any changes to the operation of these programs should be handled under Case 04-M-0159.[51]

Staff also expresses reservation concerning the Company’s proposal for mobile stray voltage testing. Staff explains that, based on the frequency of vehicular usage, the funding request for standby cost may be unreasonably high. Staff does not recommend an adjustment, but rather recommends that Con Edison be required to file a report reassessing the expenses of the program as related to the program’s standby cost and reassessing its current operation to optimize utilization of its current fleet of vehicles. Staff recommends this report should be filed with the Department within two months of the Commission’s order adopting a rate plan in this case. Any decreases in program costs resulting from the Company’s reassessment should be credited to customers and if the Company fails to reassess its costs adequately, funding for the program should be credited to customers. Staff’s proposal regarding the report and reassessment should be adopted.

The New York Power Authority observes that Con Edison’s distribution O&M has grown at a rate higher than peer utilities, and supports NYC’s argument that a larger productivity adjustment is warranted. NYPA recommends that Con Edison’s proposal to add O&M expenses be reduced by half.

The County of Westchester argues that the Company has deferred O&M projects until the rate year in order to maximize

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[50] Exhibits 122, 125, 127.

[51] Proceeding on Motion of the Commission to Examine the Safety of Electric Transmission and Distribution Systems.

its allowed expenses. The County identifies programs with a five-year maintenance cycle in which the Company chose the rate year to incur expenses. Given the large number of O&M programs, two examples do not indicate a pattern.

There is nothing per se improper in the Company waiting for a rate case to propose new expense categories, unless the delay impaired safety or reliability.[52] The fact that the Company has proposed 44 new categories of O&M spending does indicate that the timing of at least some of these categories is discretionary. Therefore, although Staff and the Company concur that all of the proposed programs are necessary, it would not be unreasonable for the Commission, for purposes of mitigating rate shock, to impose a percentage adjustment and require the Company to prioritize among its proposed programs. We do not recommend a flat percentage adjustment to the O&M budget at this time, lacking specific evidence of programs that are unnecessary or unlikely to be implemented.

CPB recommends a number of specific adjustments to the transmission and distribution O&M budget:

1. Underground Inspection Program

The Company projects rate year costs of $35 million for its five-year underground inspection program. CPB recommends that this sum be reduced by $19 million. The Company must conduct 275,000 inspections over a five-year period; 44,728

[52] It is notable, however, that during the six years from 2000 to 2005, while the Company was overspending its capital allowance by $1.2 billion, it only overspent its expense allowance by $13 million. (The cost to the Company of overspending the capital allowance is foregone carrying charges, while the bulk of expenditures will be recovered in time. Expenses in excess of rate allowance are simply lost to the Company.) The disparity between overspent capital and O&M does indicate the possibility that the Company deferred necessary O&M programs. No direct evidence indicates that this has occurred or, if it did, that this has resulted in any detriment to customers.

inspections were conducted in 2005 at a cost of $8.5 million and 45,067 in 2006 at a cost of $11.1 million.[53]

The Company projects that it will conduct 75,447 inspections in the rate year at an average cost of $463.92 per inspection. The average cost of an inspection was $190.04 in 2005 and $246.30 in 2006. The Company explains that the increase in cost per repair is due to the increased number of repairs directly related to safety inspections, as opposed to inspections performed in the course of normal maintenance. In 2006, approximately 50% of inspections and repairs were completed during normal maintenance. In the rate year, inspections and associated repairs will be performed beyond the scope of normal maintenance work, increasing the incremental cost per inspection.

CPB observed that, assuming the 2005 figure reflects only the lower cost inspection incurred during normal maintenance, the 30% increase in cost per inspection from 2005 to 2006 suggests that the cost of the direct inspections is approximately 60% above the average per-inspection costs of 2005. This would result in an average per-inspection cost of $319.20, substantially less than the Company's projection of $463.92 per inspection. The Company has also not explained why it proposes 75,447 inspections in the rate year and approximately 55,000 inspections in the following two years. CPB notes Con Edison testimony that an incremental 50,000 inspections are required and CPB suggests that the expenses allowed for the rate year be limited to 50,000 inspections at an average of $319.20 per inspection. Neither the Company nor Staff rebuts CPB's argument in their briefs. In the absence of any rebuttal, we find CPB's calculation of an average cost per inspection at $319.20 to be reasonable. Regarding CPB's

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[53] The Company appears to have presented an erroneous figure for the 2006 costs in response to a CPB interrogatory. Exhibit 215, CPB 2(d). The sum of $11.1 million is provided in the Company's own exhibit and workpapers. Exhibit 127.

proposal to reduce the inspections in the rate year, a reduction to 50,000 would leave 135,000 inspections to be performed in the following two years. We recommend an assumption of 60,000 inspections at an average cost of $319.20, for a rate year total of $19,152, a reduction of nearly $16 million from the Company's projection.

We recognize that the underground inspection program is included in the category of public safety expenses, upon which Staff reserves its recommendation, to be considered under Case 04-M-0159. Generally we concur with Staff's recommendation to consider the stray voltage detection and electric facility inspection programs in the context of that proceeding, with a provision for credit for customers in the event of a cost disallowance. In this instance, however, considering the unrebutted evidence presented by CPB and the need for the Commission to mitigate the rate increase, we recommend that the $16 million adjustment be adopted in this proceeding.

2. Distribution Line Clearance and Danger Tree Removal

The Company's initial testimony explains that in early 2007, the minimum allowable distance between electrical lines and tree branches was increased. The Company projects $13.755 million in expense for its line clearance program, an increase of $4.255 million from anticipated spending in 2007. The Company's spending in this category in 2006 is unclear. Information provided in its filing indicates that it spent $5.76 million[54] while information in response to an information request indicated that it spent $10.092 million.[55] Assuming the higher figure provided in the information request, the Company's three year average was $8.025 million per year. CPB recommends an adjustment based on the three-year average. The Company and Staff provide no rebuttal. In the absence of any Company rebuttal of CPB's adjustment, we recommend the Company's rate

[54] Exhibit 127.

[55] Exhibit 215.

year allowance for this program be limited to the $9.5 million estimated for 2007, adjusted for inflation.

Regarding the danger tree removal program, CPB argues that Con Edison's cost of removal per tree is more than twice the cost estimate used in Vermont. Because no basis for cost comparison between Vermont and Con Edison's service territory has been established, we recommend CPB's adjustment for danger tree removal be rejected.

3. Double Wood Program

The Company projects $5.235 million for this program, an increase of 489% over the test year cost. In 2004, the Company incurred no costs for removing double wood and it spent $951,000 in 2005, $889,000 in 2006, and budgeted $900,000 in 2007. CPB recommends a complete disallowance in costs.[56] The Company provides no rebuttal. The Company's initial testimony explains that municipalities require removal, but does not identify any recent developments that explain an acceleration of the program. Removal of double poles, while important, does not appear to be an urgent priority of the Company. We recommend an allowance of $1 million for the rate year, a slight increase over the average from previous years.

4. Various Programs Alleged to be Unsupported

CPB identifies numerous programs for which, it claims, Con Edison did not provide sufficient documentation and support in response to discovery requests. These include requests for five years of data, and for supporting documentation including invoices and quotes. The Company responds that CPB did not raise any objections, either formally or informally, during the

[56] CPB also supports its adjustment by noting confusion between the Company's forecast of replacing 2,250 poles in the rate year at a cost of $2,300 per pole, versus its discovery response citing costs per pole of $4,445 and planned replacement of 930 poles during the rate year. The remedy for such confusion is further discovery, not a flat disallowance of costs.

discovery process and therefore CPB's proposed adjustments should be rejected. We agree with the Company. The discovery process contains methods for parties to obtain clarification, including informal discovery and appeals to the presiding officers. Without a demonstration of extraordinary circumstances, CPB's argument that Con Edison was not responsive to discovery requests will not result in adjustments where CPB did not exhaust its remedies in the discovery process.[57]

Electric Production

The Company proposes a number of O&M program changes to its electric production category, increasing projected spending in these areas by approximately $7 million. Some of the program changes include additional spending for facilities maintenance, gas turbines and preventative maintenance.

Staff proposes one adjustment, to remove the double count of inflation contained in the Company's request, reducing water expense by $35,000. Though the Company did not originally object to this adjustment (the costs were inadvertently escalated twice), it asserts that, since its rebuttal testimony was filed, the City has announced yet another double-digit increase in water rates. It claims that this increase will bring the rate year water expense closer to the level the Company's initial request. Staff replies that since the Company offers no details or evidence regarding the City-proposed water rate increase, the parties and the Commission cannot assess what impact, if any, the City's proposal will have on the rate year water expense. Therefore, Staff asserts that its adjustment which is factually supported by the record should be adopted.[58]

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[57] The expense categories include system and transmission O&M, support economic growth, overhead inspection program, annual stray voltage, network transformer volt cleaning, maintenance associated with capital work, and facilities expense.

[58] Con Edison Initial Brief at 167-168; Staff Initial Brief at 62-63 and Reply Brief at 26-27.

CPB proposes adjustments to the Company's proposed program changes for preventative maintenance, gas turbine maintenance and facilities maintenance. It argues that adjustment is warranted due to the Company's failure to provide five years' historical information and because the proposed spending greatly exceeds historical spending and is unnecessary. CPB expresses concern that preventative maintenance costs were deferred or minimized in anticipation of this rate case. It therefore recommends that rate year preventative maintenance spending be limited to the three-year spending average (a reduction of $876,000). CPB asserts that the Commission should reject the proposed incremental gas turbine spending ($2.244 million) because it far exceeds historical spending levels. If such increase is allowed at all, CPB asserts that it should be capitalized because cross-examination revealed that this type of maintenance would restore plant output that would otherwise have been lost.

Finally, with respect to facilities maintenance, CPB proposes that the Company projection be reduced by $1.272 million, to a level reflective of its average spending in the years 2004-2006 because the proposed increase far exceeds historical spending and was not sufficiently justified by the Company.[59]

The Company argues that CPB's adjustments should be rejected. It contends that its testimony explains the basis for the proposed increases. It adds that CPB's claim that the gas turbine work should be capitalized is incorrect because the work being performed is for various activities, including, but not limited to removal and replacement of the engines, and inspection and repair of electric generator rotors and associated equipment, all of which are considered O&M and not capital, as it is not designed to extend the useful life of the equipment, and is required to be so treated by FERC. The Company claims that CPB's proposed adjustment to preventative

[59] CPB Initial Brief at 78-81.

and corrective maintenance has no justification or basis and would yield an anomalous result in that use of a three-year average would result in a spending that is below the level of expenditures the Company made in total in the historic year for these two categories. It adds that its discovery and rebuttal testimony explained that the corrective maintenance expenditures remained flat in the rate year and that this work was needed to support the reliability of station equipment. Finally, regarding CPB’s proposed facility maintenance adjustment, the Company refers to its testimony, stating that it explains why and when such work is performed, which in turn explained the lower historical level of spending and demonstrated that CPB has no basis for of its proposed electric production adjustments.[60]

We find that, with the exception of water expense, the Company has demonstrated a sufficient record basis for adoption of its proposed spending levels. However, as the Company offers no details or evidence regarding the City-proposed water rate increase, we recommend that Staff’s adjustment to the Company’s proposed rate year water expense, which is factually supported by the record, be adopted.

RATE BASE

Production

The Company’s Electric Production Construction Program provides the expenditure requirements for maintaining the infrastructure and systems of the Company's electric generating stations and establishes capital expenditures for functional programs relating to Environment, Health and Safety ("EH&S"); boilers; steam turbines; mechanical equipment replacement; electrical equipment; control systems; structures; waterfront; roofs; and security. According to the Company, past experience has shown that improvements and capital expenditures in each of these functional areas are required for continuous safe,

[60] Con Edison Initial Brief at 168-170; Reply Brief at 56-57.

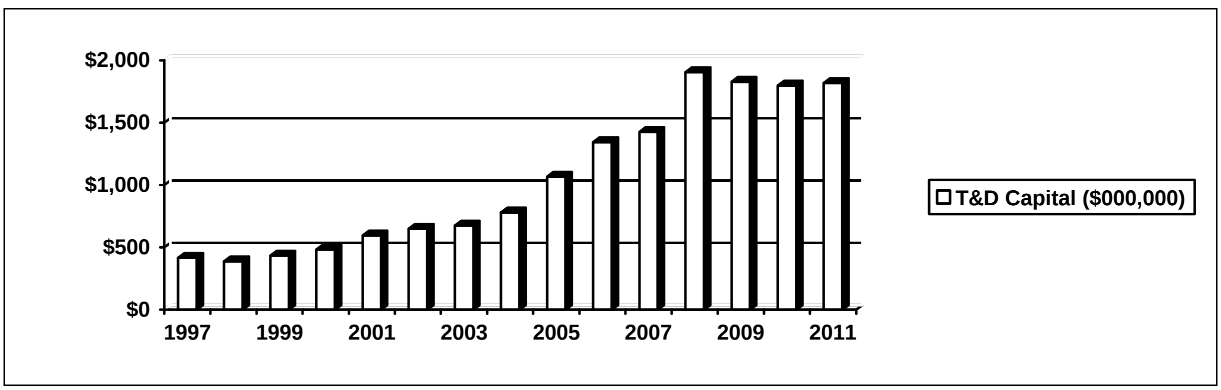
reliable, and efficient plant operations and the selected functional programs address areas of the station that require improvement. The Company's projected capital expenditures for these functional areas total $36 million and $39.7 million, respectively, for 2008 and 2009. The breakdown of projected expenditures by functional areas in 2008 is as follows:

- Environment, Health and Safety - $2.6 million (EH&S projects address conditions that could pose an EH&S risk, such as asbestos abatement, or address regulatory requirements such as fish life preservation).
- Boilers and Steam Turbines - $1 million (for refurbishment of boilers and turbines to maintain rated electrical output and equipment reliability).
- Mechanical Equipment Replacement, Electrical Equipment, and Control Systems – $5 million for the Mechanical Equipment program, $5 million for the Electrical Equipment program and $12 million for the Control Systems program (a group of projects required to address age-induced degradation, obsolescence, malfunction, and failures that might otherwise contribute to plant unavailability and unreliable operations; includes the replacement and improvement of mechanical and electrical equipment, and the replacement and upgrade of control systems).
- Roofs, Structural, and Waterfront – $6.25 million for the structural program, $2 million for the Waterfront program, and $0 (significant work was completed in 2007) for the Roofs program (these programs provide for general improvements to the East River facility that, if left unaddressed, could create unsafe conditions to plant staff, and result in restricted access to plant areas as well as potential damage to plant equipment and structural integrity, address improvements to piers, docks, and related facilities and systems, and provide for replacement and refurbishment of roofs and roof drains).
- Security - $1.6 million (for projects to upgrade and integrate the security systems, restrict access and provide effective surveillance of the East River Generating Station and Substation Complex).

Based on the record evidence indicating that the proposed expenditures will facilitate the provision of safe and adequate service, we recommend that the Company's projected capital expenditures for these functional areas for the year 2008, totaling $36 million, be adopted.

Transmission and Distribution Capital Program

The Company presents a plan for spending $1.819 billion on Transmission and Distribution (T&D) capital projects in 2008. The plan is unprecedented in size and scope. From an average of under $450 million per year from 1997 through 2000, the Company's proposed capital spending has accelerated to over $1.8 billion – approximately a 400% increase. The level of spending is forecast to dip only slightly in 2009-2011, and the Company does not anticipate a significant reduction in capital needs in the years following 2011.



The Company generally attributes this trend to three developments: growth in demand, the aging of the Company's infrastructure, and the cyclical nature of large transmission-level and substation capital projects.

The Company identifies six general themes into which the new T&D expenditures fall: Support Economic Growth, Improve Reliability, Environment and Public Safety, Storm Hardening, Advanced Technology, and Process Improvements.

	Substations		Transmission		Distribution	
($000) 2008[61]	Capital	O&M	Capital	O&M	Capital	O&M
Support Economic Growth	453,300	4,700	37,400	100	339,500	1,600
Improve Reliability	141,000	40,000	185,100	5,600	533,900	10,700
Environment and Public Safety	13,600	600	1,800	2,700	21,500	73,600
Storm Hardening	-	-	-	900	44,200	32,900
Advanced Technology	-	1,300	-	6,400	41,100	-
Process Improvement and Security	4,100	-	-	500	3,500	13,000
Totals	612,000	46,600	224,300	16,200	983,700	131,800

1. Support Economic Growth

The Company's budget for 2008 includes expenditures for new construction efforts at eleven substations and switching stations as well as the addition of capacity at existing substations. Substation investment is driven primarily by growth in demand, as load growth reduces available margins of unused substation capacity. The Company went through an extended period in the 1990s when no new substations were constructed.

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[61] Exhibits 130, 132, 133. Capital expenditures for the rate year ending March 31, 2009 are estimated to be $536 million for Substations, $271 million for Transmission, and $988 million for Distribution, excluding the Company's August 2007 updates. Exhibit 273, p. 143.

This category might more accurately be called "Accommodate Demand," because some of the projects relate to existing load rather than new development. The retirement of the 885 MW Poletti Generating Station in 2010 will leave the 13th Street load pocket in need of support. The Company intends to install a new 345 kV connection to the Astoria Switching Station. The Company is also using targeted energy efficiency measures to defer spending on this project.

Load growth on the distribution system will be addressed with a large number of projects to install, reinforce, and upgrade primary network feeders, transformers, underground secondary cable, radial system cables, and load transfers among networks, at a projected cost of $339.5 million in 2008.

2. Improve System Reliability

Needs in this category are dominated by the aging of Con Edison's infrastructure. Most of the Company's switching stations and substations are over 40 years old and require periodic replacement and/or upgrade of major components. Transmission needs include construction of the 345 kV M29 feeder and the Academy switching station, which will address issues of reliability and load growth. Various smaller projects involve the replacement of failed and aging feeders and associated equipment.

Principal programs for distribution system reliability are continued replacement of paper insulated lead-covered ("PILC") cable and associated stop joints, replacement of transformers, repair and replacement of feeders, testing feeders, and repair and replacement of secondary mains, as well as modernization of distribution substations.

In 2004, the Company began taking a more proactive approach to upgrading its secondary system. The Company acknowledged that prior to 2004, it had a "replace upon failure" approach to the secondary system. The Company's new approach is to replace degrading equipment prior to failure.

3. Public Safety and Environmental Improvements

These programs address ventilation of combustible manhole gasses, reduction of oil and dialectric fluid leaks, and stray voltage isolation transformers to increase safety of street lights.

4. Overhead Distribution System Storm Hardening and Response

These expenditures are designed to make the overhead distribution system more resilient. They include replacing obsolete switching systems and sectionalizing feeders to allow enhanced isolation of faults and reduce the number of customers affected by outages.

5. Advanced Technology

Generally, the programs categorized as Advanced Technology enhance the Company's ability to monitor and analyze system conditions from central locations, and to better coordinate workflow.

6. Process Improvement and Security

Process Improvement expenditures for the rate year are designed to increase productivity in mobile dispatching and automated customer communications, as well as enhancing the manner in which overhead transmission lines are maintained through training programs. Security Enhancement will provide for installation and upgrading of security systems at substations.

General Positions of the Parties

No party questions the need for the Company to engage in major improvements to its T&D infrastructure, and no intervenor challenges the importance of any specific project.

Staff did not find any of the Company's proposed expenditures to be unnecessary or unreasonable, although Staff questions some of the budget levels based on past spending performance. In order to mitigate rate impacts, Staff proposed a number of adjustments to revenue recovery in this proceeding, based on a category-by-category review of the Company's system needs and the proposed budget. The overall effect of Staff's recommendation is a 12% reduction in capital spending.

The City of New York, County of Westchester and other intervenors argue that the proposed rate increase is simply too high to be just and reasonable. NYC supports downward adjustments to the proposed revenue requirements, to the extent consistent with safe and reliable service. Westchester argues that special scrutiny of the extraordinary capital expenditures is warranted and that the Commission needs to send the Company a signal that constraint on spending is at least equal to the need to improve infrastructure.

The County claims that Con Edison has a motivation to expend huge sums beyond its public obligation to provide just and reasonable service. According to the County, presentations made by the Company to the investment community indicate a policy to create growth and earnings by investing in more plant. The County proposes that Con Edison's T&D plant in service additions be limited to the rate of spending of 2005 and 2006.

The New York Power Authority notes that Con Edison has added proportionately to its capital base more than any other large company in the industry. NYPA cites testimony of a Company witness to the effect that in considering construction projects, the Company has no internal corporate limit on rate increases. NYPA recommends a reduction of one-third of the allowed infrastructure investments, arguing that unless the Commission acts to curb Con Edison, the Company's spending on infrastructure will be unrestrained.

NYPA challenges Con Edison's justification for its spending program, demonstrating that projected sales growth falls below national short- and long-term averages. NYPA refers to the Company's exhibit that demonstrates high levels of reliability and argues that this removes another possible justification for a construction program of the magnitude that is proposed. As an alternative to a cut of one-third, NYPA recommends the Commission adopt a cap of an average 8% growth in T&D rate base per year.

The New York City Housing Authority states that it is unable to absorb the rate increase proposed by Con Edison.

The Consumer Protection Board recognizes that consumers benefit from prudent and cost-effective capital spending, but is concerned that Con Edison has the incentive and the opportunity to undertake capital expenditures that are not required, and to implement infrastructure projects in a manner that is not cost effective. CPB charges that the Commission's oversight and regulation of Con Edison's infrastructure spending in the last decade has not been satisfactory and that the procedures used by the Commission to review Con Edison's construction program activities should be overhauled.

CPB questions whether Con Edison can complete all of its proposed T&D capital projects on the schedule it has identified. CPB argues that the Company's proposed increase in workforce is not proportional to its increase in capital spending. To the extent that capital projects are executed by outside contractors, CPB notes that the Company does not track the cost of internal versus contractor labor to help determine which is more cost effective.

CPB recommends that Con Edison's T&D capital spending proposal be reduced by approximately 20% and that if the Company's expenditures are less than the sum included in rates, the difference should be deferred and credited to customers. CPB notes that with a 20% reduction in its proposal, Con Edison would still recover for spending that was 12% greater than the amount presented to its Board of Directors in January 2007.

Proposed Adjustments in Transmission & Distribution Capital Budget

NYC, the County, CPB, and NYPA recommend that the Commission impose a straight percentage reduction in the Company's capital spending allowance, or a cap, in order to maintain just and reasonable rates. These parties are correct that the rate of increase in the Company's capital budget is extraordinary. They are also correct that it warrants the strictest possible scrutiny from the Commission.

These parties have not, however, provided the Commission with a specific analytic basis for a percentage adjustment to capital spending. The parties are correct that at some point, marginal gains in reliability are outweighed by the need to maintain rates at affordable levels. NYPA points out that Con Edison's historic performance supports a conclusion that the Company is not facing a reliability crisis. But in the absence of a detailed review of Con Edison's construction plan, these remain theoretical observations. They do little to rebut the evidence presented by the Company and Staff that the large majority of the Company's construction program is necessary to maintain the high levels of reliability required by the residents and businesses in the service territory.

Staff's recommended adjustments are based on a category-by-category review of the Company's system needs and the proposed budget. Although Staff did not find any of the Company's proposed expenditures to be unnecessary or unreasonable, Staff proposed a number of adjustments to revenue recovery in this proceeding. The majority of Staff's adjustments are based on an analysis of historic spending levels, compared to the spending proposed by the Company for the rate year. Several of Staff's proposed adjustments are grounded in the claim that the programs, though important, must be deferred to mitigate the rate impact of the current spending program.

Transmission and Switching Stations

The Company's proposed capital budget for the rate year is approximately $262 million, nearly double its current forecast budget of $137 million for 2007. Staff argues that the Company's budgeting performance relative to its actual expenditures in this category has been poor, with actual expenditures ranging from 64% to 49% of budget forecasts. Utilizing historical data, Staff derived a ratio of 58.44% and, applying this ratio to the Company's budget forecasts, Staff recommends a budget allowance of $153 million for the rate year. Staff notes that it is not averaging past amounts in deriving an allowance level, rather it is assessing the Company's forecasting proficiency. Staff states that because there is no evidence that the Company has improved its ability to accurately forecast expenditures for this category, past performance is a reasonable indicator of future results.

The Company argues that Staff's historically-based reduction approach could be used for high-volume and repeatable programs, but should not be applied to transmission activities which involve large projects with service dates defined by system need. The Company claims that factors largely out of its control can cause specific projects to be deferred and thereby decrease the spending scheduled for that year. The Company uses the $300 million M29 project as an example, stating that the beginning of construction was delayed due to requirements associated with the Article VII approval process.

Con Edison further argues that because the M29 project must begin construction in 2008, Staff's recommendation will "essentially stop other transmission work."[62] The Company argues that Staff's adjustment would leave no additional capital funding in 2008 to start the East 13th Street load-pocket relief project, the phase-angle regulator project for the West 49th Street switching station, and other non-discretionary projects.

Staff counters that the Company would not be prohibited from making necessary investments. To the contrary, if the Company determined that it needs to invest more than the allowed amount to provide safe, adequate, and reliable service, it would be obligated to do so. The Company would then include such completed projects in rate base in the Company's next rate case filing.

Staff's rebuttal of the generalized cuts proposed by CPB and other intervenors is based on the premise that specific

[62] Con Edison Initial Brief at 68.

reviews are needed to substantiate adjustments. In the category of transmission projects, the Company is correct that Staff's historical review does not sufficiently take into account the impact on individual large projects. A review of the proposed spending in this category reveals that nearly half of the spending is attributed to one project – the M29. Staff's proposed adjustment should have taken this into account. We recommend that the $130 million allocated to the M29 project be excluded from Staff's adjustment and that Staff's proposed ratio of 58.44% be applied to the remainder of the Systems and Transmission Operations category.

Astoria Generating Company notes that Con Edison's East 13th Street project will be used to replace the support for the East 13th Street load pocket that would be lost upon the planned retirement of NYPA's 885 MW Poletti generating station. Astoria argues that Con Edison should be given sufficient funding and directed to complete the project as close to Poletti's January 31, 2010 retirement date as is possible. It urges that Con Edison should be directed to submit a project timeline with milestones and provide quarterly status reports.

Company witnesses testified that there are various means of ensuring reliability within the load pocket upon the retirement of the Poletti station. We find that the Company will be capable of balancing this need against its other priorities; therefore no special reporting requirements are warranted.

Facility Improvement Program

This program provides funding to establish permanent work locations for employees working out of temporary office locations, and also funds other large-scale improvement projects such as improvements to facades, foundations, retaining walls, floors and plumbing. The Small Capital program includes projects smaller than $500,000, while the Facility Improvement program includes larger projects. Staff recommends a reduction of $6 million, due to project overlapping between the Small

Capital program and the Facility Improvement program for projects greater than $500,000. The project list provided by the Company for the Facility Improvement program totals $14.5 million in costs, while the Company proposed recovering $6 million per year for 4 years. For the Small Capital program, the project list totaled $7 million, while the Company's work papers again proposed $6 million per year for 4 years. Because the projects listed together total approximately $21.5 million, Staff argues that the projects listed under both programs could be completed with the amount budgeted for only one of the programs. The Company responds that it has provided, in updates, additional projects bringing the total to $39.3 million. The Company notes that its response to Staff's original discovery request states that there are "a number of other candidate projects being considered for inclusion in this program that do not yet have fully developed job scopes and estimates."[63] The Company's revisions appear to be wholesale revisions and are not allowed under the Statement of Policy on Test Periods, discussed below. Therefore Staff's adjustment should be accepted.

Paper Insulated Lead-Cover Cables

Of the Company's primary feeders, 28% are paper insulated lead-cover (PILC) cables. The average age of the PILC cables is 46 years. Following the 1999 Washington Heights outage, Staff deemed PILC cables connected to sensitive stop-joints to be a reliability hazard. During the 2006 Queens outage, PILC cables contributed to 8 of the 22 primary feeder failures in the Long Island City network. Staff testified that prior to its last rate case, the Company made "minimal effort" to remove PILC cables remaining in its system. The Company responded that nearly 45% of PILC cables had been removed since 1999.

[63] Exhibit 273.

The Company now proposes to accelerate its removal of PILC cables, resulting in the date of completion moving from 2024 to 2020. Local 1-2 proposes a further acceleration of the goal. Con Edison proposes a budget of $39 million per year to achieve completion by 2020. Staff concurs that a goal of completing PILC removal by 2020 represents a reasonable balance between the factors of reliability and rate impacts. Staff proposes reducing the Company's proposed budget from $39 million per year to $33 million per year.

The accelerated goal would add 900 more sections per year. Applying the average historic cost of cable section replacements to the proposed addition of 900 per year, Staff derived a total budget of $33 million per year rather than the $39 million proposed by the Company. The Company has accepted Staff's recommended adjustment to $33 million per year, and we find this to be reasonable.[64]

Network Transformer Replacement

The Company proposed $66 million for purchase of network transformers to replace transformers operating above their ratings. Staff's testimony recommended an adjustment to $31 million, arguing that of the three categories of transformers needing replacement, the lowest (those between 100% and 115% of their normal and emergency ratings) could be deferred. Staff concedes that at some point in time the transformers operating between 100% and 115% above contingency ratings will have to be replaced. Staff's position is that replacements performed for load relief could be deferred, while work associated with emergencies and new business should go forward. On further review of its work papers, Staff concluded that adjusting only for load relief work would yield an allowance of $51.5 million. The Company accepts Staff's proposed adjustment.[65]

[64] Con Edison Reply Brief at 15.

[65] Id.

Streetlight Isolation Transformers

This project entails the installation of isolation transformers in the base of metallic streetlights in New York City to reduce the number of stray-voltage incidents associated with streetlights. The Company proposed to install these units on a four-year plan, to eliminate approximately 78% of stray voltage conditions. Staff accepts the Company's budget for the rate year, but proposes that the transformers be installed in service boxes rather than in the bases of streetlights. The result of Staff's recommendation would be full protection from stray-voltage conditions. However, the cost and duration of the program would be considerably increased. Maintaining the annual funding level at $10.95 million, the program would require 12 years rather than 4 years to complete. The Company, in its Reply Brief, is ambiguous as to whether it agrees with this proposal.[66] In its Initial Brief, the Company states that Staff's concern is understandable, but that the Company believes installation in the streetlight base is preferable.

The reasons for the Company's initial position are 1) if installation occurs in the bases, the actual protection against stray-voltage conditions would be somewhat higher than 78% because the existing bonding strap in the streetlight foundation would be removed; 2) if installation occurs in the service boxes, then a) streetlights would no longer be capable of being readily used as sources of temporary power for, for example, street fairs and holiday lighting; b) the installation schedule would be greatly delayed because service boxes are less accessible than streetlight bases, and c) cost per unit would be increased because service box installation requires the use of more specialized and trained Underground Splicers, rather than Mechanic A workers.

Staff argues that the increased safety, as well as the money saved by the Company from not having to respond to streetlight stray-voltage reports, indicates that the more

[66] Con Edison Reply Brief at 18.

extended program of installing transformers into service boxes is the preferable approach.

The spending in the rate year for this program will be $10.9 million, regardless of which option is selected. The long-term costs of the Staff-recommended course will be considerably higher. The program would require 12 years rather than 4 years to complete at $10.9 million per year, but the long-term safety benefits of Staff's proposal would also be greater.

Because the Commission has placed considerable importance on permanent elimination of stray-voltage conditions that pose a safety hazard, we recommend that Staff's position be accepted, subject to reconsideration in the context of Case 04-M-0159.

<u>Vented Manhole Covers</u>

In order to mitigate the buildup of gases and to limit the severity of incidents, Con Edison has begun installing a vented cover on its manholes in a 4-year program that is planned for completion in 2008. Staff proposed an adjustment to the $8 million submitted by Con Edison to $3 million for the rate year. This would allow completion of the program to install standard-vented covers. A separate program to initiate work on non-standard covers would be continued in future years. The Company concurs with Staff's adjustment.

<u>Rear-Lot Pole Elimination</u>

This program involves the elimination of poles located in the rear of customers' premises. Staff proposed reducing the Company's budget of $2.4 million to $1.2 million, because the program, while valuable, is of less importance than others proposed in the Company's capital plan. The effect of the 50% reduction, if maintained, would be to prolong the replacement program from 20 years to 40 years. The Company maintains that the program is important because rear-lot poles hinder access and can have the effect of prolonging service outages. Staff's recommended funding level balances a desirable program with the need to reduce rate increases and we recommend it be adopted.

Enhanced 4 kV Grid Monitoring

This program covers installation of a power-quality and battery-monitoring system at 4 kV-unit substations that would eliminate manual testing and inspection and provide enhanced monitoring and alarm functions. The Company proposes a budget of $1.5 million in 2008 and 2.5 million in 2009, with completion of the program in 2011. Staff recommends reducing funding to $1 million per year, claiming that Con Edison did not thoroughly explain its need for completing the project by 2011. Given the importance that Staff places in general on enhancement of monitoring, it would be consistent to allow this program to proceed at the pace proposed by the Company, and we recommend accepting the Company's figure.

Advanced Technology

Staff proposes adjustments in three advanced-technology programs. The first is a secondary visualization model that will provide system operators a more comprehensive picture of the secondary system on a real-time basis; second are distribution control center upgrades that would improve software and hardware for the monitoring of the Company's 134,000 remote monitoring points; and third is a system control and data acquisition (SCADA) system upgrade. Staff supports the programs, but finds that each of them showed a much higher first year expenditure that dropped off over the next two years. Staff recommends taking an average of the proposed three-year expenditures and setting the annual level at that average. The effect of Staff's recommendation to average costs over three years would be a $4.3 million reduction in capital expenditures in the rate year from Con Edison's proposed total of $11.7 million.

The Company objects to Staff's recommendation, particularly with respect to the secondary visualization model program. The Company argues that secondary mapping is directly related to a Staff recommendation from the Long Island City investigation report and that mapping presents initial costs that cause the program to be more expensive in its first year.

The Company's advanced technology projects are, as Staff agrees, important to modernizing the operation of its system. Given the relatively small portion of the Company's capital budget represented by advanced technology, we are concerned that it is not more heavily emphasized. Staff's prospective averaging would have only a small impact on revenues in the rate year, considering the in-service dates of the projects. Staff's recommendation should not be adopted.

Other Historical Budget-Based Adjustments

Staff proposes a number of adjustments in other categories, based on disparities between the Company's historical spending and proposed spending in the rate year. These include: Category Alarms ($1.52 million); Remote Terminal Units ($1 million); Spare Transformer Inventory ($2.2 million); Substation Loss Contingency ($1 million); Substation Reliability ($2.5 million); Pumping Plant Improvement ($3.5 million); Environmental Risk ($1.5 million); and Self-Supporting Wires ($1.1 million).

The Commission need not rule individually on each category. Staff has amply demonstrated the variability of Con Edison's budget forecasting, and the Company has confirmed this with its own updates. If the variation described by Staff between budgeted amounts and actual expenditures does not occur in these categories, it likely will occur in others.

In this respect, the proposals of the intervenors for generalized percentage cuts may be revisited. Rather than project-by-project adjustments, we recommend a percentage reduction in the Company's total budget. Staff's historical analysis is a useful tool to substantiate the variability of budgeting forecasting, but is not a precise indicator of future performance in any particular category. In most cases Staff has not identified adjusted categories as less important than others, but has merely questioned the ability of the Company to undertake the level of proposed spending, based on historic behavior. The purpose of the adjustments is to reflect a realistic overall funding level, not to discourage the Company from undertaking any particular project. Unless a specific project has been indicated by the Commission as being of a higher or lower importance, the Company is responsible for determining priorities. Therefore we recommend a generalized adjustment.

Conclusion

The overall impact of Staff's proposed adjustments to the Company's T&D budget was 12% prior to Staff's agreement to add $20.5 million for network transformer replacement. This percentage includes Staff's proposed adjustment in the Systems and Transmission Operations category, which should be modified as discussed above. Excluding the adjustment for the M-29 project and accounting for the increases for network transformer replacements, advanced technology, and grid monitoring, the overall reduction should be 8%, resulting in a capital budget of $1.65 billion. For purposes of calculating revenue impacts in the rate year, Staff's adjustment to Plant in Service should be reduced from $79 million to $62 million.

This represents a preliminary recommendation, conditioned on the discussion of Audit and Temporary Rates, below.

Updated T&D Capital Expenditures

On August 8, 2007, the Company provided Staff with an addendum to its filing which updated cost estimates for several substation projects. The effect of the updates was to increase capital spending by $71 million. Staff asked for more information, including a "detailed cost breakdown," and on August 30, 2007, the Company responded.[67] Staff's initial testimony, filed September 7, stated that it did not have

[67] Exhibit 273, pp.181-187.

sufficient time and information to provide an analysis of the updates. Staff's rebuttal testimony, filed September 28, did not address the updates.

On cross examination in October, Staff stated that they had not evaluated the updates and would be following up with a further information request to the Company. There is no indication that such a request was made. Staff's Initial Brief argues that, without additional information from the Company, the updated estimates should not be allowed. The Company responds that Staff did not follow up with a request for additional information, and that Staff should have performed a follow-up with respect to a different set of discovery responses.

Although no party has raised it, the determinative question is whether the Company's revised testimony conforms to the guidelines in the Commission's Statement of Policy on Test Periods in Major Rate Proceedings.[68]

The Policy Statement specifies conditions under which updates should be allowed. The pertinent provisions state:

> Revisions for changes in estimate will only be entertained when they are based on data which were not available at the time of the original filing. On occasion, significant events may occur between the time of the original filing and the revised estimate which could not have been foreseen at the time of the original filing. ... Wholesale revisions because of changed circumstances (for example a later view of the company's budget) will not be entertained unless an event beyond the control of the company has occurred ….

The intent of this provision is to prevent the Company from presenting a moving target in a rate proceeding. Other than known changes in cost rates (e.g. a tax increase), revisions will not be allowed unless they are based on developments that were not foreseeable at the time of the filing. Particularly in a case as large and complex as this one,

[68] Issued November 23, 1977; 17 NY PSC 25-R.

it is essential that there be closure so that the parties can focus their resources on analysis of the filing.

The responses given to Staff by the Company did not provide cost breakdowns in a level of detail sufficient for purposes of Staff’s review. If the issue were simply one of discovery procedure, the Company would be correct that Staff’s remedy would be to follow up with an additional request, or bring the matter to the attention of the Judges. That is the remedy that Staff urged upon CPB in a similar context, and that is the standard to which Staff would be held.

In this instance, however, the question is not one of discovery procedure but rather whether the updates conform to the Policy Statement. Here, the information given by the Company is sufficient to conclude that a great portion of the updates do not conform to the Policy. The Newtown update ($39 million) was due to acceleration and revised cost estimates. The Parkview update ($15 million) was due to an increase in costs. The York update ($33 million) was due to an increase in costs and a change in the scope of the project. The Interconnection Project update ($5 million) was due to a change in scope and a change in target date.

The Company provided no explanation or demonstration that any of these changes were unforeseeable. Moreover, the updates reflect the highly variable nature of the Company’s construction budget, and are emblematic of the manner in which the extreme acceleration of construction projects appears to be occurring, as discussed below. Therefore the updates (including the updates which reduced cost estimates) should not be accepted.

This recommendation does not imply a finding that the updated projects proposed by the Company are not important or should not be pursued. In particular, the development of third generation (3G) substation architecture at the York project represents an attempt to advance the reliability and cost-effectiveness of T&D systems and should be strongly encouraged by the Commission. As always, the Company will need to prioritize its projects based on the overall budget approved by its Board.

Reconciliation of Capital Expenditures from the Current Rate Plan

As part of the rate plan approved in Case 04-E-0572, the Company was allowed in rates a budget for T&D capital expenditures of $774 million for RY1, $825 million for RY2, and $876 million for RY3. These targets were lower than the Company's original proposal by a total of $531 million. Staff had questioned the Company's ability to complete all of the work identified within the allotted time. In order not to discourage the Company from making needed capital investments, the Commission's order allowed the Company to defer the carrying costs related to capital projects above and beyond what was imbedded in rates.

The Company was required to file annual reports identifying project expenditures compared to previously forecasted amounts, along with updated project budgets for the upcoming year. The Company's actual expenditures were $1.080 billion for RY1, $1.371 billion for RY2, and (estimated) $1.704 billion for RY3. Con Edison is expected to spend approximately $1.68 billion more than the level set in rates during the 3-year period of the current plan. After accounting for plant retirements and other factors, the figure for purposes of reconciliation is $1.616 million. [69]

Carrying charges for years 1 and 2 of the extra expenditures, nearly $200 million, were offset by the application of available customer credits. The Company proposes that carrying charges for the final rate year, approximately $198 million, will be collected in the revenue requirement over a three-year period commencing April 1, 2008. Staff reviewed the Company's annual infrastructure budget reports, met with the Company periodically, and concluded that the projects were

[69] Tr. 2481.

necessary and reasonable. Staff testified that the degree of scrutiny given to the $1.616 billion in extra expenditures was equivalent to the scrutiny given to new proposals in the present case.

CPB argues that there has not been a satisfactory review of the overspent capital expenditures. NYC characterizes the open-ended mechanism as “regulation by blank check.”

CPB acknowledges that the annual reports filed by the Company satisfy the requirements of the Commission’s order in Case 04-E-0572.[70] Noting that this is the first administrative proceeding in which this information is subject to review, CPB takes issue with the fact that Staff’s review resulted in no proposed adjustments or any recommendation to the Commission in its testimony prepared for this case. CPB recommends that Con Edison’s T&D infrastructure spending during its current rate plan be reviewed as part of the independent audit that it proposes.

In the order establishing the 2005-2008 Rate Plan, the Commission provided that: “any expense and carrying charge reconciliation amounts due to customers or to the Company at the end of the proposed three-year rate plan would be paid back to or recovered from customers at the time in a manner we would determine.”[71] Staff notes that recovery of the Company’s deferred expenditures was explicitly made subject to “audit and prudence review.” Page 10 of the Joint Proposal adopted in the rate order states as follows:

> The reconciliations in each of RY1, RY2 and RY3 will be deferred and recovered from customers or credited to customers after expiration of this electric rate plan in a manner to be determined by the Commission. However, at the end of each rate year and subject to audit and prudence review, the Company may apply any available credits except

[70] CPB Initial Brief at 25.

[71] Case 04-E-0572, Rate Order at 35.

> credits associated with TCCs to offset the deferred balance.

The "subject to audit and prudence review" phrase indicates that the Commission retained the right to question expenditures that were offset against customer credits prior to a rate proceeding. No such provision was needed to address deferrals that would be recovered in a subsequent rate proceeding, during which the Commission would have the authority to review as a matter of course. In either event, the deferred amounts would be subject to review.

Staff testified that its review of the Company's expenditures during the period covered by the 2005 rate plan was no less rigorous than its review of the Company's capital expenditures proposed in a rate proceeding.[72] Staff met with the Company periodically and asked for detailed cost breakdowns. Staff received documents describing project cost details, including material, purchases, contracted labor, overhead and contingencies.[73] Staff testified that the periodic meetings with the Company were very constructive and the Company satisfactorily addressed Staff's concern with proposed spending levels. The Company describes Staff's efforts as being, in effect, an on-going prudence review of the Company's capital investments.

Staff emphasizes that it found no reason to conclude that the expenditures were not reasonable. Staff recognizes, however, that because of the exceptional scope of the capital expenditures, the Commission may conclude that further review of the deferred amounts is necessary.[74]

CPB argues that Staff's inquiries should have been only the beginning of the review process. CPB further argues that Staff's assertion that the expenditures were properly scrutinized is not credible, because no adjustments were

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[72] Tr. 4162.

[73] Tr. 4160.

[74] Staff Initial Brief at 169.

proposed. CPB claims that the meetings and e-mails cited by Staff and the Company as evidence of a review process are not sufficient evidence to warrant full recovery in rates.

Staff and the Company respond that no adjustments were recommended because Staff conducted a thorough review and found no grounds for an adjustment. The Company notes that Staff was the only party to have conducted a detailed review of the deferred capital costs. Although the annual reports were available to other parties, no issues were raised by those parties prior to this proceeding. Staff also notes that no party sought discovery regarding the extent of Staff's review of the expenditures.

Staff vigorously opposes CPB's assertion that its review of Con Edison's infrastructure spending was not satisfactory. Staff's Reply Brief describes at length Staff's review activities and Staff's findings regarding the overspent programs. A substantial portion of this briefing material represents new testimony not included in the record. Regardless, the material does not contain any surprises and does not affect our conclusion. The record demonstrates that Staff performed a diligent review, at a level comparable to that of a rate proceeding, within the limits of its resources.

Con Edison objects to Staff's suggestion that the Commission could find further review, and further deferral of recovery, to be warranted. The Company argues that such a decision would reflect an illegal presumption of imprudence.

The reconciliation provision states that deferred amounts will be recovered "in a manner to be determined by the Commission."[75] As described above, it is clear that review of expenditures was contemplated, up to and including a full audit and prudence review. The Commission has authority to determine whether an appropriate level of review has been performed of the expenditures, including any amounts offset against customer

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[75] Order Adopting Three-Year Rate Plan, Case 04-E-0572, Joint Proposal p. 10.

credits. Notwithstanding the Company's repeated references to Staff's activities as an "audit" and a finding of "prudence," Staff's review did not constitute a full audit, and a final finding of prudence can only be made by the Commission.

At this time, there is no record evidence to support any specific adjustment to the reconciliation figure, and there is substantial evidence from the Company and from Staff supporting recovery. We recommend that the Company be authorized to begin recovery of the deferred amounts but, as explained further below, any revenues attributable to the $1.616 billion, including the carrying charges for the third year of the current plan and net plant and depreciation recovery in the rate year, should be recovered on a temporary basis, subject to an audit.

Regarding the term of recovery of the deferred carrying charges, the Company proposes to recover the $198 million over a three-year period. CPB proposes that recovery occur over a ten-year period, to mitigate the impact on rates in this proceeding. The Commission has discretion to determine a reasonable recovery period. Extending the recovery period will have the long-term effect of increasing the overall cost to ratepayers. The Commission, however, may determine that avoiding rate shock in the rate year is of paramount importance and may fix a longer term for the recovery of these costs.

Audit and Temporary Rates

The recommendations of a total capital T&D budget of $1.65 billion, and recoveries associated with the 2005-2008 Rate Plan, represent a conventional analysis of the evidence presented by the parties in this proceeding. Under ordinary circumstances they might be final recommendations. The circumstances of this proceeding, however, are anything but ordinary. The sheer size of the Company's construction program, and its long-term impact on rates, place the Commission's decision-making process outside of "business as usual."[76]

For the reasons stated below, we lack confidence in the record supporting the conventional analysis. We recommend that a portion of the Company's revenues be awarded on a temporary basis, subject to an independent audit.

1. The Historical Context

In evaluating the necessary level of review, the impact on ratepayers of a large and abrupt rate increase must be considered. The New York City Housing Authority, for example, testified that its budget process simply cannot accommodate the sudden large increase proposed by Con Edison.

The County of Westchester observes that over the last five years delivery rates for the Company have increased at a rate of 2.3% per year. The County states that a fair balance of rate levels and service had been achieved, and that the Company's proposed rate increase would destabilize that balance.

The County is correct when it describes the proposed rate increase as the end of a sustained period of stable delivery rates. The County is incorrect, however, when it describes that prior period as reflecting a reasonable balance between infrastructure needs and rates. In fact, as the Company points out, the modest rate increases of the current rate plan were only made possible by a large deferral of costs, and by the use of customer credits that might otherwise have been available to mitigate the increase in the coming rate year.

During the 1990s the Company maintained capital budgets at levels that were 25% of their 2008 level. The aging of the infrastructure, which drives a substantial portion of the current construction budget, could not have come as a surprise.

[76] In the previous rate case, the Commission deemed construction budgets between $800-900 million per year to be "extremely large." If those sums were "extremely large," then it is difficult to find a suitable adjective to describe annual budgets approaching $2 billion. The Company's proposal taxes the regulatory lexicon beyond its limits.

And the cyclical need for new substations and switching stations, while accelerated by the increase in the rate of demand growth, was also foreseeable. When asked if the Company had analyzed the benefits of deferring construction, versus the cost premiums that we are now experiencing, the Company's witness responded that he would guess the benefits outweighed the costs, but no systematic analysis had been performed.[77]

Prior to the current rate plan, the Company overspent its construction allowance by an average of $200 million per year over a six-year period.[78] That suggests the Company was well aware that its aging infrastructure was in need of more investment than was authorized under the Company's rate plans – agreements into which the Company entered voluntarily. A Company witness conceded that construction decisions during the current rate plan may have been influenced by the existence of the reconciliation mechanism that allowed deferral of carrying charges on overspent programs.[79] Far from a healthy balance, the history of the past ten years suggests an under-funded construction program straining at the limits of restrictive rate agreements, then bounding ahead at an all-out sprint when the financial constraints were removed in 2005.

Whether the benefits of deferral enjoyed in previous years outweigh the costs of compression now being experienced is

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[77] Tr. 2200.

[78] During the same period, the Company only overspent its O&M allowance by $2 million per year. When a utility overspends its capital budget, it loses carrying charges until the next rate case, but eventually recovers the bulk of its costs. When a utility overspends its expense allowance, it recovers nothing.

[79] Tr. 2531. The County of Westchester is correct when it asserts that building infrastructure will result in increases to the Company's rate base and its overall returns. The County has presented no direct evidence of deliberate overbuilding to accomplish this purpose. The County's point is well taken, however, that the Company's economic incentive to overbuild must be checked by effective regulation.

unknown; the Company did not perform an analysis. It would not be productive to attempt to reconstruct an answer to that question, especially because rates during the entire period reflected negotiated agreements, which presumably included other inducements to customers and the Company.

2. The Company's Management Process

The extraordinary pace at which the capital program has grown presents questions regarding the Company's ability to manage the program in a cost-effective manner.

On January 18, 2007 the Company's Board of Directors was presented with a five-year capital budget. On March 8, 2007, pursuant to a recommendation in the Long Island City outage investigation, the Company presented the same five-year budget to the Commission. The forecast for 2008 in that budget was $1.325 billion.[80] On April 30, 2007, the Company presented its rate plan, in which the construction forecast for 2008 totaled $1.807 billion, nearly a $500 million increase over the forecast presented on March 8, 2007.

The Company's infrastructure witnesses, when asked about the discrepancy between the two budgets, were skeptical that it could be as large as $500 million.[81] It then became apparent that a discovery response by the Company which summarized the variations[82] had been prepared without their knowledge.[83]

The Company's Reply Brief explains the $500 million discrepancy by referring to a financial witness who described

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[80] DPS 313 R-79-80 5-year Capital Budget and Details, attachment to Staff Interrogatory 313.

[81] Tr. 5385, 5407.

[82] Exhibit 294, Schedule 6.

[83] Tr. 5408, 5411. The Senior Vice Presidents who presented the Company's infrastructure case appear to be highly capable individuals. Yet the difficulty of overseeing a 400% increase in capital budgets over a period of several years is illustrated by the confusion that surrounded the $500 million increase in the Company's annual budget.

the five-year budget as merely putting the annual budget into context for the Board, while the Brief explained that the rate year budget is assembled with a more rigorous process.[84] A discrepancy of more than 35% over such a short time period cannot be explained as a matter of imprecision. Putting aside the question of whether this is an appropriate manner in which to present information to the Company's Board, we are strongly concerned that it is not an appropriate manner in which to present information to the Commission.

The Company acknowledged that there are cost premiums associated with the acceleration of the construction program.[85] There have been dramatic increases in the cost of construction materials, particularly copper, resulting in high prices for transformers and other equipment.[86] Because of the compressed time frame of required construction, the Company cannot mitigate the risk of these price spikes.

Another example of the cost premium is the increased use of overtime and contractors. Typically, general construction work is contracted out while the specialized electrical portions of the projects are performed by Con Edison employees. At present, the Company's workload has left it "maxed out" on overtime, with 5% to 10% of work normally performed by employees being performed by contractors, at a higher price.[87] The precise cost increase resulting from the use of contractors for work normally performed by employees is unknown, because the Company does not perform that analysis.[88]

It is also not clear how the Company's management structure is accommodating the rapid growth. In the Company's

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[84] Con Edison Reply Brief at 24.

[85] Tr. 2199-2200. For example, of the $39 million in increased cost estimates for the Newtown substation, roughly half were attributed to the acceleration of the schedule. Tr. 2193.

[86] Tr. 1911.

[87] Tr. 2195-96.

[88] Exhibit 168; Tr. 2489.

last rate case, Staff questioned whether the Company could manage such a large ($900 million per year) construction program.[89] Now the Company is proposing a figure twice as high. The Company has demonstrated that it is capable of spending large amounts of money; whether the money is being spent efficiently is still, in our opinion, an open question.

The Company has performed some reorganization of its project management structure. When asked whether management resources had been expanded to keep pace with the rate of construction, a Company witness responded that the Company has added personnel and has improved the efficiency of its operations to achieve more work per person. This is encouraging. The record on this issue, however, consists primarily of ad hoc, generalized responses to questions from the bench.[90] On a question of this importance, the Commission's final decision should be informed by an independent management audit.

3. <u>The Degree of Review</u>

PSL 66(19) states that management and operations audits "shall be performed at least once every five years" and

> shall include an investigation of the company's construction program planning in relation to the needs of its customers for reliable service and an evaluation of the efficiency of the company's operations. The commission shall have discretion to have such audits performed by its staff, or by independent auditors. In every [major rate case] the commission shall review that corporation's compliance with … the most recently completed management and operations audit.

CPB asserts that the Commission has not performed the management and operation audits required by PSL 66(19) in over fifteen years. CPB's claim was not rebutted by either Staff or the Company. CPB and NYC call for an audit of the Company's

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89 Case 04-E-0572, Rate Order at 35.

90 See, <u>e.g.</u>, Tr. at 2197-2199, 5390, 5399.

capital budgeting process, and CPB calls for an audit of the Company's capital overspending under the current rate plan.

Considering the size and pace of the Company's construction program, and the specific concerns enumerated above, a comprehensive audit of the Company's planning and performance is warranted.

The statute provides that the Commission can have such audits performed by Staff. It could be argued that the many activities of the Department, in its ongoing supervision of utilities, satisfy the statutory requirement. Whether that is generally true is not an issue in this proceeding.[91] For purposes of the Company's capital expenditures from 2005 through the rate year, Staff has not maintained that its review functions satisfy the statutory requirement of an operations audit.[92]

One difference between a rate proceeding and an audit is illustrated in the Company's discussion of CPB's discovery claims. CPB requested supporting documentation including quotes and invoices; the Company responded that "getting into invoices and details like that on literally thousands of projects would be unnecessary and unmanageable."[93] The Company further made its point by distinguishing between an IRS data request and an IRS audit.[94]

The Company is correct that a typical review of proposed expenditures for a rate case does not require a widespread examination of quotes and invoices. For the same

[91] It should be noted that an outside audit can increase the complexity of rate proceedings due to the statute's requirement that every recommendation be tracked and evaluated.

[92] The Company, in its Reply Brief, refers to Staff's review of expenditures from the current rate plan as an "audit," but does not explicitly connect those activities to the statutory requirement.

[93] Con Ed Reply Brief at 122.

[94] Id. at 123.

reason, the Company is incorrect when it refers to Staff's review as an audit. Staff argues that its review of the Company's past and future expenditures was thorough, but does not claim that its activities rose to the level of an audit.[95]

Staff's testimony carries great weight, but under the circumstances of this case we are not convinced that it supports full recovery of the Company's spending, both past and proposed, without further scrutiny of the expenditures. We do not question Staff's diligence or capabilities. We do question whether it is reasonable to expect Staff, without a large addition in resources, to fully analyze a capital spending program that has grown by 400% over recent years, $1.6 billion in unanticipated spending from the previous case, and 44 new O&M programs, while conducting two major outage investigations and a prudence proceeding, in addition to its ongoing oversight responsibilities including monitoring of safety and performance standards.[96] The sheer volume of the workload confronted by Staff speaks to the need for further review.

4. Conclusion

The concerns elaborated above do not, individually or collectively, warrant an outright disallowance. They do not outweigh the testimony of Staff and the Company -- unrebutted by any party -- that the individual components of the Company's

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[95] CPB questions the adequacy of Staff's review of the Company's infrastructure proposals in general. CPB argues that the large majority of Staff's proposed adjustments are based on a ratio of actual spending to historical spending. CPB acknowledges this is a useful indicator, but states it may not be appropriate for large projects that occur infrequently and that in addition, it does not assess whether the spending in the historical period was necessary and cost effective. CPB argues that an analysis based on historical spending falls short of the comprehensive review that is required by the Public Service Law.

[96] Staff acknowledged that ongoing outage investigations placed a strain on its resources. Tr. 4162.

construction program are necessary, and that their costs are reasonable.

Where there is doubt, however, the Commission should be conservative on behalf of ratepayers. As the intervenors argue, the extreme circumstances of this case warrant the strictest possible review. We recommend that a portion of the revenue requirement associated with the Company's capital program be authorized in the form of temporary rates,[97] subject to refund pending the results of a management and operations audit.

Temporary rates are a reasonable approach to the uncertainty discussed above. They would allow the Company cash flow while reserving for the Commission the ability to order refunds, should the results of an audit or a resulting prudence proceeding so warrant. The carrying charges already recovered through offset against customer credits are also subject to refund pending the results of further review.

The amount of temporary rates should be derived from the areas most in need of scrutiny – i.e., spending above expectations and above historical averages. A reference figure of $330 million represents the rate year revenue impact of three numbers: the overspent capital expenditures from the 2005-2008 Rate Plan being added to rate base ($219 million); the reconciliation of carrying charges ($68 million); and the amount by which the recommended rate year capital budget exceeds the previous five-year average of $1.014 billion ($43 million).[98]

Considering the extent of Staff review that has already been performed, the Commission should consider subjecting only a portion of the reference figure to temporary status. This would reflect the likelihood that a majority of the expenditures will be found reasonable. Another alternative

[97] Pursuant to PSL §§72 and 114.

[98] This figure is an estimate derived from applying a mid-year assumption to $642 million, the amount in excess of the five year average.

for the Commission to consider would be continued deferral rather than temporary rates. Parties are encouraged to address these alternatives in Briefs on Exceptions.

Demand-Side Management and Construction

A long-term concern that should be addressed by the Commission is the need for greater integration of demand-side management (DSM) into the Company's construction planning. The Company presently conducts a 150 MW program of targeted DSM, for the purpose of deferring capital spending. Because the Company forecasts spending nearly $2 billion annually for years to come, and because many of the Company's construction needs will be demand-driven, DSM can play a much greater role in reducing costs for ratepayers.

The demand growth forecast presently used by the Company's T&D planners does not assume any reductions resulting from the Energy Portfolio Standard proceeding. This is reasonable, given the preliminary status of the EPS at that time this proceeding was initiated. But, Company witnesses stated that aggressive energy efficiency programs could have an impact on capital needs in coming years. In particular, several new substations will need to be built in the second half of the Company's ten-year outlook. Those projects could be deferred or potentially eliminated by targeted demand management.[99]

Rough numbers provided by the Company indicate that this is feasible. A new substation typically costs $150 million to construct, and accommodates 250 MW of demand. At $600/kilowatt, the value of an avoided substation easily falls into the range of cost-effective efficiency projects, when combined with other values of energy efficiency.[100]

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[99] Tr. 5343.

[100] Naturally, planners whose responsibility is to maintain a reliable system will have many legitimate concerns that need to be addressed, regarding the dependability of efficiency programs for long-term reductions in demand.

CPB also notes that utilities have little if any incentive to consider or implement DSM alternatives to T&D investment because such solutions do not augment rate base. In future proceedings, CPB urges that the Company should be required to demonstrate that reliability needs could not be met at a lower cost by DSM solutions.

CPB’s proposal does not take into account the substantial lead time required for DSM to replace major construction projects. By the time a utility is prepared to include a construction project in rates, it will likely be too late to replace the project with targeted DSM.

While CPB’s specific proposal is not practical, its general approach should be adopted by the Commission in a more proactive manner. The Company should be required to compile a report, as part of its ten-year planning process, identifying demand-driven construction needs, geographic areas in which targeted DSM programs have reasonable potential to defer or eliminate the needs, and estimates of the economic value of such potential measures. CPB’s concern regarding financial incentives for the Company is addressed below.

NYC also urges that the Company be ordered to report on measures to expedite the interconnection of distributed generation to the Company’s system. NYC’s concern is significant; however, there is insufficient evidence in this proceeding to support the City’s specific request. Also, the performance standard for replacement of over-duty breakers addresses the issue in part.[101]

Advanced Technology

CPB questions whether many of the Company’s capital projects might be rendered obsolete by technological

[101] NYC further requests studies related to generation resources and transmission planning. The appropriate forum for these requests is the proceeding on Long-Term Planning initiated by the Commission on December 19, 2007.

developments, specifically the development of third generation architecture for substations.

According to Company forecasts and testimony, it is nearer the beginning than the end of a multi-year, multi-billion dollar construction effort. The seven-year period beginning 2005 will see approximately $11 billion in construction, and the Company does not expect spending to trend downward following 2011. This gives rise to the question of what sort of system will emerge from the investment of what could be $20 billion by 2016.

The Company states that it has made a priority of modernizing its system with a range of measures that will enhance monitoring and control functions and real-time analysis of system conditions. The Company also plans to introduce 3G "System of the Future" network architecture to enhance asset-sharing characteristics. In the near future, the Company's plans for advanced technologies do not extend to interactive behind-the-meter or "smart grid" functions.

The Company's planners face the dilemma of needing to build immediately with available technology to accommodate system needs, while risking that the new construction might not be able to accommodate advanced technologies when they are adopted. There is insufficient record in this proceeding to evaluate whether the Company is achieving a reasonable balance of those goals. We recommend that this issue be addressed in greater detail in a subsequent proceeding.

Reconciliation for Shortfalls between Budget and Actual Expenditures

Con Edison proposes to eliminate the current true-up mechanism for capital budget expenditures, if its proposed forecasted T&D budget is accepted. Con Edison proposes that if the Commission establishes rates that reflect a lump sum adjustment to its T&D budget, the existing reconciliation provision should be continued.

Staff proposes that if the Company spends less than its allowance, the difference be deferred as a ratepayer credit.

Staff makes this proposal generally applicable to the Company’s T&D capital expenditures, and also proposes it specifically with respect to the Company’s Storm Hardening and Response, Advanced Technology, and Process Improvement budgets. In these three categories, the disparity between the Company’s January budget and its proposal in the rate case was particularly large (from $35.7 million to $88.9 million). Staff recommends that given the significant increase in funding requests, a true-up is warranted for these areas separate from the other categories.

The Company objects to an asymmetrical reconciliation mechanism, arguing that it would be unduly preferential to customers. The Company also observes that the mechanics of Staff’s proposed mechanism are not clear. Staff has not explained how reconciliations for specific project categories would be different from the general reconciliation of capital expenditures. The Company also argues that it is inconsistent for Staff to recommend reductions in numerous spending categories, based solely on historical disparities between budgeting and spending, while also recommending a general reconciliation of under-spending. Staff’s reconciliation mechanism would compensate ratepayers for any under-spending and would, therefore, make Staff’s proposed adjustments unnecessary.

The Company’s points are well taken, and in an ordinary rate case they might be persuasive. In the current extraordinary situation, however, the Company’s arguments should be rejected. The $1.616 billion subject to reconciliation in the Company’s favor from the current rate plan, and the huge increase in capital spending proposed for the rate year, give the Commission a compelling reason to take all reasonable measures to protect the interests of ratepayers. The Company’s argument that an asymmetrical reconciliation mechanism is unduly preferential to customers has little weight under the current circumstances. Staff’s recommendation should be adopted.

Business Incentive Rate Discount

Con Edison has proposed to include in rate base about $3.34 million of Business Incentive Rate (BIR) discounts that have not been collected in the rates charged to customers. Staff has proposed that the BIR discounts be excluded from rate base because, to the best of its knowledge, the Commission has not granted the Company any authority to defer them. In response to Staff's position, the Company has pointed to a Commission order that provided it authority to merge with Northeast Utilities.[102] However, Staff states that the order does not support the rate base treatment proposed in this case, absent a demonstration by the Company that the lost revenues are related to the retention of existing load. According to Staff, no such demonstration has been provided and the Company has not established any other basis for the BIR program lost revenues to be recovered in the future.

If Con Edison is unable to demonstrate the basis for any BIR discounts to receive deferral accounting treatment, there is no basis for including them in rate base and providing the Company a return on the balance. We recommend that the Staff rate base adjustment be adopted.

Deferred Federal Taxes - Section 263(a)

Con Edison has included in rate base $298 million of deferred taxes it may have to pay the future. In 2002, the Company began to use a costing method that reduced its tax expense. However, the Internal Revenue Service (IRS) challenged it and it is possible that Con Edison will have to pay, with interest, for the tax benefits it claimed.

The amount that has been included in rate base reflects the average accumulated deferred taxes from 2002 to 2005. It does not include the amount for 2006, another year the

[102] Case 00-M-0095, et al., Consolidated Edison and Northeast Utilities Merger Petition, Opinion No. 00-14 (issued November 30, 2000).

claimed deduction has been challenged by the IRS. Con Edison and the IRS have entered into settlement negotiations concerning this matter.

If no settlement is reached by the time the Commission decides this case, Staff proposes that the deferred taxes included in rate base include the amount for 2006. If a settlement is reached, Staff proposes that the settlement result be reflected in the Commission's decision. In its initial brief, Con Edison reports that that there have not been any new developments and it will continue to accrue carrying charges on the deferred tax balance for now.

We recommend that the Commission accept Staff's proposal to update the deferred tax amount included in rate base for the 2006 tax year pending a resolution of this matter with the IRS.

Average Rate Base

The Company proposes a positive adjustment to its average rate base in order to align its rate base with its capitalization (a.k.a. the "EB/Cap adjustment"). The Company notes that its proposed adjustment is positive due to a number of factors, including its prepaid pension balance and the level of working capital. Staff and NYPA oppose the adjustment.

Staff argues that a portion of the Company's prepaid pension balance should be excluded from rate base in order to address the effects of certain pension credits the Company recorded while it was off the Commission Pension Policy Statement.[103] Staff states that since the Company was off the Pension Policy Statement, the credits in excess of the levels reflected in rates flowed to shareholders, not customers. It calculates that a rate base adjustment of $141.9 million is

[103] Case 91-M-0890, Development of Statement of Policy Concerning Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other than Pensions, Statement of Policy and Order Concerning the Accounting and Ratemaking for Pensions and Post Retirement Benefits Other than Pensions (issued September 7, 1993)(Pension Policy Statement).

required to eliminate the value of pension credits that flowed to shareholders so that customers are not required to pay a return on benefits that they did not receive.

Staff asserts that the current electric rate plan does not bar its recommended adjustment because, as a negotiated result, it cannot be cited as precedent, and because the current rate plan terminates March 31, 2008, while its recommendation, if adopted, would take effect April 1, 2008.[104] Staff asserts that the Company raises the negotiated $100 million pretax charge in an attempt to “confuse the issue.” According to Staff, no adjustment to the Company’s capitalization was made as a result of the $100 million pretax charge. Staff explains that its proposed $141.9 million adjustment represents the gross $276.6 million pension over–collection, reduced by $47.3 million of benefits potentially shared with customers and $87.4 million of income taxes the Company paid on the resulting retained earnings enhancement.[105]

The Company argues that Staff’s proposed adjustment should be rejected on several grounds. First, it asserts that Staff’s position fails to acknowledge that the Company provided a $100 million credit to customers under the current rate plan in order to resolve all issues regarding prepaid pension expense

[104] Staff also asserts that this fact demonstrates that, contrary to the Company’s assertions, the Staff-proposed adjustment is not retroactive. Staff Reply Brief at 31-32.

[105] Staff notes that, during the period Con Edison was off the Pension Policy Statement, it shared excess earnings with customers in two rate years. Staff states that it accounted for the earnings that were potentially shared with customers, and ultimately calculated that the Company retained $229.3 million of the over-collection. Staff Initial Brief at 74-75. Staff states that its calculation reflects a 65/35 earnings sharing ratio. Staff Reply Brief at 35-36.

for the period prior to April 1, 2005.[106] Second, the Company contends that Staff incorrectly asserts that customers received no benefit from the difference between the negative pension credits reflected in rates and the higher negative pension expense booked by the Company (other than the customers' portion of shared earnings for two rate years). The Company states that the growth in the pension investments achieved during the period the Company was off the Pension Policy Statement provides current benefits to customers in that the income from these investments reduces the current pension costs borne by customers. The Company also states that Staff understated the benefits customers received from the shared earnings provision effective for the rate years ending March 31, 2003 and 2004, because Staff assumed a 50/50 earnings sharing when the actual sharing level was 65/35, and Staff failed to recognize the recent Commission decision on its recent tax petition.[107]

Staff responds that its proposed adjustment should not be updated because the decision upon which the Company relies dealt with excess earnings sharing in the rate years ended March 31, 2003 and 2004. Staff adds that Con Edison's suggestion, if adopted, would reflect the resulting higher level of shared earnings that will be passed back to customers. Moreover, Staff adds that the subject matter of the recent decision upon which the Company relies deals with a tax accounting error and has no relation to the pension costs.

Staff asserts that the Company's claims that customers benefited from its pension over-recoveries because it was able

[106] The Company adds that (1) Staff's proposed adjustment is also barred because Staff's comparison of the Company's pension expenses for the period April 1, 1997 to April 1, 2005 to the rate allowance for pension expenses constitutes retroactive ratemaking; (2) Staff failed to recognize that it had to finance the $100 million credit; and (3) the 2005 rate plan adopted the pension and pension credit provisions of the joint proposal and therefore can be cited as precedent and is binding.

[107] Con Edison Initial Brief at 101-105; Reply Brief at 36-39.

to delay filing for a rate increase or sought lower increases when it did file for rates, have no record basis, are "not true" and should be given no weight.[108]

Staff also responds that the Company's argument that performance (earnings) of pension investments while off the Pension Policy Statement provides benefits to customers by reducing current pension expenses is true but it should not be "accepted on its face." Staff argues that expected (forecast) earnings on pension plan assets offset current pension costs and it is therefore appropriate that customers receive this benefit because they fully funded the pension plan. Staff adds that now the Company is back on the Pension Policy Statement, customers bear the risk of pension plan asset performance including losses while off the Statement. Staff states that the below expectations performance of pension plan assets while Con Edison was off the Policy Statement resulted in substantially increased pension costs for customers and adds that there is no doubt that the benefits related to growth in pension plan investments are offset many times by the actuarial losses the Company amassed while off the Policy Statement.[109]

NYPA argues that the Company's only authority for its adjustment lies in a "historical anomaly" in which the Commission made an adjustment to prevent a different utility company from earning returns on a base that was larger than its capitalization. Here, NYPA states that the circumstances are just the opposite (claimed rate base is smaller than capitalization) and concludes the adjustment should be rejected as improper ratemaking. NYPA also states that the primary reason for the excess of capitalization over rate is unrecognized pensions and OPEB costs. It argues that adjusting rate base for assets that are sensitive to market fluctuations is not sound ratemaking. NYPA concludes that the Company failed to meet its burden of demonstrating that its proposed adjustment

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[108] Staff Initial Brief at 68-77.

[109] Staff Reply Brief at 32-36.

is necessary and therefore recommends that the proposal be rejected, or in the alternative, the Staff adjustment thereto be adopted.[110]

The Company argues that there is no basis for NYPA's proposed elimination of the EB/Cap Adjustment. The Company offers several reasons for urging the rejection of NYPA's position. First, the Company argues that NYPA contradicts itself by contending that the balance sheet can be used to calculate working capital but not the EB/Cap adjustment. Second, the Company states that while NYPA argues that the FERC 1/8 formula should not be used, the Commission has noted its preference for the FERC 1/8 formula over the lead-lag approach. Third, the Company asserts that the simplified approach advocated by NYPA in testimony ignores certain cash payments and all financings. Fourth, the Company claims that NYPA (inappropriately) utilized a mix of consolidated and stand-alone data in its calculations. Finally, the Company contends that NYPA's criticism of the Company's EB/Cap adjustment because it results in a "negative number" is a red herring, and it refers to the 2005 Rate Plan as establishing the basis for retaining the pre-paid pension balance in earnings base for ratemaking purposes.[111]

We reject the Company's assertions that the Staff adjustment is barred by the previous rate order or prohibitions regarding retroactive making. The previous order clearly indicates that the rate plan adopted therein was intended to continue through March 31, 2008 and the joint proposal attached thereto expressly states that its provisions will continue "unless and until electric delivery base rates are changed by Commission order. The Company's filing requests that new rates be established effective April 1, 2008, therefore it is clearly appropriate that the current rate levels be examined and that

[110] NYPA Initial Brief at 22-23.

[111] Con Edison Initial Brief at 106-111.

the prospective level of such rates be properly set so as not to exceed a just and reasonable level.

In addition, Staff has explained that in calculating its adjustment, it removed benefits potentially shared with customers and income taxes the Company paid on the resulting retained earnings enhancement during the term of the current rate plan, thus there is no violation of the prior rate order's adoption of a provision stating that electric pension/OPEB expense or credit will not be eliminated from the Company's earnings base or capitalization for ratemaking purposes. In our view, the proposed Staff adjustment will ensure that the prospective ratemaking treatment of prepaid pension expense accurately reflects actual pension expenditures without disturbing or modifying the ratemaking treatment that was allowed prior to April 1, 2008.

In contrast, NYPA's proposal to eliminate the entire adjustment is rejected because it is premised on an outmoded approach and would inappropriately understate the level of adjustment. We therefore recommend that the Staff's proposed adjustment be adopted. For the reasons offered by Staff, the Company's proposed update to the Staff adjustment should be rejected.

COST OF CAPITAL

Capital Structure

Con Edison supports the use of a stand-alone, average capital structure as follows:

Long-Term Debt	48.88%
Common Equity	48.68%
Preferred Stock	1.21%
Customer Deposit Rate	1.23%

This capital structure represents the capital that the Company reports on its books. According to Con Edison, this structure ensures that the actual sources of the invested funds are compensated. The Company also states that this capital structure coincides with the approach that the major rating agencies use to rate its securities. Further, Con Edison states that its proposal conforms to the most recent rate plans the Commission has adopted for the steam department and the natural gas operations.

In contrast, DPS Staff started with the Con Edison Inc. (CEI or parent company) capital structure and derived the following capitalization for the Company:

Long-Term Debt	49.65%
Common Equity	47.98%
Preferred Stock	1.13%
Customer Deposit Rate	1.24%

This capital structure results from Staff's assignment of debt and equity capital to the parent company's utility and non-utility operations. Staff states that the non-utility operations face greater amounts of business risk and competition than the utility operations, and the non-utility operations are financed with more equity capital for this reason. To arrive at its capital structure for the non-utility operations, Staff used Standard & Poor's guidelines for firms with a business profile score of "8" and an "A" rating. This produced a 38.5% debt and a 61.5% equity ratio for the non-utility operations. It also indicated the amount of debt and equity capital to be subtracted from the consolidated capital structure to arrive at the capital structure stated above. In support of its proposal, Staff states that its results are close to the capital structure results that the Commission used in recent Con Edison steam, gas and electric rate proceedings.

Nonetheless, according to Con Edison, it was not necessary for Staff to assign CEI debt and equity capital to the non-utility operations because this is not a case involving the use of debt financing to fund equity investments in the utility operations. There is no suggestion here that CEI has engaged in any "double leverage" tactics. The Company also states that the amount invested in the unregulated subsidiaries is relatively modest and there are no plans to increase the size of these investments. In these circumstances, the Company believes there is no regulatory problem that warrants the use of Staff's approach. It also doubts that the investment in the unregulated subsidiaries has any impact on the rating that CEI receives from the rating agencies. According to the Company, the rating agencies do not view the non-regulated subsidiaries as a source of significant additional risk for the parent company.

Con Edison also claims that Staff has misapplied Standard & Poor's guidelines to the non-regulated companies because very few competitive generation businesses have an "A" rating. According to it, competitive electric businesses generally have non-investment grade ratings and greater amounts of book leverage. It points to three large and public generation businesses and states that they have average debt balances of almost 60% of their total book capitalization.

Westchester County and the Consumer Power Advocates are concerned about the size of the rate increase that Con Edison has sought in this case. To temper the magnitude of the rate increase, Westchester County and the Consumer Power Advocates favor a capital structure that makes less use of higher-cost equity capital and more use of lower-cost debt financing.

The Commission, in at least two recent and fully-litigated rate proceedings, has stated its support for the approach that DPS Staff has used in this case. The consolidated capital structure of the parent company starts the examination and the capital that the parent company obtains and allocates to the subsidiaries on the basis of their relative business and financial risks. Since Staff has adhered to the Commission's preferred approach, we recommend the capital structure it has provided for ratemaking purposes.

Cost of Equity

Three financial experts testified in this case and provided estimates of Con Edison's cost of equity capital for the rate year. Dr. Morin testified for Con Edison and provided an 11.2% cost of equity using the Capital Asset Pricing Model

(CAPM) method, the Discounted Cash Flow (DCF) method and a Risk Premium analysis.[112]

A DPS Staff finance panel also testified and supported an 8.9% cost of equity by applying the DCF and the CAPM methods to a proxy group of 29 electric utility companies. With its initial brief, Staff updated its cost of equity recommendation to 9.0% using more current information. CPB also provided expert testimony and has recommended a 9.0% return on equity using the approach developed in the Generic Finance Case.[113]

1. Criticisms of the Company’s Approach

DPS Staff criticizes the proxy groups that Dr. Morin selected for his DCF and CAPM analyses. Dr. Morin employed two proxy groups for the DCF analysis, one consisting of the 17 investment grade companies in Standard & Poor’s *Value Line* publication considered to be electric distribution companies. The other is Moody’s *Electric Utility Index*.

According to Staff, half of the companies in the Standard & Poor’s group obtain less than 70% of their revenues from regulated utility operations with some receiving less than 50% from utility operations. Moreover, Staff considers the Moody’s group to be stale. It has not been updated since 2002 and it is unclear whether it can still be used to represent a common or average utility. Staff also states that the proxy groups Dr. Morin used are riskier than Con Edison and an adjustment would be necessary were they to be used.

Staff also considers the Company’s DCF, CAPM and Risk Premium method analyses problematic. With respect to the DCF method, Staff objects to Dr. Morin’s use of analysts’ long-term

[112] If the Commission were to set rates for three years, Con Edison would qualify for a stay-out premium that would be added to its cost of equity for the risk that the Company assumes for the rates set for an extended period. Con Edison has requested a 30 basis point stay-out premium and an 11.5% cost of equity for a three-year rate plan.

[113] Case 91-M-0509, Generic Finance Proceeding, Recommended Decision (issued July 19, 1994).

growth forecasts presented in *Value Line* and *Zacks*. Dr. Morin used growth rates of 6.4% to 7.4% in his DCF calculations that Staff considers to be too high. Instead, Staff believes Dr. Morin should have used expected dividend growth. Staff points out that the ten-year average annual growth rate in dividends has been 3.1%. Pointing to the Orange & Rockland electric rate proceeding recently decided by the Commission, Staff states that Dr. Morin provided a similar DCF analysis in that case and the Commission rejected it.[114]

According to Staff, Dr. Morin used the same type of CAPM analyses that it used; however, Staff objects to his market risk premium and claims that it is overstated. Dr. Morin used a 7.6% market risk premium which is the average of the historic and forward-looking studies he examined.

With respect to his use of an Ibbotson Associates study of market risk premiums from 1926 to 2005, Staff claims that these data are not representative of the current investment conditions. Staff believes that equity risk premiums may be decreasing over time. Pointing again to the Commission's recent decision in the Orange & Rockland electric rate proceeding, Staff notes that the Ibbotson Associates study was determined not to be as reliable as the estimates available from Merrill Lynch.

Addressing Dr. Morin's forward-looking study that provided an 8.1% market risk premium, Staff believes that the dividend growth projections are too high and not sustainable. Returning to the recent Orange and Rockland electric rate decision, Staff states that the Commission has determined that this growth rate is unreliable.

Staff is also critical of the other methods Dr. Morin used to determine a market risk premium. A report that provided a 7.0% market risk premium is considered by Staff to be out of

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[114] Case 06-E-1433, Orange & Rockland Utilities, Inc. – Electric Rates, Order Setting Permanent Rates (issued October 18, 2007) pp. 9-10.

date. An updated version of the study only supported a 6.5% market risk premium. Another study covering only three years supported a 7.2% market risk premium but Staff considers this study period far too short to provide useful results.

Addressing Dr. Morin's "reverse" market risk premium estimate, Staff does not accept the 7.0% market risk premium he derived by examining regulatory decisions from 1997 to 2006. Without knowing the details of the various rate decisions and rate plans, Staff does not believe it is possible to ascertain the market risk premium that they may support.

Con Edison's witness also performed two risk premium methods. He provided an historical analysis that used *Moody's Electric Utility Index* as a substitute for the utility industry which provided an average risk premium of 5.6%. According to Staff, risk premiums do not remain constant over time and the circumstances prevailing in the electric utility industry now are rapidly changing. Staff also disagrees with the use of the Moody's index because no studies were performed to compare the companies' risks with Con Edison's.

The other risk premium analysis Dr. Morin performed considered the allowed returns on equity provided by various regulatory commissions. Staff does not accept the 5.5% spread that he observed between the allowed returns and long-term Treasury bonds. Nor does Staff accept his assertion that a 5.9% risk premium is appropriate in times like these when interest rates are low. Among the flaws Staff sees in this approach are the lack of analysis of the companies' various risk levels, and the details and results of settled rate cases that are unknown to outside observers. Significantly, Staff points out that the Commission has repeatedly rejected the use of the risk premium methods due to the circularity problems of using the returns allowed by other commissions.

2. Criticisms of the Staff Approach

Con Edison believes that no one method should be used to set a fair rate of return. According to it, all the available methods are useful for an informed judgment and a good decision. Nevertheless, the Company believes that the Staff witnesses' analyses are plagued by errors. Con Edison also doubts the validity of Staff's rate of return recommendation which is more than 200 basis points lower than the allowed returns of the companies in the proxy group that Staff employed. According to the Company, Staff has understated the cost of equity capital. And, it fears that if the Company were to suffer a ratings downgrade, it would become more costly and difficult for Con Edison to finance the extensive system improvements it is making.

According to the Company, Staff has misapplied the DCF method and it should not have relied predominantly on the DCF method in this case. Rather than give two-thirds weight to the DCF method, Con Edison believes it should receive the same weight as the CAPM method in the final results.

Con Edison believes that the market price used for the dividend yield component of the DCF method may be unduly influenced by structural changes in the electric industry and changes in investor expectations. The Company also believes that the assumptions that support the DCF method are unrealistic in today's capital market environment. According to it, no longer should a constant price/earnings ratio be assumed given the surges experienced by utility stocks in the last decade. Stock prices may no longer be expected to grow at the same rate as earnings and dividends.

Con Edison points to wide variability in Staff's DCF method results for the companies in its proxy group, ranging from a low of 6.4% to a high of 15.4%. According to the Company, this variability demonstrates the lack of reliability in the DCF approach and the need to use a variety of methods.

The Company also claims that the DCF model Staff used incorrectly ignores the time value of quarterly dividend payments which understates the cost of equity by about 20 basis points. Con Edison also objects to Staff's use of the average dividend yield for a six month period. It considers these stock prices to be stale and would prefer to see current market prices used. Further, the Company objects to Staff's use of earnings retention growth in the second stage of the DCF analysis, and Staff's use of Value Line forecasts for the major inputs in the DCF analysis. According to the Company, sole reliance on the Value Line growth forecasts runs the risk that the forecasts are not representative of all investors' and analysts' expectations. Con Edison believes that investors are expecting greater growth than Staff has used in its DCF calculations, about 180 basis points greater long-term growth than Staff would recognize.

Further, the Company opposes Staff's DCF analysis because it does not relate market-derived rates to the book measures used to set the allowed return on equity. It recommends that book value per share be substituted for the market prices that Staff used in its DCF analysis. According to the Company, other regulatory commissions have come to doubt the reliability of the DCF model and it believes that the Commission should avoid exclusive reliance on the DCF model when market-to-book ratios are in the range that they have been for several years. Con Edison asserts that the DCF method will understate the required return on equity in these circumstances and thus fails to satisfy the just and reasonable rates standard.

Con Edison is far less critical of Staff's use of the CAPM method. The Company and Staff agree on the inputs for the risk free rate and the beta estimates. However, they disagree on the market risk premium. Rather than rely on Merrill Lynch's in-house forecast, the Company believes that Staff should have used market results over an extended period. The Company claims that Staff's market risk premium estimate understates the properly calculated CAPM results by about 100 basis points. Con Edison also believes that Staff should not have applied CAPM inputs derived from market data to the Company's book value investments. Instead, it believes that Staff should have multiplied its derived return by a factor that would relate the current market value of domestic equities to their underlying tangible accumulated book value. For the Standard & Poor's 500, about 75% of the domestic equity market, a factor of 6.4 would be supported.

Further, the Company criticizes the adjustments that Staff applied to its results. Con Edison believes that Staff should not have reduced its return on equity estimate by 29 basis points to account for credit quality differences between the Company and the proxy group that Staff used. According to the Company, Staff has not provided adequate evidence of a relationship between credit quality and the observed equity returns in the utility industry. Also, Con Edison states that its credit rating is deteriorating and an understated return on equity will compound a bad situation at a time when the Company is going to the market to support its capital expenditure program. The Company considers it improper to reduce the yield on long-term bonds, as Staff's adjustment would do, given its bond rating, the volatile and unpredictable capital markets, and the negative outlook that currently applies to Con Edison.

The Company also objects to the 10 basis point reduction that Staff applied for the revenue decoupling mechanism and the risk-reducing effect that is expected from the adoption of the mechanism in this rate case. According to Con Edison, this adjustment is improper, unsupported and arbitrary. It states that there has not been any recent experience with revenue decoupling mechanisms in New York and the experience elsewhere in the electric industry is limited. Thus, it believes that Staff's adjustment is premature. The Company believes that regulatory risks could rise with this mechanism, particularly if deferred balances become too large. Also, it states that if the mechanism provides investors lower returns than they expect, it is not clear that they will favor its use.

In sum, Con Edison considers Staff's equity return recommendation to be incompatible with the actual earned returns found in the broader economy and claims that it is inherently unreasonable. The average of the currently allowed returns for the companies in Staff's proxy group is 11.1%. Con Edison believes that this shows that Staff's recommendation is too low and will, along with other positions taken by Staff in this case, increase the Company's regulatory risks. Con Edison objects to having to make periodic revenue decoupling mechanism filings and the regulatory scrutiny that such filings with foster. It also objects to the type of incentive performance program that Staff supports, Staff's expense adjustments, and Staff's rejection of reconciliation mechanisms. According to the Company, this rate case will increase its risks and eliminate sources of upside earnings potential. It claims that Staff's return on equity proposal fails to account for these developments. It would be the lowest allowed return in the country in decades and it would make it difficult for the Company to retain an "A" credit rating.

3. Other Parties' Positions

Westchester County did not provide an expert witness to address cost of capital matters; however, it has stated its position. The County believes that the Company's return on equity should be set at about 9.1% or lower, based on the information available when it submitted its initial brief. Westchester would support an allowed return as high as 9.7%, but only if the Company's equity ratio were reduced to 44%.

In any event, from its review of various recent rate case determinations, Westchester County believes that Con Edison's request for an 11.5% return on equity is excessive. The County points out that the Company's business risks have decreased since the time it divested its generating plants and the costs for energy and capacity are automatically collected through adjustment clauses on customers' bills. According to Westchester, it is important to keep to a reasonable rate of return to keep the amount of the overall rate increase down. In setting the allowed rate of return for Con Edison, Westchester County does not believe that the Commission should be overly concerned about the expectations of rating agencies that may overstate the credit rating concerns posed by Con Edison's need to finance the infrastructure improvements it is making to the electric transmission and distribution systems.

Similarly, NYPA did not provide a rate of return expert but it has considered the Company's earnings, financial strength and stable stock prices and believes that its performance is at the pinnacle of the electric utility industry. Given the Company's financial measures and earnings stability, the Authority believes that Staff's proposed rate of return should be adopted. NYPA also believes that Con Edison has less risk than it claims and points to the revenue decoupling mechanism that will diminish earnings volatility. It also points to the advantages the Company obtained in the 2005-08 rate plan that permit it to recover capital expenditures.

In response to Westchester and NYPA, Con Edison criticizes these parties for not submitting financial expert testimony and claims that the positions they have taken are no substitute for the evidence the Commission should examine to establish the allowed rate of return on equity for the Company.

The CPB has provided expert witness testimony in this case and recommends a cost of equity that follows from the Commission's Generic Finance Case. CPB points out that the Generic Finance Case approach has been followed by the Commission for over a decade and adherence to it would support an allowed return of 9.0%.

CPB used the two-stage DCF method and the CAPM method and applied them to a proxy group of electric and combination utilities with investment grade securities. It applied two-thirds weight to the DCF results and one-third weight to the CAPM results in accordance with the Generic Finance Case approach. It also adjusted its indicated results for credit quality differences and anticipated issuance costs. The results that CPB achieved corroborate those arrived at by DPS Staff. In response to CPB, Con Edison states that its criticisms of the DPS Staff approach apply equally to the CPB presentation.

4. Discussion and Recommendation

We find no basis in this case for the Commission to depart from the Generic Finance Case approach that has been a cornerstone of the Commission's standard ratemaking for the last decade. This approach has been used successfully to establish the multi-year rate plans that the Commission has approved in the recent past and its use has been upheld in at least two fully-litigated rate proceedings recently decided by the Commission. The assertions and arguments presented by the Company are not new and they are no more persuasive having been presented here by Con Edison.

While Con Edison believes that the Commission should use more than two approaches to estimate the cost of equity capital, it has never been its practice to rely to any extent on the results of any Risk Premium analysis and the Company has no reasonable basis for believing that this method would receive any greater amount of consideration in this case than it has in the past. The Commission has come to rely, in part, on the CAPM method but only secondarily to the DCF method that it continues to prefer and in which it places greater stock. The debate in New York concerning the use of various methods, and the degree to which any one method should be used, culminated in the Generic Finance Case and the guidance from that case has been employed consistently since the mid-1990s. We recommend that the Commission continue to rely predominantly on the DCF method and also on the CAPM method. No substantial weight should be given to the other method that Con Edison has presented in this case.

In almost all major rate proceedings, the record becomes full and, perhaps, cluttered by the parties' various criticisms of and alternative approaches for the components of the DCF and the CAPM methods. This matter was also addressed in the Generic Finance Case with the hope that such matters would be simplified and standardized in future rate proceedings. To the extent that the Generic Finance Case approach has been followed in multi-year rate plans and have been sustained by the Commission in the litigated rate cases, such results have been achieved. We do not find any need in this case to adopt any alternatives or variants for the components the DCF and the CAPM methods. We believe that the Commission should adhere to the calculation of these methods as specified in the Generic Finance Case.

With respect to the use of proxy group results, it has become increasingly difficult to find representative firms, in sufficient numbers, for the electric combination and the natural gas utility companies that operate in New York. If a sufficient number of companies cannot be found to provide a good proxy group, or if the proxy group results cover too broad a range or required too many adjustments for the results to be applied to Con Edison or any other company that the Commission regulates, it may become necessary for the Commission to calculate and determine the allowed rate of return for the companies it regulates by using, in the first instance, the market data that is available, either the utility Company itself or the utility company’s parent, with appropriate adjustments for the diverse business and financial risks that the affiliated companies may have. As long as the Generic Finance Case approach can be sustained, we do not recommend that the Commission revert to the approach that it previously used that relied predominantly on the market data available for the company it was addressing in a particular rate proceeding.

With respect to the return on equity adjustment proposed for the revenue decoupling mechanism, the Commission recently determined that a 10 basis point adjustment is warranted for this mechanism that is expected to reduce the amount of revenue volatility for the utility company. In this case, Staff proposed a 10 basis point adjustment that is consistent with the Commission’s recent decision and we find that it is proper.

Finally, we are not persuaded by Con Edison that the market-to-book ratios currently observed for the companies in the proxy groups identified in this case, provide any reason to modify either the DCF method or to provide less weight to this approach. Market value is not the measure for the allowed equity return which has been, and should continue to be, determined on the basis of the book value of the Company's assets.

In sum, we recommend that the Commission adopt the return on equity results supported by the DPS Staff and CPB financial witnesses and that the Company's request for a higher equity return allowance be denied.

SUMMARY OF RECOMMENDATIONS ON REVENUE REQUIREMENTS

The recommendations contained in this recommended decision would support a revenue requirement increase of $601.4 million. Of this amount, we recommend that $330 million be considered for temporary rates.

COST ALLOCATION ISSUES

NYPA Cost Allocations

Con Edison performed an embedded cost of service study that it used to determine the amount of revenue to collect from various customer classes. The study considered the costs Con Edison incurred in 2005 and classified them as transmission system, distribution system and customer costs, among other functions. The functionalized costs were allocated to the customer classes using various allocation factors.

Con Edison also considered the revenues it has been receiving since April 1, 2007 when the current delivery rates went into effect. The revenues for each class of customers either exceed the costs assigned to the class or they do not cover the assigned costs. When the difference between the revenues and the costs exceeds 10% of the target for the class, the class can be assigned either a greater or lesser portion of the rate award to make up the difference.

The embedded cost of service study Con Edison provided in this case indicates that NYPA is about $30 million deficient in meeting the costs that the Company would assign to it. To cover this amount, NYPA would have to pay about 25% more in rates than it would if the rate increase were equally allocated to all customer classes. Con Edison's proposal is opposed by NYPA, the NYC Government Customers and Westchester County.[115] This matter is also addressed by DPS Staff.

1. NYPA

NYPA claims that there are three problems with Con Edison's cost of service study. First, it believes NYPA was singled out for an unfair, special analysis that does not apply to other classes of customers. In this regard, it criticizes the cost of service study for addressing only three classes: the NYPA governmental customers; Economic Development Delivery Service customers; and, all other Con Edison customers.

NYPA also believes that Con Edison skewed the data it used against the Authority and that the claimed deficiency must be viewed in a proper context. It proposes that the rate increase be applied uniformly to all classes without any deficiency ascribed to NYPA. Alternatively, if the Company's cost of service study is used, NYPA believes that the normal 10% tolerance band should be increased to 20%. If a 20% tolerance band is used, NYPA would only be required to make up about a $13 million deficiency.

NYPA observes that the cost study Con Edison provided in its 2004-05 electric rate proceeding showed a $43.7 million deficiency. It states that this deficiency was addressed and NYPA doubts that its costs have since increased faster than the cost of serving other groups of customers.[116] NYPA also believes that the Company's cost of service study data are unstable and produce unreliable results. It states that the Con Edison cost

[115] NYPA provides electricity to the NYC Municipal Customers and to Westchester County.

[116] According to Con Edison, NYPA was only assessed $10.5 million of the deficiency indicated in the 2004-05 rate case. Con Edison's Initial Brief at 296.

model is very sensitive to the assumptions incorporated into the model.

NYPA also maintains that the proposed rate increase would have an undue economic impact on it that should be ameliorated by applying the rate increase uniformly across all customer classes.[117] If the Commission accepts a $30 million deficiency for NYPA, the Authority urges that it be implemented gradually and the full amount not be applied to it in this rate proceeding.

In support of its position, NYPA addresses the cost allocators that Con Edison used and claims that they do not reflect properly the load growth differences between it and other customer classes since 2005. It points out that the 2005 customer demand levels are used in the study to allocate over 80% of the Company’s rate base and no adjustments were made to recognize changes in the customer demand levels since then.

As to Con Edison’s substitution of a 9% earned return in the cost of service study for the 8% rate of return that was authorized in 2005, NYPA claims that this update is improper, retroactive and it exaggerates the amount of the claimed deficiency. According to NYPA, a proper cost of service study should determine the fair share that each class of customers should pay and, in that regard, it believes that the rate of return authorized by the Commission should be used.

NYPA also objects to the allocation factors Con Edison used for the high tension and low tension systems. To assign the high tension system costs, Con Edison used the higher of the summer or winter non-coincident peak, except in four instances. According to NYPA, the non-coincident, summer peak demand is the proper allocator to use. It would reduce the indicated deficiency by $1.3 million.

[117] In support of this rationale, NYPA cites to the Commission’s 1980 *Statement of Policy Concerning Evidence of Economic Impact in Rate Cases* (issued January 14, 1980).

With respect to the low tension system, NYPA states that these costs should be allocated using individual customer maximum demands. Con Edison allocated them using an average of such demands and non-coincident peak demands, with several exceptions. This change in the cost of service study would reduce NYPA's indicated deficiency by $16.8 million.[118] NYPA does not dispute the Con Edison approach for non-residential customers. However, it claims that it is incorrect for the residential class because many customers live in apartment buildings where the addition of the customers' individual peak demands overstates the apartment buildings' demand on the grid given the load diversity within the apartment buildings. According to NYPA, Con Edison should have but did not provide a study to support its approach which differs from the one recommended by the National Association of Regulatory Utility Commissions (NARUC), which supports the use of individual customer maximum demands.

2. <u>NYC Government Customers</u>

The NYC Government Customers believe that the 2005 cost study results are not representative of Con Edison's operations in the upcoming rate year. They note large disparities in the Company's rate base, operation and maintenance expenses, and earnings for these periods, and observe that investments in the distribution system should not be allocated to NYPA to the same degree as are the transmission system investments. Due to a wide difference, they believe that the 2005 cost study does not represent the performance expected to occur during the rate year. For this reason, they urge that the cost study not be used for interclass revenue allocation purposes.

The NYC Government Customers also claim that the cost of service study is flawed. According to them, errors in the

[118] The NYC Government Customers would have preferred to use the individual daily peak demand; however, this information was not provided by Con Edison.

study systematically overstate the costs to NYPA. They recommend that the rate award be allocated equally to all customer classes, net-of-fuel transmission and distribution revenue.

The NYC Government Customers disagree with Con Edison's high tension plant allocator. Rather than treat all NYPA customers as a single class, Con Edison treated the 14 subclasses as individual classes. In doing so, the Company is said to have deprived NYPA of the diversity benefits that other Con Edison customer classes enjoy. Thus, the NYC Government Customers claim that Con Edison has overstated NYPA's non-coincident demand and its cost responsibility.

These customers also disagree with Con Edison's use of the summer peak demand to allocate high tension plant to three classes (SC 7, SC 12 and SC 12 TOD). For other customer classes the Company used the higher of the summer or winter demand. They point out that, for these three classes, the winter demands far exceed the summer demands. The proposed changes to the high tension plant allocator would reduce the indicated deficiency for NYPA by $14.3 million.

Next, the NYC Government Customers criticize the cost of service study for not including a customer component to allocate line transformer costs. They consider this to be a clear error and an inconsistency with the guidance provided by the NARUC Manual. This proposed change would decrease the indicated deficiency by $2.6 million.[119]

These customers also believe that Con Edison's low tension underground demand allocator should be rejected. They do not believe that there is as much non-coincident demand diversity as the Company's study assumed and there are limited diversity benefits at the secondary voltage levels on the distribution system. By applying slightly less diversity

[119] According to the NYC Government Customers, the adjustment would be larger if historical costs were used instead of replacement costs.

benefits to the low tension underground demand allocators, the NYC Governmental Customers believe that the indicated deficiency should be reduced by $6.4 million.

Con Edison allocated transmission plant using the peak demands on the highest five days during four-hour intervals. The NYC Government Customers believe that the highest five-day, single-hour peaks should have been used and that the “near-peak” hours produce misleading results. According to them, their approach does not dilute the peak demand data and it provides a better, cost causation signal to customers. The use of this allocation factor would reduce the indicated deficiency by $0.6 million.

These customers also disagree with Con Edison’s demand allocator for the underground and the overhead low tension systems which they consider to be illogical and lacking support. According to them, this is another reason why the Company’s study should not be used in this case.

As to the working capital included in the study, the NYC Government Customers disagree with the amount and the way it is assigned. They state that the $1.2 billion of working capital claimed here is four times greater than the amount in the last electric rate case. They also disagree with $143 million of the working capital being assigned to NYPA. This amount is about half of the NYPA revenues and it does not correspond with the allocation of working capital to other customer classes. They doubt, as well, that there is a six month lag in NYPA’s payments to Con Edison.

Finally, the NYC Government Customers believe that the functionalization of administrative and general expenses should be proportionate to the operation and maintenance costs. In the cost of service study they are disparate and a disproportionate amount of the administrative and general expenses are allocated to the transmission and high tension categories.

3. Westchester County

Westchester County agrees with NYPA and the NYC Government Customers that the Con Edison cost of service study should not be used to re-allocate revenue requirements among the service classifications. It proposes that the parties meet, collaborate and examine alternate methods of allocating demand related plant.

Westchester criticizes Con Edison's five-day, four-hour average, summer peak demand allocator as greatly reducing the rate impacts for customers who use electricity during peak periods. It believes that the coincident peak demand should be used for peak demand allocations. Westchester notes that, if a different cost allocation method were used, the indicated deficiency for NYPA would be eliminated.

Contrary to Con Edison's attribution of peak demand growth to the use of air conditioning by residential customers, Westchester believes that the demand levels experienced at the time of the system peak should be used to determine who pays for the investments being made to meet the system peak. In general, Westchester agrees with many of the criticisms of the cost study that are made by NYPA and the NYC Government Customers.

4. DPS Staff

DPS Staff generally accepts the results of Con Edison's cost of service with one exception. Staff criticizes the Company for not providing a formal, load diversity study to support its approach for low tension overhead and underground facilities. The Company's allocation factor used non-coincident demand (75%) and individual customer billing demands (25%). According to Staff, the Company should provide a load diversity study with its next major rate filing to support the use of this allocation factor. For now, Staff proposes that a 15% tolerance band be used with the Company's cost of service study.

5. Con Edison's Response

Con Edison opposes Staff's proposal to use a 15% tolerance band in this case. According to the Company, Staff has not provided a valid reason for adjusting the band. Staff has not shown a link between the issue it raised—the weighting of the demand factors—and the proposed change in the tolerance band.

The Company also opposes NYPA’s proposal to use a 20% tolerance band and denies that there is any instability in the cost study results. Con Edison considers NYPA’s proposed changes to the cost study to be drastic and unwarranted. The Company also believes that the traditional 10% tolerance band should continue to be used.

Also in response to NYPA, Con Edison states that, if the 9.0% earned return is lowered to 8%, pro-forma adjustments would also have to be made to align costs, revenues and the allocation factors. Moreover, the Company insists that the class relationships would have to be maintained so as not to render a meaningless calculation. With proper adjustments, the Company believes that the indicated deficiency would decrease by only $1.6 million and not by the $14.3 million NYPA has claimed.

The Company also believes that NYPA incorrectly recalculated the coincidence factors for the traction and substation loads in SC 65 and SC 85. These groups are not billed on a non-coincident basis as NYPA may have believed. According to Con Edison, they are billed on a coincident basis.

Also in response to NYPA, Con Edison states that it is reasonable to allocate the costs of the high tension system that serves a mix of customer classes to the residential heating customers using summer demands because they are winter peaking and not isolated to any particular high-tension geographic area.

Addressing NYPA’s proposed allocation factor for the low tension system costs, Con Edison supports the use of an average of the non-coincident peak and individual customer maximum demands to recognize that both factors play a role in the design of the low tension system. It states that its method has been in use since 1996. It believes that NYPA’s proposal should be rejected because it incorrectly assumes that the secondary networks are designed to supply the sum of individual customer loads. According to the Company, it would be improper to shift costs to residential customers and away from NYPA and large commercial customers.

Con Edison also disagrees with a NYPA proposal to eliminate research and development from the costs allocated to it. According to the Company it matters not that NYPA participates in its own research and development programs. Con Edison states that the research and development it conducts is intended to reduce costs and improve reliability for all customers, including NYPA.

With respect to the contention that the 2005 costs should not be used to establish future rates, Con Edison states that any concern about the relative amount of capital investments in distribution and transmission facilities is misplaced because the total revenue requirements are determined by the return provided on the total rate base and expenses. In any event, the Company also states that there has not been any change in the relative investments in transmission and distribution facilities since 2005

Addressing the NYC Government Customers, Con Edison asserts that the revisions they have proposed would arbitrarily shift costs to other customers. To calculate the high tension allocator, Con Edison is opposed to treating NYPA as a single customer with a single coincident load shape which, it states, would ignore the cost responsibility of the underlying customer groups. According to the Company, internally homogeneous groups, such as traction load and the New York Housing Authority, should not be included in heterogeneous groupings. It believes that the different class characteristics that have developed over time are important and they should be used to assign cost responsibility to the subgroups. According to Con Edison, if a single load shape were developed for its customers, like the one that the NYC Government Customers developed, it would still produce an indicated $26.5 million deficiency for NYPA.

Con Edison also disagrees with the NYC Government Customers' functionalization of low tension distribution line transformers as being customer related. The Company assigns the line transformers to the demand component because its system mostly has large transformers. Less than 1% of the book cost of the line transformer account represents small transformers. Therefore, the Company believes it is entirely proper to classify the book costs as being related to demand.

Con Edison also argues against the NYC Government Customers' proposal to increase the weighting of individual customer maximum demands in the low tension allocation for the same reasons it opposes NYPA's proposal to just use the individual customer maximum demands. According to the Company, the NYC Government Customer proposal is not a slight change and it would dramatically shift costs from NYPA to residential customers. It would not make any such change without a study to support a non-equal weighting.

In defense of its functionalization of administrative and general expenses, Con Edison states that it uses a more detailed methodology than required by the NARUC Manual. It states that the approach it uses is appropriate and similar to the three-factor approach recognized by the NARUC Manual.

With respect to Westchester County, Con Edison disagrees with its proposal to allocate transmission costs on the basis of the one-hour peak on the system peak days. It states that the system is designed to sustain short-term overloadings but not repeated high loads over a longer period. For this reason, it believes that a four-hour demand over five days better recognizes the system design; how the system operates; and, the cost causation principles at work. The Company also disagrees with the transmission allocator presented by Westchester for assuming no growth in NYPA's allocator. According to Con Edison, this would provide an unwarranted reduction in the transmission costs allocated to NYPA.

With respect to high tension costs, Con Edison states that they should be allocated on the basis of class peaks or non-coincident peaks but not the one-day, one-hour allocator that Westchester also used for the transmission costs. The Company states that its approach has been the standard used in previous rate cases and there is no basis for changing it now.

Con Edison also disagrees with Westchester's proposal for another collaborative proceeding to examine alternate methods of allocating demand related plant. According to the Company, adequate time was spent on such matters in the last collaborative and none of the parties presented any cost studies to warrant a change in the demand allocation methodologies that it uses.

In sum, Con Edison is willing to gradually phase in the $30 million NYPA deficiency if the Commission were to implement a multi-year rate plan in this case. Absent the use of such an approach, the Company is opposed to a DPS Staff proposal to limit the increase applicable to NYPA to 150% of the system average increase. It believes a higher ceiling should apply to NYPA to be consistent with past practice. The Company also observes that its delivery service represents only 25% of the NYPA customers' total bills. Con Edison is opposed to applying a uniform percentage increase to NYPA and the other customer classes as to do so would ignore the fundamentals of good rate design and the application of cost causation principles. The Company insists that NYPA should not be subsidized at the expense of other groups of customers and that all classes should provide returns on investment at about the overall system average return.

6. Discussion and Recommendation

As demonstrated by the positions taken and the arguments mustered by the parties interested in the results of Con Edison's embedded cost of service study, substantial work goes into performing such studies and evaluating their results. The results presented will depend on the expert opinions and judgments of the engineers who classify the costs and investments according to their functions, and allocate portions of the electric system to various customer groups that use the network. A range of competing views is possible and the accuracy of any study is always subject to debate. To avoid such debates, except in instances where clear technical points produce sizable differences that alter the study results, the Commission has employed a tolerance band around the indicated results that avoids cost allocation swings that may be uncertain or may be undone from one case to another. This approach has the advantage of avoiding multiple adjustments to the service classes that could alter direction from one rate proceeding to another.

In this case, if a $30 million NYPA deficiency were accepted, the parties generally concur that it should be implemented gradually to avoid any detrimental impact on the customers that NYPA serves. The use of gradualism is not reserved only for multi-year rate plans. It is also used by the Commission in single-year rate proceedings in instances where the results appear to be too much for a customer class to bear in one fell swoop.

It is significant to us that DPS Staff accepts the results of the Company’s embedded cost of service study and has not proposed that any adjustments be made to it. And, while Staff has not asserted a direct relationship between the additional study it has asked the Company to perform in its next electric rate proceeding and its proposal to use a 15% tolerance band in this case, we surmise that the Staff proposal is intended to provide for only a gradual shift in the allocation of costs among the service classifications at this time.

We are not persuaded from the parties’ criticisms of the Con Edison cost of service study that the Commission should instruct the Company to modify either its cost functionalization procedures or the allocation factors that the study employs. Instead, we recommend that the Commission implement in the rates set in this case only one-half of the indicated deficiency. Instead of the $30 million proposed by the Company, the interclass re-allocation to NYPA should only be $15 million to more gradually adjust the allocation of costs to this service class.

Street Lighting Cost Allocations

Con Edison has proposed to increase its street lighting facilities charge from $5.86 to $12.51 per month. New York City opposes the proposed increase and observes that the number of street lights has not changed appreciably since the time that the $5.86 charge was set.

The Company used its embedded cost of service study to determine a $9.14 per month rate for such facilities. The City believes that the cost of service study should not be used because of the errors it has detected in the study that affect the allocation of costs to the street lighting class. Moreover, the cost study is based on Con Edison’s costs in 2005 and the City believes that 2005 was an aberrational year for street lighting purposes. The incentive mechanism adopted in the 2005-08 rate plan required the Company to repair an extraordinary number of out-of-service street lights, approximately double the number in previous years. The City does not believe that the abnormal amount of street lighting expenses in 2005 should be the basis for increasing the facilities charge in this case.

According to the Company, the increase in street lighting repairs in 2005 was not abnormally high. It states that the expenses incurred in 2006 and 2007 match the level incurred in 2005. It also states that the operations portion of the street lighting expenses increased in 2005 and thereafter. However, New York City opposes the Company’s direct allocation of stray voltage costs to the street light facilities charge because the stray voltage program, which includes underground structures and facilities not allocated exclusively to street lighting, is intended to benefit all customers.

We find that the 2005 cost study results are not representative or useful for determining the cost amounts that should be allocated to the street lighting class in rates set for 2008 and thereafter. The amount of street lighting work that was performed in 2005 was the result of the incentive program that was adopted to improve the Company’s previous performance that had been criticized. Thus, the activity levels in the years before 2005 were probably too low and the levels since then have been abnormally high. Also, New York City has made a persuasive case against assigning all the costs of the stray voltage program to the street lighting class of customers. For these reasons, we do not recommend that the results of the cost study be used to increase the street lighting facilities charge.

The Company also applied the system-wide rate increase to the street lighting facilities charge to arrive at its proposed monthly charge. While New York City is opposed to this increase in the charge, it states that if there is any increase in the charge it should be limited to the lesser of the system-wide average percentage rate increase, or $0.68 per month which is an alternative charge calculated by the City’s consultant.

Rather than use the City’s alternative calculation for the monthly facilities charge, we recommend that the Commission apply to the street lighting class the system-wide average percentage increase without Con Edison’s cost of service study results. We are not persuaded by New York City that its alternative calculation examines the category costs any better than the Company’s study. Nor does it appear to provide a specific result, or a general methodology, that the Commission would use to set rates for this service class.

RATE DESIGN

Delivery Service Rate Design Matters

Con Edison has proposed to increase the New York City street lighting facility charge. This matter is addressed above and, as noted, we are recommending that the charge only be increased by the system-wide rate increase and by no other amount.

Con Edison has proposed to recover NYPA’s portion of the rate increase in the Rate I and Rate II charges included in the PASNY No. 4 delivery service rate schedule. Consistent with the guidelines for standby rates, the Rate III and IV rates in the PASNY No. 4 service schedule for each class would be revenue neutral at the proposed revenue level. These rates will produce the same delivery revenues as the equivalent non-standby rates. It does not appear that the Company's proposal is opposed by any party.

With respect to Economic Development Delivery Service (EDDS), Con Edison has proposed that the conventional and time-of-day rates (and SC 15-RA of the P.S.C. No 2 rate schedule) be increased by the base rate percentage increase applicable to EDDS. It does not appear that this rate design proposal is opposed.

As to Con Edison's other service classes, the Company proposes to unbundled the rates for competitive services in accordance with the Commission's applicable policy by determining the transmission- and distribution-related revenue increase to be applied to delivery charges. The basic rate design principles for the non-competitive delivery charges have produced only a few, limited issues.

1. Customer Charges

The customer charge for residential customers in SC 1 and SC 7 is currently set at $11.78. CPB proposes that the customer charges be maintained at this level. Alternatively, it proposes that they be set no higher than the embedded customer costs.

Con Edison opposes CPB's proposal. According to it, the 2005 embedded cost of service study indicates that the customer costs for SC 1 and SC 7 are $12.20 and $17.37, respectively. Con Edison believes that the customer charge for both service classes should be increased to $15.21 to keep them in line with the level of costs and revenues projected for the rate year.

CPB does not believe that the residential customer charge should be increased by about 30% as the Company has proposed. It insists that the current charge is close to the indicated cost of service for SC 1 customers as presented by the Company's 2005 embedded cost of service study. It therefore believes that no increase is warranted and it would be better to promote energy conservation and efficiency by collecting more revenue through usage charges.

We recommend that the customer charge for SC 1 and SC 7 be set at $12.20 consistent with the 2005 embedded customer cost of service study results for SC 1 customers and for the reasons provided by CPB.

2. Standby Rate Tariffs

E-Cubed and Joint Supporters have proposed that the current exemption for distributed generation facilities from the Company's standby rates be extended to March of 2011. These parties also oppose the use of ratchet charges and surcharges that apply when a customer exceeds its contract demand level. They believe that the first time a customer exceeds the demand level by 10% it should not be held responsible for any ratchet charge. Also, they believe that a means needs to be developed to hold host facilities responsible for the performance of their systems, but only at a level that is appropriate for the electric market conditions prevailing at the time when the system fails to deliver as scheduled.

Con Edison states that the Commission has already considered the E-Cubed and Joint Supporters proposal to extend the exemption period and has decided to extend the deadline to May 2009 and provide a phase-in through February 2011. For this reason, Con Edison believes that this matter requires no further action.

With respect to the use of ratchet charges and surcharges, Con Edison states these matters have been considered by the Commission and have been rejected. According to the Company, the charges provide a proper incentive for customers to manage their loads and to estimate their demands correctly to avoid the ratchet provision.

As to the surcharge, customers can avoid it by agreeing to have the Company set the level of the contract demand. Con Edison also states that customers have considerable leeway to establish their own contract demand and remain within 10% of their contract demand.

We find that the Company has adequately explained why there is no need to make any standby rate changes. We recommend that Con Edison's position on these matters be adopted.

3. BIR Discounts

Con Edison discounts its delivery charges for eligible electric customers to retain and attract commercial and industrial customer, and to promote economic development in its service area. Customer who qualify for a comprehensive package of economic incentives from a local municipality or a state authority, customers served in new or vacant premises that receive a substantial real property tax incentive or energy rebate, and non-for-profit institutions that occupy newly constructed or converted laboratory space can receive Con Edison's Business Incentive Rate (BIR).

According to Consumer Power Advocates (CPA), the BIR discounts available to non-profit biomedical research facilities should be increased because this sector is a major economic engine for New York City. Over the last five years, 59,000 jobs were created in this sector. CPA believes that a further allocation of power for non-profit biomedical research is justified given the success experienced in this area and with 95% of this allocation being subscribed. CPA states that biomedical research facilities can relocate almost anywhere in the world and it is important to attract and retain them in New York. It believes that an additional 77 MW of load should be assigned to the non-profit biomedical sector.

Con Edison does not believe that any additional MWs are necessary to entice biomedical facilities to move to New York. It is opposed to an additional set aside for biomedical facilities which it believes are no different than any other type of customer. The Company believes that the existing allocations and programs are sufficient. According to the Company, CPA has not provided sufficient evidence or data to support its claim that cost considerations warrant the use of the BIR to entice biomedical facilities to relocate to New York City. Con Edison states that there are sufficient allocations remaining under the existing BIR programs for biomedical facilities to apply for rate incentives as would any other qualified customers.

We do not recommend that the Commission increase the BIR amount specifically for biomedical facilities as requested by CPA. We do not believe that the record in this case adequately supports a substantial increase in the BIR program as CPA has suggested. Nor does it suggest to us that it would be just and reasonable, or equitable, to provide so much support for the biomedical research industry and not provide as well for any other sector or industry.

Monthly Adjustment Clause (MAC)/Market Supply Charge (MSC)

The MAC is paid by all customers, except the NYPA and EDDS classes (up to a peak cap kW for each). It allows the Company: to recover the difference between its total cost of supply and the costs recovered through the MSC; to collect or credit customers for certain other costs, including production-related costs and NYISO credits related to TCC revenues; and to recover the costs of certain programs, such as demand side management (“DSM”) programs. The MSC allows the Company to recover the market value of the capacity and energy it purchases on behalf of its full-service customers. It is estimated and posted every three months, for the subsequent three-month period based on forecasted sales and supply-related costs. The MSC is paid only by customers who purchase their supply from the Company.[120]

[120] Tr. 227-228, 4908-4909; Staff Initial Brief at 211; RESA Initial Brief at 4.

Con Edison proposes that the following cost elements be moved from the MAC to the MSC: (1) all costs incurred for financial hedging instruments and the net impact of financial hedging instruments, on and after May 1, 2008, (2) NYISO commodity-related rebills for prior months' costs issued to the Company on or after May 1, 2008; (3) total costs, rather than only market costs, associated with energy and capacity contracts entered into on or after May 1, 2000 to serve full service customers, except for public policy contracts; (4) the monthly amortized cost of TCCs purchased on behalf of full service customers through NYISO auctions, direct sales or from the secondary market, on or after May 1, 2008; and (5) revenues received on and after May 1, 2008 from TCCs held on behalf of full service customers.[121] The Company argues that recovery of these costs from full service customers would better reflect cost causation and is consistent with Commission orders.[122] The Company also proposes to modify the MSC tariff provisions to include recovery of all costs related to Regional Greenhouse Gas Initiatives ("RGGI") and other environmental initiatives and to include the recovery of unforeseen commodity related charges.[123]

The Company proposes to modify the MAC tariff provisions to (1) clarify that the cost of Company-owned

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[121] Con Edison Initial Brief at 411. The May 1, 2008 effective date is proposed because it coincides with the beginning of the three-month period for which estimated MSC and MAC rates would normally be filed and with the May 1 start of the NYISO summer capability period. Con Edison Initial Brief at 414.

[122] Specifically, the April 19, 2007 "Order Requiring Development of Utility-Specific Guidelines for Electric Commodity Supply Portfolios and Instituting a Phase II to Address Longer-Term Issues" (Case No. 06-M-1017, "Hedging Order") and the January 23, 2006 "Order Concerning Petitions for Rehearing and Clarification" (Case No. 04-E-0572). Con Edison Initial Brief at 412.

[123] The Company states that these costs cannot be reasonably projected at this time, but undoubtedly, "if and to the extent incurred, will be incurred to serve full service customers." Con Edison Initial Brief at 412-413.

generation assets includes oil storage and handling costs; (2) reflect only non-commodity-related rebills issued to the Company beginning May 1, 2008; (3) defer on and after April 1, 2008, wholesale Transmission Service Charges ("TSC") revenues received from non-firm transmission contracts and the difference between monthly amortized revenues from sales of the Company's system TCCs and the amount reflected in setting rates; and (4) provide for recovery of unforeseen transmission-related charges. The Company also proposes to simplify the calculation of MAC estimates, which currently consist of per kW (demand) and per kWh (energy) components for all demand billed classes except SC 14 RA and a per kWh (energy) component for all non-demand billed classes. It asserts that the distinction was previously (but is no longer) required to comply with a Commission determination that the combined MSC and MAC rates for customers in NYC and Westchester should be equalized. As equalization is no longer required, the Company proposes that a flat MAC rate per kWh apply, commencing May 1, 2008.[124] Finally, the Company proposes that the transition from the existing to the proposed MSC/MAC mechanisms be earnings neutral.[125]

Staff states that the Company's proposed changes are appropriate but also recommends that the Company's MSC reflect the market value of supply and the Adjustment Factor–MSC[126] be

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[124] The Company explains that is not proposing a per kWh MAC for customers billed under SC 14-RA because the Commission has indicated that stranded production costs should be recovered from standby customers through a uniform mark-up of all delivery service rates and, since the delivery rates in SC 14-RA consist of a customer charge, contract demand charge, and daily as-used demand charges, the MAC rates for standby service customers must be designed to be specifically referable to each of those charges. Con Edison Initial Brief at 414.

[125] Con Edison Initial Brief at 411-414.

[126] The Adjustment Factor-MSC reconciles the difference between the estimated MSC and actual supply-related costs on a one month lag. Staff Initial Brief at 211.

used to reconcile the difference between the actual market values and the Company's cost of electric supply. It states that providing the actual market price of electricity will provide customers with information to make decisions on their consumption and on competitively priced alternative supplier offers. Staff asserts that no party, including the Company, has raised an objection to this proposal. Staff therefore recommends that the Commission order the Company to file a plan, within 60 days, to revise its MSC charge so that it reflects actual day-ahead market prices that were in effect during each customer's billing period. In that plan, Staff states that the Company should be required to identify specific issues that will need to be resolved and include a proposed implementation schedule.[127]

The Retail Energy Supply Association (RESA) recommends rejection of the Company's proposals to recover in the MSC the costs and benefits associated with financial hedging instruments; total market costs associated with specified energy and capacity contracts; and TCC costs and revenues.[128] RESA argues that the required and long-established MSC pricing structure is that the MSC would be applicable to full service customers and avoided by retail access customers and will include "market prices for the cost of capacity, energy and ancillary services needed to supply the full service customer's load."[129] RESA contends that Con Edison is modifying the

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[127] Staff Initial Brief at 211-212; Tr. 4908-4909.

[128] RESA does not object to the Company's proposed recovery of NYISO rebills through the MSC. RESA Initial Brief at 5, n. 10.

[129] RESA Initial Brief at 4, citing Case 96-E-0897, In the Matter of Con Edison Company of New York, Inc.'s plans for (1) Electric Rate/Restructuring pursuant to Opinion No. 96-12; and (2) the formation of a Holding Company pursuant to Public Service Law, Sections 70, 108, 110, and certain related transactions, Order Concerning Market Supply Charges and Monthly Adjustment Clauses (issued April 24, 2000).

established structure by incorporating new cost elements that are not reflective of current market based prices. It asserts that the Company’s proposal, if approved, will mask accurate pricing signals, conflicting with recently instituted Commission energy efficiency and pricing initiatives and the best interests of customers.

RESA argues that the Commission’s approval of the current rate design has directly resulted in the establishment of a robust competitive retail structure in Con Edison’s service territory. It asserts that movement away from the provision of accurate pricing signals would occur under the Company’s proposals and would harm the existing and developing retail market in the Con Edison territory, be inconsistent with the “15x15 initiative” and conflict with goals of accurate pricing and the encouragement of efficient energy usage set forth by the Commission in its MHP[130] and Hedging Orders. RESA states that in the MHP Order, the Commission noted that “masking current pricing signals reduces customer awareness of the relationship between their usage and the actual cost of energy, and obscures opportunities to save on electric bills and reduce usage….”[131] RESA also states that in the Hedging Order, the Commission’s directive to mitigate price volatility was “specifically limited” to mass market customers and was not intended to apply to broader classes of customers billed under the MSC/MAC rate.[132]

RESA asserts that Con Edison’s proposal does not, as is purported, adhere to cost causation principles. It argues that major components (such as post-May 1, 2000 contracts, financial hedges and TCCs) of the Company’s proposal lack

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[130] Case 03-E-0641, Proceeding on Motion of the Commission Regarding Expedited Implementation of Mandatory Hourly Pricing for Commodity Service, Order Instituting Further Proceedings and Requiring the Filing of Draft Tariffs (issued September 23, 2005) (“MHP Order”).

[131] RESA Initial Brief at 8.

[132] RESA Initial Brief at 5-9.

analysis that convincingly demonstrates whether these instruments solely affect the cost of electricity for full service customers. RESA continues that, absent such demonstration, it is unreasonable to flow such costs through the MSC and thus solely to full service customers.

RESA contends that the Company's proposed treatment of costs related to the Indian Point 2 contract highlights the lack of adherence to cost causation principles. RESA asserts that since the stranded costs associated with Indian Point 2 were paid for by all customers, all customers should receive any associated benefits from a contract accruing from the plant. RESA contends that this could only occur if the existing rate design, under which recovery of Indian Point 2-related contract costs is made through the MAC, is retained.

RESA adds that the Company's justifications for its proposed treatment of Indian Point 2 energy related costs are not supported by substantial or convincing evidence. RESA asserts that relevant data suggests that the level of contracted energy combined with the continuing decline in Con Edison's full service customer base provides compelling evidence that the energy-related portion of the Indian Point 2 contract will not be limited to solely meeting the prospective needs of full service customers. RESA concludes that it would therefore be unjust and unreasonable to shift such costs from the MAC to the MSC.[133]

The County of Westchester (the County) urges the rejection of the Company's proposal to recover all Regional Greenhouse Gas Initiative (RGGI) expenses through the MSC. It argues that the proposed scope of recoverable expenses is overly broad and the proposal itself is premature in that the RGGI costs and ground rules have not yet been defined and developed.[134] The County also urges rejection of the Company's proposal to change the recovery of MAC costs from a combination

[133] RESA Initial Brief at 9-14; Reply Brief at 2-7.

[134] County Initial Brief at 30.

of per kWh (energy) and per kW (demand) to per kWh (energy) only. The County argues that since MAC recoveries include cost items that are both energy and demand related, the current system of applying such recoveries to both demand and energy is consistent with good ratemaking practice and should continue. The County argues that the Company's proposal would impose a burden to non-demand classes such as SC 1 residential, claiming it could result in an additional[135] increase of $20 annually to residential customers' bills. The County states that, if necessary, the Company could be directed to meet with the active parties to determine if there are ways to "simplify" the MAC calculation that would avoid the "disruption" attending its current proposal.[136]

Consumer Power Advocates (CPA) asserts that the cost of legacy contracts should be closed out and excluded from the MAC and MAC because it is "almost entirely" responsible for the volatility in electricity delivery rates and interferes with customers' ability to budget delivery costs. It argues that the magnitude and volatility of these costs warrant greater scrutiny and transparency than is afforded by the monthly MAC filings.[137]

The Company generally agrees with Staff's proposal to modify the Adjustment Factor-MSC. However it would modify the proposal such that a second Adjustment Factor-MSC component would be created, and it would reflect the recovery of non-market supply related costs being moved from the MAC to the MSC while the current Adjustment Factor-MSC would continue to reconcile the difference between estimated and actual market costs. The Company states that this would avoid mixing the

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[135] I.e., in addition to the base rate increase proposed by the Company.

[136] County Initial Brief at 31-32; Reply Brief at 6-7.

[137] CPA Initial Brief at 9; Reply Brief at 3.

normal reconciliation of the market price estimate with non-market supply related costs.[138]

In response to RESA, the Company contends that it fully justified its proposal regarding the treatment of energy related contract costs. It refers to testimony explaining that: in 2001, when the Company sold Indian Point 2 to Entergy, the Company and Entergy agreed to a power purchase agreement providing the Company with capacity and energy at fixed prices through December 31, 2004; that the agreement provided for a "call option" under which the Company and Entergy could negotiate further capacity purchases through 2011; and that these capacity purchases were intended to mitigate the potential market power that Entergy would otherwise possess in New York State. The testimony also explains that post-2004 purchases of energy from Entergy, are post-restructuring, short-term arrangements made to serve full-service customers; unlike the original contract associated with divestiture, they have no provision for energy purchases after December 31, 2004; and, unlike the call option for capacity purchases, there was no public policy objective to be satisfied by continuing energy purchases, nor has any such policy objective been identified. Finally, the testimony notes that, with respect to the post-2004 arrangements, the Company determined that the Entergy fixed-price energy would be an effective hedge of its wholesale energy costs, which are incurred solely on behalf of full service customers.[139]

The Company states that the nature of its contracts with Entergy (i.e., entered into annually, for staggered three-year term, based upon the forecasted requirements of the Company's full service customers for such time periods) disprove RESA's assertions that it is "'highly unlikely that Con Edison signed additional long-term contracts after May 1, 2000 solely

[138] Con Edison Initial Brief at 415-416. Staff agrees. Staff Reply Brief at 90-91.

[139] Con Edison Initial Brief at 419-421.

to benefit an ever-shrinking class of Con Edison full-service customers…'."[140]

The Company characterizes RESA's argument that the MSC should be close to the market price as a collateral attack on the Hedging Order. The Company contends that in that order, the Commission dismissed this rationale, rejecting proposals for utilities to cease hedging and instead to flow through spot market prices to their mass market supply customers. The Company also cites to the Commission's January 23, 2006 Order in Case No. 04-E-0572, specifically the following passage (at 43), for additional support for rejecting RESA's position: "…we agree generally that it would better reflect cost causation principles if all commodity-related costs and credits would be recovered from or flowed back solely to Con Edison's full service customers, especially where such costs or credits relate to periods of time after retail access was an option for such customers."[141]

The Company asserts that RESA's claims regarding TCC costs should also be rejected. The Company argues that it fully explained that the TCCs it purchased to protect against fluctuations in the transmission costs or rents realized when moving energy from its point of injection to its point of withdrawal are incurred solely for the benefit of full service customers. Specifically, it recounts evidence explaining that since the Indeck, Selkirk and Entergy supplies noted on Exhibit 77 all reside outside of Con Edison's service territory, the Company participates in NYISO-sponsored auctions of TCCs, which are sold for 6-month or 1-year terms, in order to hedge the cost of delivering energy from those plants to its system. From this it concludes there can be no dispute that the energy purchases

[140] Con Edison Initial Brief at 421. The Company adds that RESA's conclusions are incorrect because the Company is not obligated to take the energy quantities available to it under its other contracts as RESA suggests. Con Edison Reply Brief at 153.

[141] Con Edison Initial Brief at 421-422.

and associated financial hedges, including purchases of TCCs, are made solely to serve the needs of the Company's current (and projected near-term) full service customers only and, as such, from both a cost causation standpoint, and consistent with Commission rulings on this matter, these costs should be recovered solely from full service customers through the MSC.[142]

Contrary to the County's assertions, the Company argues that RGGI costs and ground rules need not be defined as a prerequisite to seeking their recovery through the MSC. According to the Company, such costs will be part of the variable costs of energy production that is used to meet the demand of full-service customers and are therefore properly recovered through the MSC.[143]

With respect to the County's opposition to the conversion of the MAC to an energy-only charge, the Company states that neither ground offered by the County provides a basis for rejecting its proposal. Assuming these costs will be included in the market price of energy, the Company posits that they would be passed on to retail access customers by their ESCO. In that event, the Company argues that recovering these costs through the MAC (rather than through the MSC) could result in retail access customers paying a disproportionate share of these environmental costs.

The Company further contends that the County's argument ignores Commission precedent for the recovery of other demand-related costs through a volumetric charge. The Company cites, as an example, the Commission's allowance of per kWh charges for the recovery of public policy costs, even if demand-related, specifically, the System Benefits Charge and the stranded cost recovery mechanisms of other New York State electric utilities.

The Company characterizes as incorrect the County's claim that the change will result in a significant additional

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[142] Con Edison Initial Brief at 423.

[143] Con Edison Initial Brief at 416-417.

cost burden on classes of customers that are billed using an energy only charge. It points to testimony that: the SC 2 class billed under the energy-only MAC rate proposed by the Company would actually have seen a small revenue decrease in 2005 and a revenue decrease of $10 million in 2006; the SC 12 energy-only class would have seen small revenue increases in both years; and the SC 7 and the SC 9 maximum rate classes would have experienced decreases in revenues in at least one of the two years studied. The Company also argues that, if MAC costs were allocated to classes based upon contribution to peak demand as represented by the transmission allocator used in the 2005 ECOS study (as Westchester suggests would be proper), the impact on the customers that the County wants to protect would have been worse (i.e., 34.9% instead of 29.3% of total Company MAC costs would be allocated to SC 1). Finally, the Company asserts that the effect of its proposal on a typical Westchester County residential customer using 500 kWh per month would have been an average bill increase of $0.55 per month for the 24-month period ended April 1, 2007, while a typical New York City residential customer using 300 kWh per month would have experienced an average bill increase of $0.34 per month for the same period.[144]

In response to CPA, the Company argues that CPA never describes precisely what “close out” means and fails to provide any justification for its request. The Company asserts that CPA’s proposal is based on the incorrect assumption that any residual stranded costs remaining at the end of the multi-year rate plan would be small. The Company however notes that record Exhibit 77 shows that its legacy contracts have terms extending to 2014, 2015, 2016, 2017 and 2036. It argues that the remaining stranded costs resulting from these agreements have been the primary driver of MAC costs. The Company concludes that, given the magnitude, volatility, and longevity of these legacy contract costs, the current mechanism, which has been

[144] Con Edison Initial Brief at 417-419.

effective for seven years, remains the most appropriate method of cost recovery.[145]

With the exception of its proposal regarding inclusion of RGGI costs, “other environmental initiatives” and recovery of unforeseen commodity related charges in the MSC tariff provisions, we recommend that the Company implement its proposed MAC/MSC changes as modified by Staff (i.e., keeping the current Adjustment Factor-MSC limiting to reconciling the difference between estimated and actual market costs and adding a second Adjustment Factor-MSC component to reflect the recovery of non-market supply related costs being moved from the MAC to the MSC).[146] We further recommend adoption of the Staff proposal that the Commission order the Company to file a plan, within 60 days, to revise its MSC charge so that it reflects actual day-ahead market prices that were in effect during each customer’s billing period, identifying specific issues that will need to be resolved and include a proposed implementation schedule.

We make these recommendations based on finding that that the Company persuasively rebutted the arguments of RESA, the County and CPA and cited sufficient record evidence demonstrating that the proposed changes will result in rates that better reflect cost causation, consistent with the Commission’s Hedging Order and its January 23, 2006 “Order Concerning Petitions for Rehearing and Clarification” in Case

[145] Con Edison Initial Brief at 423-424.

[146] We are recommending that transmission congestion credits be addressed in base rates; however, to the extent any such credits need to flow through an adjustment clause, we agree with the Company’s position.

No. 04-E-0572.[147] We were also persuaded by the County's concerns regarding the proposed scope of recoverable RGGI and other environmental or "unforeseen costs"; we find that the categorization of such costs is overly broad and the proposal itself is premature in that the RGGI costs and ground rules and the other costs that the Company proposes to recover have not yet been defined and developed.

OTHER POLICY MATTERS

DEMAND SIDE MANAGEMENT (DSM)/ENERGY EFFICIENCY

In Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard ("EPS") the Commission established a goal of reducing electricity usage 15% from expected levels by 2015. The Commission identified the rationale for the EPS goal as "to reduce consumer bills, mitigate increasingly volatile fuel prices, prevent stress on the State's delivery system and reduce fossil fuel-related emissions …."

Although the Commission's policy is statewide, it is particularly important in the Con Edison territory, where consumer bills are the highest and where, as the Company's Infrastructure Panel testified, increased demand forecasts are a significant driver of the Company's extraordinarily large transmission and distribution construction program.

The Company has proposed a program to achieve 500 MW of permanent energy efficiency reductions by 2016. The program target date and the reduction goal reflect the NYISO 2007

[147] Though RESA cited the MHP order for its language advocating the design of rates that will send accurate pricing signals, the order's focus is on the encouragement and expansion of real time pricing, which is not the issue we are addressing here. In any event, this record demonstrates that the MAC/MSC rate changes recommended herein are consistent with the goal of designing rates that send accurate pricing signals in that the changes are designed to result in rates that accurately reflect their underlying costs.

Reliability Needs Assessment, in which the NYISO determined there was need for 1,000 MW in new capacity in the downstate area by 2016. The Company's proposal consists of a targeted initiative focused on load relief in certain T&D load areas, where the proposed levels of DSM reductions would result in deferral of Company planned load relief projects (approximately 150 MW) and programs designed to reduce demand throughout the Company's service territory (approximately 350 MW). Although the goals of the program would be expressed in demand, all measures to implement the program would achieve permanent energy efficiency reductions. Cost of the program in rate year one would be $6.6 million including $2 million in Company labor, $0.9 million in administration funding, and $3.7 million in program funding that would be recovered through the MAC.

Staff recommends that the Commission not authorize any new efficiency programs pending a determination in the EPS proceeding of the optimal role to be played by utilities in delivering energy efficiency services. Beyond the general concern regarding consistency with EPS, Staff has two principal concerns with the Company's proposal. First, Staff claims that the Company failed to put forth any concrete program plans or proposals towards territory-wide programs. Second, Staff maintains that the incentives proposed by the Company are excessive, and that incentives should be accompanied by negative adjustments for poor performance.

The NYC supports the rapid expansion of DSM efforts in the Con Edison system and supports a collaborative to develop a bridge program. NYC urges that interim targets for the bridge program should be established at levels that place the Company on a linear track to achieve its projected share of the savings under the EPS targets, subject to revision when the EPS proceeding concludes. NYC also expresses concern that Con Edison's proposal lacks specific details.

NRDC/PACE supports the role of Con Edison in the delivery of energy efficiency programs. NRDC/PACE urges the Commission to impose a direct responsibility on the Company to reduce electricity consumption 15% below forecasted 2015 levels and to hold the Company accountable for ensuring that its service territory achieves the goal.

The New York Energy Consumers Council (NYECC) urges that the Commission be very cautious in increasing DSM programs. NYECC states that efficiency program expenditures should be kept to a minimum and that customers should be encouraged to invest in efficiency on their own initiative.

Con Edison argues that it is uniquely situated to deliver efficiency programs in its service territory because it has data systems that provide proprietary account, customer, and facility intelligence. Con Edison also states that through its T&D load relief planning process it can identify potential uses of DSM as a tool to defer capital expenditures. According to Con Edison, determining which T&D investments can be deferred results from an iterative process and requires engineering and financial understanding of all load relief options. Con Edison cites comparative studies suggesting that utility-run programs, e.g. in California and Connecticut, can be twice as cost effective as the programs run by state agencies.

New Programs

As noted, Staff recommends that the Commission not authorize any new efficiency programs, pending a determination in the EPS proceeding of the optimal role to be played by utilities in delivering energy efficiency programs.

NYSERDA and CPB agree that coordination of the program through the EPS proceeding will minimize competition among programs, duplication of efforts and customer confusion. The roles and responsibilities among the various entities must be clearly delineated and cooperation among entities will be critical to the effectiveness of individual programs.

Joint Supporters support new programs initiated by the Company that do not directly compete with NYSERDA-managed programs.

The Company, NRDC/PACE and Joint Supporters argue that waiting for a resolution in the EPS proceeding would cause undue delay toward the achievement of the Commission's goal.

In evaluating this question, it is essential to distinguish between issues of statewide policy and issues specific to Con Edison's service territory. Questions of program targets, structure, participants, and incentives are all generic policy issues that will be determined by the Commission in the EPS proceeding.

Staff is correct that it would be premature for the Commission to approve substantial new programs while generic policy issues are still under consideration in the EPS proceeding. The Company would require a six-month ramp-up period for the initiation of any new programs. It would be counterproductive for the Company to expend the resources to ramp up new programs while there is a possibility that a generic decision in the EPS proceeding might determine a different role for the Company. The Company's proposed funding for new programs, including its proposal for $2 million to hire new employees, should not be adopted.[148]

Staff is also correct that the Company's proposals lack sufficient detail. If the Commission were to approve new programs, a collaborative should be established as suggested by Staff and other parties.

The Company suggests in its Reply Brief that, short of implementing new programs, it is important for the Company to begin the market research component of its proposal. Market research has been identified as a priority in the EPS proceeding; however, there is no specific proposal from the Company for the Commission to consider at this time. The Company is entitled to initiate its own market research work

[148] Developments in the EPS proceeding prior to the issuance of a rate order in this proceeding may give the Commission cause to award some portion of the Company's proposal for new employees.

without specific approval of the Commission. If, as the Company urges, performance incentives are eventually put into place by the Commission, then the Company's investment in market research is likely to pay for itself in the form of enhanced performance.

Joint Supporters state that the long-range element of the EPS proceeding may lag behind this case by as many as two or three years, in which case delay would be particularly harmful. We agree that action in this proceeding would be warranted if that were the case. At the time a decision is made in this case, the Commission will be in a position to evaluate the progress of the EPS proceeding. In the event the Commission agrees with the Company and with the intervenors who urge immediate action, a discussion of the proposals of the parties is presented below, following the discussion of Interim Measures.

Interim Measures

There is at least one issue unique to Con Edison that must be decided in this proceeding. Because the Company already has electric efficiency programs in place, the Commission must decide whether an interim program is needed, pending a determination in the EPS case.

Staff states that it would be unwise to allow a lapse in program considering the importance of continued progress towards the EPS goals. For that reason, Staff recommends an interim program to be developed through a collaborative process.

The Company agrees with Staff and others that the Commission should authorize a program beginning April 1, 2008 when the new rate plan begins, to avoid a gap in the provision of efficiency programs in the service territory. Con Edison opposes Staff's proposal that a collaborative should be held as a pre-condition for any further program. Con Edison does not oppose a collaborative to establish parameters for a longer-term program, but urges that it should be an advisory, rather than a decision-making collaborative. This argument applies to a permanent program as well as an interim program.

Under its current rate plan, Con Edison administers a targeted program to achieve 150 MW of permanent energy efficiency reductions, targeted to load areas to provide deferral of necessary load relief projects. Under the rate plan, NYSERDA also administers a 150 MW system-wide demand reduction program. In Con Edison’s existing targeted program, 78 MW have been contracted for and 3.2 MW have been installed. The Company estimates that all 150 MW will be contracted for prior to April 1, 2008. As of July 15, 2007, NYSERDA had contracted for 133 MW while committing 44.6% of its budgeted amount. The budget for each program was established at $112 million, not including administration and evaluation fees and the present value of construction revenue requirement reductions achieved by the deferral of planned T&D investments. At the conclusion of the rate plan, any funds collected by NYSERDA that have not been committed will be returned to the Company.

NYSERDA urges the Commission to extend the term of the system-wide program administered by NYSERDA under the current rate plan for two years or until the budgeted funding is exhausted. NYSERDA presented evidence demonstrating that it is meeting the targets of the program within the budget limits imposed by the Commission.

Con Edison opposes the extension of NYSERDA’s system-wide program. Con Edison engaged NYSERDA in substantial colloquy regarding the precise costs of its programs, but has not claimed that NYSERDA’s costs are beyond its budget. The Company states that, rather than running a separate program funded by Con Edison’s ratepayers, NYSERDA should reallocate SBC funding into Con Edison’s service territory. Con Edison argues out that NYSERDA’s SBC programs have disproportionately funded programs in other service territories because NYSERDA has not sought to develop standard offers specifically geared to Con Edison’s service territory. Con Edison also notes that under the current system-wide plan, only 28% of the demand reduction for which NYSERDA has contracted represents permanent energy efficiency. NYSERDA responds that it has met its target for permanent reductions by funding Distributed Generation projects as well as energy efficiency.

Joint Supporters support the continuation of both the targeted program and NYSERDA's system-wide program. Joint Supporters point out that every dollar of ratepayer funded initiatives in NYSERDA's programs is leveraged on average by $2 of private investment. Joint Supporters oppose restricting demand reduction programs to permanent energy efficiency measures. They argue that long-term performance-based commitments can achieve similar results and that the Company should be directed to include demand reduction and load management measures in its targeted program under long-term contracts.

Staff is circumspect in not recommending a continuation of the Company's existing Targeted Program. Staff claims that the targeted program lacks a sufficient track record to justify significant future investments without an independent program evaluation. NYSERDA does not take a position on the potential extension of Con Edison's targeted program.

Con Edison's costs under its targeted program have been approximately $1,000/kWh, which represents the outer limit authorized by the Commission. Con Edison explains that this price is influenced by the fact the targeted program has geographic limits because it must target specific load areas. Joint Supporters observe that the program consists primarily of lighting and air conditioning retrofits, which are among the easiest types of reductions to achieve. Several parties noted that although the Company has entered contracts, very few measures have actually been installed.

The evidence supports a conclusion that the Company is meeting its targets within the budget established by the Commission. The possibility that the program could be improved, or that there may be other programs that could achieve more cost-effective results, is outweighed by the need to maintain continuity while the respective roles of utilities and other entities are determined by the Commission in another proceeding.

It would be disruptive and counterproductive to terminate an ongoing program that is presently achieving its targets. This is particularly important in the Con Edison service territory where there is a clear and compelling need to achieve targeted demand reductions and system-wide efficiency gains. If it is determined that there are more effective programs, they will be implemented in the context of the EPS proceeding. Although it is premature to draw any conclusions, the amount of additional effort needed to meet the EPS goal indicates that new programs are likely to supplement rather than supplant existing programs.

For that reason we recommend that Con Edison’s Targeted Program be authorized to continue on the terms approved under the current rate plan. The Company anticipated 150 MW of targeted efficiency over an 8-year period; 30 MW of efficiency measures should be authorized for the rate year, reflecting the need for targeted load relief. If the Commission issues an order in the EPS proceeding prior to a determination in the Company’s next rate case, the Company should be required immediately to revise the Targeted Program, if necessary, to make it consistent with any ruling in the EPS case.

A similar analysis applies to NYSERDA’s system-wide program. Whether it is an optimal program for the long term is a question for the EPS proceeding. Again, given the pressing need in the service territory, it would be unwise to interrupt any ongoing program that is meeting its targets in a cost-effective manner. NYSERDA’s proposal that the term of the system-wide program be extended for two years should be accepted. Like the Targeted Program, the system-wide program should be subject to being superseded by an order of the Commission in the EPS proceeding.

Con Edison’s argument that the system-wide program should be replaced by a reallocation of SBC funds toward its territory is misplaced. The Commission has already addressed this issue and has established measures to prevent the use of

Con Edison money to supplant SBC3 money. [149]If an adjustment is warranted in the SBC, that issue should be raised within either the SBC proceeding or the EPS proceeding. It is not a reason to cut back on existing efficiency programs within the territory.

Staff and CPB propose a collaborative to develop the interim program. CPB cautions that if an interim program is not based on the existing system-wide program, consumers could be confused in the transition between current programs and long-term programs that will result from the EPS proceeding. A collaborative at this point would not be timely.[150] If there has not been a final determination in the EPS proceeding within six months of an order in this case, Staff and the Company should be ordered to institute a collaborative to consider proposals for an expansion of the interim program.

Reduction Target

Staff notes that the Company's 500 MW goal is linked to the NYISO Reliability Needs Assessment, rather than the goals established by the Commission in the Energy Efficiency Portfolio Standards proceeding that calls for a 15% reduction in electricity usage below the 2015 forecasted levels.[151] The Company's 2016 500 MW goal would only decrease its energy requirements by 2% to 3% of its forecasted load.

Several intervenors agree with Staff that the 500 MW goal is insufficient. NRDC/PACE urges that targets should be established for Con Edison to achieve its share of the 15x15 target; and that interim targets should be set to assess progress. NRDC/PACE further argues that the targets should be

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[149] Case 04-E-0572, Order on Petitions for Modification and Modifying Electric Rate Order, December 22, 2006

[150] A mid-case collaborative was established in the recent National Fuel Gas rate proceeding; however, in that case the Company had no existing program.

[151] Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standards, Order Instituting Proceeding (issued May 16, 2007).

established in kilowatt-hour savings rather than demand reductions. Joint Supporters propose a 750 MW program, which they testify is achievable based on their collective experience providing service in the Con Edison territory.

The Company responds that 500 MW is a reasonable goal because Con Edison's program will be only one of the energy efficiency programs that could reduce electricity consumption in the Company's service territory. Improvements related to building codes and appliance efficiency standards, NYSERDA programs, and those of other parties will also contribute to the EPS goal.

The question of program size is particularly difficult to resolve outside the context of the EPS proceeding. As the Company points out, other entities will make contributions toward the Commission's target. The NRDC/PACE proposal, that each utility be given a target of 15% within its own territory, presumes a finding by the Commission that the statewide goal can be efficiently achieved with proportional targets in each territory.

It is clear that 500 MW is insufficient in itself to meet the EPS target. It is also clear that 500 MW will allow for displacement of only a small portion of the Company's planned T&D construction. In this respect, the 150 MW proposed by the Company for targeted load relief appears to be far too little. If the Commission were to authorize a permanent Con Edison program rather than awaiting a result in the EPS case, the Commission should consider basing the size of the program on the extent of the Company's demand-drive construction needs.

Customers With Pre-existing Efficiency Investments

NYECC argues that all electric customers should not share equally in the cost burden of investment in the proposed new DSM program because some customers, who have already invested heavily in their own energy efficiency improvements, can derive no further energy efficiency benefits. NYECC argues that prudent electric customers who have been energy-efficiency minded should not be penalized.

The Company observes that NYECC has not explained how such a determination could be made. Con Edison also argues that NYECC has not identified which of its own members might meet such a definition, or how many of them invested in energy efficiency with the benefit of incentives supported by SBC programs. Finally, Con Edison points out that the Commission rejected this proposal in its previous rate proceeding, concluding that "information provided in support of such a broad exemption is anecdotal at best."[152]

NYECC's argument should be rejected for several reasons. There is no more record evidence supporting its claim than there was in the previous case when the claim was rejected by the Commission. Even if NYECC's proposal were adopted in principle, Staff's expert on measurement and verification of efficiency programs explained that it would be very difficult to identify which customers might qualify for such an exemption. NYECC proposed no specific criteria for making this determination. It is also not clear whether the customers to whom NYECC refers made efficiency investments with assistance from SBC or other sponsored programs. Regarding the difficulty of identifying customers who have acted efficiently in the absence of programs, the brief of NYECC refers to a portfolio-manager tool developed by the United States Environmental Protection Agency. There is no reference in the evidentiary record to this tool; NYECC can introduce the tool for consideration in a subsequent proceeding.

Finally, advanced technology programs under the SBC and, potentially, advanced technology programs established in the EPS proceeding, will be available offering additional opportunities for highly proactive energy efficiency-minded customers.

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[152] Case 04-E-0572 Rate Order at 90.

Incentives

1. Positions of the Parties

The Company proposes three separate financial incentives. First, it proposes continuation of its previously authorized incentive of $22,500/MW which presently applies to incremental enrollment in the NYSERDA SBC3 program, a NYSERDA system-wide program, Con Edison's targeted program and NYISO demand reduction programs. Second, the Company proposes that it be allowed to retain 20% of the "net resource benefits" realized by energy efficiency programs implemented by the Company, or 30% of net resource benefits achieved beyond the baseline goal of the program. Finally, the Company proposes to retain the value of any greenhouse gas emission reductions achieved by its program.

Staff maintains that the incentive levels proposed by Con Edison are unreasonably high. The shared net resource benefits incentive could result in incentive payments of approximately 90% of the program budget. Staff asserts that if Con Edison did not receive an incentive of this magnitude, the Company would be able to increase its program budget by over 90% and provide substantially more DSM programs and services. A national American Council for an Energy Efficient Economy (ACEEE) survey referenced by Staff showed performance incentives in other states generally ranged from about 5% to 10% of the program budgets. Finally, Staff is concerned that Con Edison's proposal does not provide for any negative consequences for failure to perform.

With respect to the $22,500/MW incentive, Staff recommends that it be reconsidered in the context of the EPS proceeding. Staff argues that the Company's proposed collection of greenhouse gas reduction market credits is premature as no market for such credits presently exists.

Staff is not opposed to utility incentives, but cautions they must be carefully considered. Staff identifies seven elements of a properly designed incentive policy.

- A focus on encouraging exemplary performance.
- Incentives linked to program goals at the high end of the expected range.
- An incentive level that is sufficient to encourage high performance, but not so high as to burden ratepayers with unnecessary expense.
- A structure that is simple to understand, administer and monitor.
- A design tailored to meet the needs of specific program types.
- Scaled incentive benefits for meeting or exceeding goals in order to avoid the disincentive of “all or nothing” achievement.
- Downside provisions to protect against poor performance.

NYC agrees that Con Edison’s proposed incentives are excessive and supports Staff’s seven criteria for establishing incentives. CPB also agrees that the proposed incentives are too large, and emphasizes the need for corresponding negative incentives.

NRDC/PACE observes that a decoupling mechanism only removes disincentives and does not provide an incentive. NRDC/PACE states that awards should be based largely on actual verified performance, subject to independent verification, not based on simply completing certain milestones such as entering into contracts for reductions. Awards should be scaled with higher incentives for higher achievement, and negative adjustments[153] for poor performance are essential. Incentive levels should be based on total resource net benefits, although additional goals tied to other criteria such as low-income participation should be set as well.

[153] Adjustments resulting from reliability performance mechanisms are frequently referred to by parties as “penalties.” They are properly known as “adjustments,” reflecting that they are a function of on-going ratemaking processes and regulatory oversight, as opposed to “penalties” resulting from a violation of a Commission regulation or order.

NRDC/PACE cites a recent decision of the California Public Utilities Commission (CPUC)[154] establishing scaled incentives, with a minimum performance standard of 85% of the base energy savings goal. At that level the Company would earn an incentive of 9% of net benefits increased to 12% if the Company meets or exceeds the full goal. Negative adjustments would be assessed per kilowatt hour for each unit below the goal if the Company's performance falls to or below 65% of the base goal. The purpose of negative adjustments would be to deter the Company from taking insufficient or ineffective action for failing to afford appropriate attention and resources to DSM programs.

NRDC/PACE disagrees with Staff and other parties who evaluate an incentive program based on how the incentives would relate to the DSM program budget. NRDC/PACE states that rewards should be based on outcome, not input. The budget amount does not necessarily correlate to the result achieved by a program. NRDC/PACE opposes the Company retaining greenhouse credits, unless there are transaction costs associated with capturing and maximizing the value of such credits that would result in the credits being left unclaimed.

Joint Supporters argue that Con Edison's proposed incentive levels are too high although they urge that it is important to have the Company engaged, invested and focused on the success of the DSM program. Joint Supporters refer to Massachusetts, in which the incentive is 5% of the total budget for achieving minimum threshold savings goals.

NYECC and CPA urge that no incentives are necessary. NYECC also argues that any definition of cost effective must include not only the total resource cost test, but any possible incentives to be paid by ratepayers. NYECC cites a principle Staff articulated in the EPS proceeding that "where possible, the market place should be providing services without the need

[154] CPUC Decision 07-09-043, issued September 25, 2007.

for ratepayer support" and urges the application of this general principle.[155]

NYECC cites the testimony of Con Edison including the many reasons why the Company supports DSM, and argues that if the Company values demand reduction for its own merits, electric consumers should not have to pay incentives. As an alternative to ratepayer-funded programs, NYECC urges programs that will encourage consumers to make wise investment decisions. NYECC also cites the programs of NYPA in which the customer pays back the costs of the efficiency upgrade out of savings associated with the measure. Consumer Power Advocates argues that NYSERDA has administered similar programs without cash incentives, and Con Edison administers its own business functions without specific incentives.

The Company cites the approach adopted by the California PUC: assuming utilities are to be involved in delivering efficiency services, than incentives should be set at a level sufficient that "utility investors and managers view energy efficiency as a core part of the utility's regulated operations that can generate meaningful earnings for its shareholders."[156] The Company also cites the federal Energy Policy Act of 1992 establishing a policy that demand side management measures should be "at least as profitable" as investments in construction of new generation transmission and distribution equipment.[157]

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[155] NYECC challenges the credentials of the Company's witness, Mr. Zielinski, on the issue of incentive policy, and argues that there can be no expert testimony on matters of policy. Such testimony is not inadmissible; we have admitted it but recognized it as opinion rather than fact.

[156] California Public Utilities Commission, Decision 07-09-043, September 25, 2007, at 77: "All levels of management and personnel throughout the company, not just within the energy efficiency division, need to be motivated to view energy efficiency as a core business activity …."

[157] 16 USC §2621(d)(8).

The contrary approach to the question would be a policy that efficiency programs, where they are the most cost-effective means for the utility to provide reliable service, should simply be considered a mandatory element of the utility's service obligation, with no incentive needed.

If incentives are needed, moreover, this may influence the threshold decision of whether such programs are better delivered by a non-profit governmental entity.

It is also argued that incentives reduce the total amount of program dollars that are available for the use of customers. Con Edison responds that incentives should not be measured against program expenditures but against program achievements, and that the nominal cost is less important than the benefits enjoyed by ratepayers. Con Edison observes that incentives calculated as a percent of customer benefits are also used by the Commission to encourage utilities to pursue property tax refunds. The Company argues that DSM is more important than property tax refunds.

The question of negative performance incentives is also controversial. The Company argues that negative performance incentives are much less effective than positive incentives, and that in no event should a utility be subject to negative consequences for a program that relies on voluntary decisions of customers. Other parties supporting incentives argue that an incentive program must be symmetrical and that incentives for meeting targets must be balanced with negative adjustments for failure to meet targets.

In response to the study of the ACEEE cited by Staff, Con Edison refers to a 1995 Lawrence Berkeley Laboratory survey from 1993-94 showing incentives in the range of 8.2% to 50.3% as a percentage of program costs. The study was not introduced into the record in this proceeding, but Con Edison notes that it was cited by the California Public Utilities Commission decision. The Company also observes that the cap incentive adopted in California represents approximately 25% of the program budget.

Staff defends its use of the ACEEE report, which is much more current than the LBL study. Staff also notes that the high-end incentives reported in the LBL study represent only a small percentage of the overall programs represented in the study. Staff cites the ACEEE Report for incentive levels of 5-8% of program costs in Connecticut, and notes that the Company had cited Connecticut as an example of a utility-run program that was more cost-effective than a centralized program. The inference, according to Staff, should be that Connecticut demonstrates that a utility can run a cost-effective program without the level of incentives proposed by Con Edison.

Staff also notes that its opposition to Con Edison's proposal does not represent an insistence that incentives must be based on program budgets. Staff emphasized the percentage of program budget in the Company's proposal in order to place the potential cost of incentives into context.

Con Edison observes that the 90% incentive level, provided in a discovery response, was merely an example that assumed customer benefits of $457 million from a $102 million program. The Company would not be opposed to a cap on the total incentive, although it notes that that would also place on a boundary on the Company's economic incentive to pursue energy efficiency gains.

2. Discussion

The incentives proposed by Con Edison clearly exceed what would be needed to establish efficiency as a priority for the company. The balance of risk and reward reflected in the Company's proposal lies outside the range of what constitutes just and reasonable rates. The Company would bear no financial risk other than prudence, but would have the opportunity to earn returns approaching 100% of its investment. It would not be reasonable to allow Con Edison the potential rewards of an unregulated company without a corresponding level of risk.

Given the limited, interim nature of the recommendation that the Target Program be continued, it would be premature for the Commission to make a policy determination in this proceeding identifying an approach to incentives for longer-term utility programs.

Con Edison presently receives an incentive of $22,500 per MW of achieved demand reduction. At the average cost of $1 million per MW experienced in the Targeted Program to date, that represents an incentive of 2-3% of program expenditures. This leaves the Con Edison program lower than the average range from other states identified by Staff; however, as Staff noted, in many of the states surveyed, utilities are not protected by revenue decoupling mechanisms.

Where the Commission chooses to reserve a policy issue for decision in a separate proceeding, an interim measure should be taken in a manner that avoids the appearance of a precedent. Therefore we recommend, on an interim basis, that the Company be allowed to continue receiving the incentive of $22,500 per MW, and that no low-performance adjustment be established at this time. This decision should be made without prejudice, in the EPS Case, to any arguments regarding incentives and negative performance adjustments.

New York Power Authority (NYPA) Customer Participation

Con Edison proposes that New York Power Authority (NYPA) customers should be able to participate in Con Edison's DSM programs and that the Company should be permitted to recover DSM program costs from all NYPA customers.

Staff opposes Con Edison's proposal because the record contains insufficient information regarding the business arrangements, financial impacts, and the degree of additional energy savings opportunities that would result from expanding Con Edison programs to NYPA customers.

NYC opposes the Company's proposal. NYC cites NYPA's own energy efficiency program and the City's commitment to invest funds equal to 10% of its energy bills in energy efficiency measures. NYC argues there is no basis for concluding that there is any net benefit associated with reversing the Commission's precedent of not requiring NYPA customers to support Con Edison DSM programs.

NYPA also opposes the proposal. NYPA states that since 1991 its DSM program has cumulatively achieved more than 114 MW in savings. NYPA argues the Company has not demonstrated the cost effectiveness of its own programs, and that NYPA's programs are different in scope, making an effective comparison difficult.

Con Edison questions whether NYPA's programs are sufficient to satisfy the DSM needs of NYPA customers. Con Edison cites testimony of the New York City Housing Authority (NYCHA) that if its 268 properties and 135,000 apartments could participate in the Con Edison program, the impact on energy savings would be significant. NYCHA and NYC propose that NYPA customers be authorized to participate on a voluntary basis while non-participating NYPA customers would not be required to pay for the program. Con Edison argues that proposal is unworkable. NYPA proposes that a collaborative be established to identify a mechanism that would allow NYPA customers to participate on a voluntary basis.

There is insufficient evidence in the record to support a change in policy regarding NYPA customers' participation in Con Edison efficiency programs.[158] However, given the very large theoretical potential for efficiency gains among NYPA customers, the Commission should reconsider this issue in a future proceeding, or in the generic proceeding, if there is a specific demonstration of cost-effective measures that are available to Con Edison customers, but are not being pursued by NYPA.

DSM Coordination Board

Beyond a collaborative to establish an interim program, NYC recommends the formation of a permanent DSM Coordination Board that would include the Company, NYC, NYPA,

[158] Moreover, this is an issue of statewide policy that is best resolved in the context of the generic proceeding.

NYSERDA, and KeySpan. The DSM Coordination Board would be established in the context of a longer-term collaborative. NYC cited the Steam Task Force created by the Commission in 2004 as an example.[159]

One of the functions of the Coordination Board would be to ensure, according to NYC, that a more equitable share of statewide SBC funds would be directed to the Con Edison service territory. According to NYSERDA's 2006 SBC Report, Con Edison customers contributed 50% of SBC funds while the City calculated that only 35.85% total SBC program dollars were spent in the Con Edison service territory.[160]

The Company urges rejection of NYC's proposal, arguing that it would add a needless layer of bureaucracy and that even developing the ground rules for such a board could be a time-consuming process. Staff also opposes the creation of a Board, arguing that it would add delay and complexity to the process of delivery efficiency services.

We do not recommend that the City's proposal be adopted at this time; nor do we recommend that it be dismissed lightly as a needless layer of bureaucracy. Con Edison is unique in having most of its territory represented by a single municipal entity that has committed substantial financial resources to energy efficiency. Also, due to the potential contribution of codes and standards, municipal efforts need to be closely coordinated with efficiency planning. If an entity similar to that proposed by the City is not established as a

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[159] Con Edison observed that the Steam Task Force delivered its work product five months late.

[160] NYC also adds two proposals to encourage efficiency efforts. First, Con Edison should reduce contributions in aid of construction that it charges to customers if they fully participate in NYSERDA or other DSM programs for new construction. Second, Con Edison should amend its BIR tariff to require customer participation in applicable energy efficiency programs as a condition to receiving the BIR discount. Both of these proposals have merit but lack specificity.

result of the EPS proceeding, the Commission should reconsider the proposal in a subsequent rate proceeding.

East 13[TH] Street Load Pocket

Con Edison disputes the concern of Astoria Generating Company that its targeted DSM program may not be able to defer load-relief program for the East 13[th] Street load pocket. The Company notes that in contrast to the geographic limitations on some of its other targeted programs, the East 13[th] Street project includes energy efficiency that can be implemented across 10 networks. The Company also notes the testimony of its Infrastructure Panel that if the required amount of DSM cannot be obtained, systems needs would still be met. The Commission should not interfere with the Company’s plan to use DSM to defer this project.

RELIABILITY PERFORMANCE MECHANISMS

The 2005-2008 Rate Order established a reliability performance mechanism (RPM) for Con Edison.[161] The RPM consisted of six performance metrics to ensure the Company provided reliable service generally, and with respect to several parameters of special importance. The two general parameters were part of an existing reliability performance mechanism. The other four metrics were new and included the repair of poles, removal of shunts installed as temporary repairs, renewal of service to street lights and traffic signals, and the replacement of circuit breakers with high fault-current levels (over-duty breakers). The two pre-existing metrics measure

[161] Case 04-E-0572, Consolidated Edison of New York, Inc. – Electric Rates, Order Adopting Three-Year Rate Plan, issued March 24, 2005 (the 2005-08 Rate Plan). The Commission expressed a strong preference for performance-based ratemaking in Case 94-E-0952, In the Matter of Competitive Opportunities Regarding Electric Service, Opinion and Order Adopting Principles to Guide the Transition to Competition, June 7, 1995, at 8 (Opinion 95-7).

system-wide frequency of outages, and duration of outages. Exclusions are provided for incidents beyond the Company's control such as major storms or other catastrophic events.

Staff proposes: 1) that the RPM continue into the rate year; 2) that adjustments[162] under the system-wide duration index be increased from $4 million to $5 million to bring it to par with the frequency index; 3) that two new performance measures be established; and 4) that the amount at risk in the street light and traffic signal category be increased from $1 million to $1.5 million. Staff proposes that the metrics be placed in effect as of January 1, 2008.

The frequency index, or System Average Interruption Frequency Index (SAIFI) and the duration index, the Customer Average Interruption Duration Index (CAIDI) are divided into separate standards for network and radial distribution systems. The maximum annual exposure for the Company is $5 million for each of the two SAIFI targets and $4 million for each of the two CAIDI targets, with a total amount of $18 million at risk per year. Staff's proposal to increase the CAIDI adjustments would increase the total risk to 20 million per year. Because there is no apparent reason for a difference between the two indexes, Staff's proposal should be accepted. [163]

The first new metric proposed by Staff would hold the Company liable for restoration times for all outage events affecting its network and radial systems. Restoration targets would be established based on the emergency level created by the outage. Failure to meet those targets would result in a $5 million revenue adjustment per event, with unlimited annual exposure.

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[162] As noted previously, the Company is referring to rate adjustments; the Company uses the word "penalties" in its arguments.

[163] Subject to the recommendation of a higher adjustment level for both indexes, below.

The second new metric relates to the Company's remote monitoring system for individual network transformers. Staff's proposal is that the Company should have 95% of its remote monitoring system units reporting properly in each network by January 31, 2008. If this is not achieved, the Company will incur a revenue adjustment of $5 million/network. After January 31, 2008, failure to achieve the target level will result in a revenue adjustment of $10 million/network with unlimited annual exposure. Staff does not propose a specific measurement interval.

Staff proposes to increase the adjustment for no-current street lights and traffic signals from $1 million to $1.5 million for the winter month period performance and also for the summer month period performance.

Con Edison has numerous objections to Staff's RPM proposals. As a threshold matter, the Company argues that negative incentive adjustments in general are ineffective. The Company argues that it takes its public service obligation seriously and that no sanctions are necessary for the Company to properly discharge its responsibilities. Moreover, the Company has a financial interest in preventing outages, even if there are no direct penalties applicable to the outage. An RPM can penalize a company for superior performance by ratcheting targets to require higher performance to avoid a penalty. Also, where a number of performance standards exist, a company can comfortably exceed all standards except one and still suffer negative revenue consequences.

Instead of performance adjustments, the Company proposes that corrective action plans be required where standards are not met.

The Company notes that Staff recommends parts of the RPM become effective in January 2008 and observes that they could not become effective until April 1, 2008 when the rate year begins.

SAIFI and CAIDI Target Levels

Con Edison argues that existing SAIFI and CAIDI standards must be adjusted to take into account the Company's recent implementation of a new outage management system called "System Trouble Analysis and Response" (STAR). According to the Company, STAR will detect more outages than its previous management system, resulting in a greater risk of exceeding thresholds mainly because the Company has gained better information. The Company cites a study using STAR system stimulation to replay outages and compare the results using the STAR system versus a legacy management system.

Staff responds that in an interrogatory response in the Long Island City proceeding, Con Edison dismissed the usefulness of simulations using the STAR system.[164] Staff also notes that Con Edison's study erroneously duplicated STAR data from the Bronx and Manhattan.

The Company responds that it had not dismissed the usefulness of a STAR simulation but rather had cautioned that the results of that particular simulation were questionable due to the lack of an interface between STAR and the legacy outage management system. Regarding Staff's second objection, the Company explains that STAR has two functionalities – grouping trouble calls and reporting outage information – and only the first function was in effect in the Bronx and Manhattan prior to 2007.

Con Edison also notes that Staff's report in the Long Island City investigation recognized that STAR "can provide a better account of outages than the Outage Management System."[165]

The Company recommends that the reliability performance metric should be based on overall system-wide SAIFI and CAIDI, inclusive of both network and radial systems, because the network system represents fewer than 7% of total customer

[164] Exhibit 159.

[165] Staff LIC Report at 25.

minutes of interruption. Staff responds that Con Edison's resources for its network system are substantially different from resources used for the radial system.

The Company also argues that CAIDI and SAIDI thresholds should be established using recent historical results rather than standards derived from the less accurate pre-STAR legacy system. Staff counters that such a recommendation could work against the Company, to the extent that the Company achieves superior performance in a short-term historic period. The Company argues that historical data from 1985 to 1989 do not reflect advances in technology that have improved reliability performance.

Finally, Con Edison argues that reliability standards based on a simple average do not account for the natural variability of results, which will fluctuate so that in any given year the historical average may not be achieved despite performance that meets the average over time. The Company recommends that threshold standards be based on a two-standard deviation deadband above and below the average of the Company's five years of historic SAIDI and CAIDI results. Staff argues that this would not sufficiently protect reliability.

The Company has demonstrated that an enhanced outage reporting system is likely to result in higher reporting of outage frequency and duration. This indicates that the existing CAIDI and SAIFI target levels are not optimal and should be revisited in light of the Company's implementation of STAR. Staff has raised sufficient doubt regarding the Company's proposal to support a conclusion that the existing targets should remain in place pending development of new targets.

The Company is also correct that a standard based on a historical average should either reflect a standard deviation in setting the threshold levels, or allow for a deviation in the application of the standard. The Company has not, however, demonstrated that its proposed two-standard-deviation deadband is the optimal alternative.

Regarding the use of recent data versus historical data to establish the threshold, the Company's argument for recent data is puzzling. If outage rates in the recent past are higher than rates from the 1980's, despite advances in technology, this reflects poorly on the manner in which Con Edison has maintained its system. The Company's position also contradicts its general argument that standards based on recent performance tend to punish a company for high performance.

We recommend that the SAIFI and CAIDI mechanisms remain in place but that Staff be directed to propose revised targets, in light of the Company's implementation of STAR and in light of its reasonable argument that some level of deviation from the average should be tolerated.

We further recommend, however, that the adjustment amounts of the mechanism also be reevaluated; Staff should propose higher figures. The significance of $5 million has diminished, relative to the Company's total revenues and relative to the size of the Company's infrastructure program. Given the dramatic increases in spending and their commensurate impact on rates, the interests of customers require that the Company be motivated to provide that its large expenditures result in adequate service. [166]

Major Outage Mechanism

Staff's proposed RPM includes a continuation of the major outage mechanism which provides for a $10 million negative incentive adjustment for each network shutdown event with three hours or more in duration or radial system interruption event in which 70,000 customers are interrupted for three hours or more.

The Company argues that Staff did not provide a rationale for continuing the major outage mechanism and therefore there is no substantial evidence to support it in the

[166] The Company claims that negative incentives are not necessary because it takes its public service obligation seriously. But the Commission cannot fulfill its statutory duty by relying on the Company's good intentions.

record of this proceeding. This is a specious argument, as a large portion of this proceeding was dedicated to the subject of the Company's need to improve infrastructure to avoid outages, including major outages. The major outage mechanism should be retained.

Although no party raised the issue, the Commission should entertain proposals from Staff and other parties to revise the definition of "major outage" under Con Edison's RPM. The fact that neither the Long Island City nor the Westchester outages of 2006 fell under the current definition of a "major outage" indicates that the definition should be reevaluated.

Remote Monitoring System (RMS)

Con Edison's Remote Monitoring System (RMS) provides information as to the status of critical transformers during outage events. RMS can provide voltage readings, oil temperature, oil level and tank pressure. Components of RMS include transmitters, pickup coils, and receivers. The importance of RMS is highlighted by the numerous specifications and procedures of Con Edison that reference RMS or data derived from RMS.

Because Staff has found that RMS failure contributed to the severity of the outages at Long Island City and Washington Heights, Staff has recommended a new performance mechanism designed to encourage RMS readiness. Staff's proposal is that the Company should have 95% of its remote monitoring system units reporting properly in each network by January 31, 2008. If this is not achieved, the Company will incur a revenue adjustment of $5 million/network. After January 31, 2008, failure to achieve the target level will result in a revenue adjustment of $10 million/network with unlimited annual exposure. Staff does not propose a specific measurement interval.

The Company argues that Staff's proposed RMS performance mechanism is both unnecessary and unreasonably aggressive. The Company's goal for RMS reporting is to maintain

95% availability on a regional basis, with no network at less than 90% availability. The Company first achieved this goal in all three regions in April 2007. Staff notes that following the Long Island City event, the Company made a revision to its procedures manual from a “minimum 95%” reporting rate to a “goal of achieving 95%.” The Company states that this revision was made necessary by higher-than-anticipated equipment failure rates.

The Company claims that Staff’s proposed target of 95% availability in every one of the Company’s 60 networks is not realistic, given the Company’s sustained efforts to maintain these levels that have been unsuccessful due to inadequate equipment. The Company describes in detail its history of dealing with vendors whose transmitters did not perform as promised, and its attempts to develop improved equipment on its own initiative. Approximately 21,500 first and second generation RMS transmitters remain in the field. The current failure rate for these transmitters is 6% per year, and the Company is engaged in a 10-year, $125 million program to upgrade these transmitters to third generation units.[167] The Company also notes that the power line carrier technology used to transmit data from the field to the substation pre-dates fiber optics and is vulnerable to noise that detracts from performance.

In response, Staff notes that following the Long Island City event, the Company was able to bring the RMS reporting rate within the Long Island City network up from 80% to the required 95% within two months.

The Company states that the cost of maintaining a 95% RMS reporting rate at each network would be an incremental annual increase of $5 million in equipment and approximately $10 million in labor. The record does not indicate how long it

[167] Staff’s Infrastructure Panel recommended acceptance of this program at the Company’s proposed spending level. Tr. 4022-23.

would take the Company to achieve full compliance with a 95% reporting requirement, if those funding levels were available.

The Company also argues that Staff's proposal for a $10 million negative revenue adjustment per network is excessive. Because there is no limit, the Company could potentially be penalized $600 million should each of the 60 networks not achieve 95% reporting at a periodic measurement juncture. The Company claims that Staff has provided no rationale for the disproportionate size of this measure compared to the other revenue adjustments in the RPM. The Company further argues, that the proposed adjustment for RMS is particularly incongruous because failure to achieve a 95% reporting level does not interrupt service to any customers. Staff states that the $10 million adjustment is based on the critical role of RMS in network system performance, as identified in investigations of both the Washington Heights and the Long Island City outages.

Staff has not challenged Con Edison's narrative regarding its efforts to improve the performance of RMS technology.[168] The fact that Con Edison was able to improve its performance in the Long Island City network does not demonstrate that it could readily do so throughout its system. Staff's proposal that the performance mechanism be effective January 31, 2008 is not supported by the record.

Staff has not refuted Con Edison's testimony that the cost of maintaining a 95% reporting level would be an additional $5 million in capital and $10 million in labor; neither has Staff proposed an increase in the Company's construction or O&M budgets. In effect, Staff's proposal would amount to an order that the Company must reallocate funds within its proposed budget. Reallocating $5 million in capital would not be a substantial burden, given the size of the recommended budget.

[168] In light of that, the Company's revision of its own internal goal may have been reasonable, though the timing was questionable.

Reallocating $10 million in O&M, however, would not be a reasonable demand.

Staff's proposed adjustment levels are also excessive. A total exposure of $600 million is more than what is necessary to motivate the Company; the result would be unnecessary financial risk. A reasonable annual cap should be established.

The Company does not dispute the importance of RMS in limiting the scope and duration of outages. We recommend that Staff be ordered to revise its proposal, consistent with these findings, and present it to the Commission in conjunction with the revised proposals for CAIDI, SAIFI and major outages described above.

Special Projects

Regarding the other special projects--double poles, shunts, street lights, and over-duty circuit breakers--the Company has incurred no adjustments for any special project categories since these measures were established in 2005. The Company urges that these measures should now be changed to standard-only measures without penalties.

Regarding no-current street lights and traffic signals, the Company objects to Staff's proposal to increase the negative adjustment from $1 million to $1.5 million. Staff states that this adjustment was deemed necessary to create an exposure equivalent to the other special projects. The Company claims that merely making these adjustments equal to the other special projects categories is not a sufficient rationale. The adjustment levels of the RPM were established in a settlement, and there is no discussion in the proceeding supporting the differential. Because no-current street lights and traffic signals are an obvious safety concern on a par with the other categories, Staff's proposal should be adopted.

Regarding the replacement of over-duty circuit breakers, the Company has met the annual target of replacing at least 60 over-duty breakers per year. Replacement of breakers is necessary to allow the interconnection of synchronous distributed generation (DG), and $8.8 million per year are included in the Company's revenue requirement to continue this program. The Company argues that the performance adjustment mechanism is counterproductive. In order to accommodate a synchronous distributed generator all of the breakers in a supply substation must be replaced. The negative incentive mechanism, according to Con Edison, encourages the Company to focus on replacing breakers wherever a bus section outage can be arranged, rather than completing each substation to accommodate a DG interconnection. Because no parties who benefit from interconnection opportunities have recommended a change, the Company's argument should not be accepted.

NYC maintains that the street light and traffic signal standards are particularly important and appear to have been effective. As NYC points out, the fact that no violations have occurred indicates that the Company has taken the performance incentives seriously and that they have been effective. It would be premature to eliminate them.

Because the special project mechanisms are all existing mechanisms that utilize a calendar-year interval as a reference, an effective date of January 1, 2008 is reasonable.

Restoration

The Company argues that there are no current performance standards for emergency management and that restoration time is not the place to start; rather, best practices standards should be developed. The Company notes that the recently-filed audit report on the Company's electric emergency outage response program states that "getting the lights back on is not sufficient in Con Edison's current environment … the narrowly defined view of emergency management must give way to a more holistic perspective in which Con Edison's measures of performance cover many elements of an emergency and not just the physical restoration work." The Company also notes that the Commission established a Reliability Standards proceeding two years prior to the approval of rate plan settlement agreements that incorporated reliability performance mechanisms based on those standards.

The Company also takes issue with Staff's recommended disallowance of four Company programs related to emergency response - Coastal Storm Mitigation Plan, Electric Operations Emergency Management Group, Control Center Screening Group, and Storm-Hardening Program changes – while recommending new performance mechanisms related to emergency response.

Regarding the restoration mechanism itself, the Company claims that it has a number of flaws. First, it is based on a preliminary event classification for storms that does not reflect restoration times established upon the assessment of actual damage. The event classifications are only a guide for mobilization of resources, and the severity of storms which underlies the matrix does not reflect actual damage done by a storm.

Second, that the Company points out factors out of its control will affect actual restoration time, including the severity of weather during and following the storm, and problems with access caused by local conditions. The Company also notes that a number of system improvements have allowed it to isolate damage to a smaller number of customers; though this reduces the customer outage count, it does not reduce the time required for restoring customers to service.

Finally, the Company argues that the restoration mechanism as proposed by Staff will have counterproductive outcomes. In some cases, the highest priority following a storm is to establish "normalcy" in affected areas by restoring traffic lights, service to schools, and opening roadways blocked by trees. The proposed restoration mechanism would encourage the Company to focus exclusively on the restoration of customers rather than working collaboratively with local municipalities to address local concerns.

The Company states that the restoration mechanism would also be counterproductive because utilities rely on mutual aid from other utilities. If utilities are subject to negative revenue adjustments for failing to meet restoration times, they will be reluctant to send mutual aid until all of their own customers are restored. The mechanism could also have a chilling affect on Con Edison’s ability to provide mutual aid.

Staff has demonstrated that restoration times are a problem that needs to be addressed. However, the Company’s arguments regarding Staff’s specific proposal are compelling. Staff’s proposal should be denied at this time. Following a full assessment of the Audit Report and its recommendations, consideration of an alternative performance mechanism for restoration may be timely.

RETAIL ACCESS

Con Edison implemented several retail access programs with the 2005-08 rate plan and it proposes to continue them during the rate year. The Company will enhance the ESCO referral program and allow ESCOs to enroll customers in the program. The purchase of receivables program will be modified to apply the discount to the sales taxes that are billed to customers for commodity supplies. The Company will also conform the electric retail access tariff to the gas tariff provisions for the ESCO dispute resolution process. No party objects to these retail access program modifications.

At issue in this case are two proposals made by the Retail Energy Supply Association (RESA) and one by the Consumer Power Advocates (CPA). RESA proposes that the referral program be expanded to enroll new customers when they apply for service. It also proposes that a collaborative proceeding be established to consider customer information issues. CPA proposes that the information Con Edison provides to ESCOs, kept in the Retail Access Information System (RAIS), also be provided to non-ESCOs.

Also addressed in this section, are Staff’s proposals concerning the merchant function charge and issues related to bill issuance and payment processing.

1. Enrollment of New Customers

RESA believes that the ESCO referral program should be available to customers who contact the Company to obtain new service. Under this proposal, the Company would inform new customers of their ability to obtain commodity service from a competitive supplier when their delivery service is initiated.

According to Con Edison, any such expansion of the referral program would require system and process changes that it is willing to evaluate. However, the Company does not currently know if it is feasible to expand the program in the manner suggested by RESA or how much time it would take to make the changes. If the change were to be made, Con Edison states that it must be provided a means for recovering its costs. If the proposal is impractical, the Company believes it should be rejected.

We recommend that Con Edison fully evaluate the RESA proposal and provide a timely and full report to the Commission concerning the feasibility of providing new customer referrals to ESCOs.

2. Customer Information Collaborative

To further enhance competitive choice in the Con Edison service area, RESA recommends that a collaborative examine whether ESCOs can be provided access to customer data in a fair and reasonable manner. RESA is interested in obtaining customer lists, consumption information, and other data that would enable ESCOs to developed tailored products for specific customer needs. The ESCOs are also interested in customer usage profiles to develop products and offerings for customers with different usage patterns and usage levels.

Con Edison disagrees with the proposal for a collaborative proceeding. It is aware that retail access programs and practices are being evaluated in Case 07-M-0458 and it believes that the issue raised by RESA can be addressed there. However, if it is not addressed in that proceeding, RESA requests that its proposal be considered here.

We recommend that the merits of establishing a collaborative process to address ESCO access to customer data be handled in this rate proceeding and that the matter not be deferred elsewhere. Con Edison should provide with its brief on exceptions a statement of its current views on the access that RESA seeks to customer lists, consumption information and usage profiles. RESA, and other interested parties, should respond to Con Edison in their reply briefs on exceptions.

3. Information for Non-ESCOs

According to CPA, a customer interested in obtaining electric supplies in the competitive market should have adequate access to its account information to take advantage of any fast moving opportunities. CPA states that customers cannot formulate their procurement strategies without immediate access to the data. In effect, CPA requests that customers have the same information as ESCOs. Currently, customers must access multiple sources and systems, and the process is cumbersome if they have many accounts. Rather than take days to assemble the necessary information, CPA believes that Con Edison customers should be able to download all pertinent and timely information from a single location.

Con Edison disagrees with CPA's proposal. It states that customers and their consultants receive, upon request, the information that is otherwise accessible through RAIS. According to the Company, the RAIS is not merely a data base. It is a system that administers retail access transactions and it was designed specifically for ESCOs to use as the Company's trading partners. The RAIS supports ESCO enrollment activity, transfers, and the exchange of customer cycle usage and billing determinants. Moreover, due to security concerns, ESCOs do not obtain access to all of the RAIS to avoid unauthorized changes in Company records. It therefore believes that the CPA proposal should be rejected.

If Con Edison is unable to provide customers interested in competitive opportunities the same access to the

RAIS as ESCOs receive, the Company should provide a full demonstration that it is providing its customers and their authorized representatives a fair opportunity and the ability to make informed decisions concerning the supply offers they receive from ESCOs. If the Company is unable to provide its full demonstration with its initial brief on exceptions, the Commission should consider whether Staff should be directed to follow-up on this matter and report its results to the Commission following this rate proceeding.

4. Merchant Function Charge

In this case, DPS Staff proposed that Con Edison merge its two merchant function charges (MFCs) into a single charge. Staff also proposed that a single MFC and purchase of receivables discount be calculated that includes the commodity-related credit and collection costs. The Company is willing to implement the Staff-proposed changes. It agreed previously to make the changes for the gas department and it is prepared to also make them now for the electric operations.

5. Bill Issuance and Payment Processing

Staff states that customers should pay Con Edison a bill issuance and payment processing (BIPP) charge when they receive both their delivery service and their commodity service from the Company. When a customer receives a consolidated bill from Con Edison that includes ESCO charges, the consolidated bill should not contain a BIPP charge. Instead, the Company should collect a billing fee equal to the BIPP amount from the ESCO. When a customer is served by two ESCOs, one for electricity and another for natural gas, each ESCO should pay half the BIPP charge.

In this case, Con Edison proposed to collect half of the BIPP from the ESCO that provides one of two services to a customer when the Company provides the other service. Staff states that this is contrary to the Commission’s applicable orders and it proposes that the Company’s tariff provisions be changed to state that customers are only assessed a BIPP charge when they take all of their commodity service from Con Edison.

The Company disagrees with Staff's proposal and observes that in this instance it must render a bill for a commodity service. It also states that it seems strange to collect one-half the BIPP charge from each of two ESCOs servicing the same customer and to require a single ESCO to pay the entire BIPP charge when Con Edison provides the other commodity service. Con Edison also believes that Staff's approach provides a disincentive for a second ESCO to provide a competitive service if there is no additional BIPP cost savings to be had. Further, the Company asserts that its proposal is supported by the provisions of the recent rate plan that the Commission adopted for the gas department.

In response to these arguments, Staff insists that the Commission's orders on the matter should be followed and notes that, in all circumstances, Con Edison is rendering a bill for delivery service. Also in support of its proposal, Staff states that the approach it proposes was used when BIPP credits were used instead of BIPP charges. Staff disagrees with the Company's assertion about an adverse incentive and states that its approach provides a correct allocation of the bill issuance and payment processing costs. With respect to the recent rate plan for the gas department, Staff states that it does not address electric BIPP costs and that electric customers should pay either a $0.94 BIPP charge or their bills should not contain the charge.

In its reply brief, Con Edison adheres to its position and states that there is a fundamental difference between Staff's position and the Company's. While Staff believes that a customer should pay the full BIPP charge or nothing, the Company believes that, when a customer receives its commodity services from the utility company and an ESCO, the customer should pay part of the BIPP charge and the ESCO should not be required to bear the entire cost burden. It also asserts that its proposal is cost based and the charge would be applied using cost causation principles.

We find that both approaches are rational and logical, and either could be employed. It is not clear to us that either approach is superior to the other. However, it is important that there be adherence to the Commission's policy preferences for developing a competitive market throughout the State and consistency in the approach used will help the public better understand the operative principles and guidelines for ESCO matters such as this one. We therefore recommend that the Staff proposal be adopted.

ADDITIONAL ISSUES

Local 1-2

1. The Union's Positions

The Utility Workers Union of America, AFL-CIO, Local 1-2 (Local 1-2 or the Union) supports Con Edison's proposed electric rate increase. It states that capital investments and modern equipment are needed to provide good and reliable service, and to meet the growing energy needs in New York City and Westchester. The Union observes that the proposed rate increase will support the Company's financial condition and provide the funds needed for the infrastructure improvements.

Nevertheless, Local 1-2 criticizes Con Edison for having too few workers and insufficient troubleshooters to care for the underground electric network. The Union is concerned about adequate staff levels when vacations and illnesses reduce the number of workers. It also objects to the small number of crews used to cover entire boroughs. The Union supports the hiring of additional employees to install, maintain and repair the underground electric network.

Local 1-2 also objects to the amount of outside contractor labor Con Edison uses to perform work that its regular employees are capable of doing. The Union claims that excessive use is made of outside contractors and the Company does not retain the documents and information that would be useful to evaluate its practices. If the information were properly kept, the Union believes it would show whether Con Edison is operating the electric system efficiently and at the lowest cost and greatest value for customers.

Local 1-2 criticizes the mutual assistance that Con Edison obtains from other utility companies to restore the underground electric network when system emergencies occur. It believes that the workers provided by the other utility companies do not have sufficient knowledge, training or adequate experience to work on the unique and complex electric system under the City. To avoid safety hazards, improve system reliability and reduce the duration of electric system outages, the Union believes that the Company should maintain an internal workforce that can handle the emergency situations.

The Union is also concerned about the security risks presented by undocumented aliens who may obtain access to the electric network, and the safety risks presented by unqualified contractors who may perform work on the electric system. Local 1-2 points to several instances in which it believes safety was compromised by unskilled workers. To address such situations, the Union asserts that Con Edison’s security program should be revised and greater attention should be given to avoiding manhole events. It suggests that a financial incentive mechanism be used to encourage the Company to eliminate any poor practices. It also believes the Company should limit access to electric facilities and identify the persons who come in close proximity to the electric network.

Addressing the Commission’s ratemaking practices, Local 1-2 opposes the productivity adjustment typically applied in rate proceedings and claims that the adjustment is misplaced and counterproductive. According to the Union, the productivity adjustment has caused reductions in the historic level of internal weekly workers and increased use of more costly outside contractors who do not have as much experience with the underground electric network. According to Local 1-2, productivity adjustment should be eliminated.

Local 1-2 also proposes that the Commission perform a management audit to evaluate the size and effectiveness of Con Edison's management. According to the Union, there appears to be too many managers for the number of weekly employees.

The Union recommends that Con Edison accelerate the replacement of paper insulated lead- covered cables to improve safety and system reliability. It believes that twice as much of this cable should be removed annually. The Union is also concerned about Ray-Chem stop joints that can fail and cause service outages. According to it, all such stop joints should be removed within two years.

Addressing manhole incidents, the Union believes that there have been too many of them in recent years and congestion in the manholes can hinder service restoration following an outage. It believes that the Company's performance can be improved by applying an incentive performance program that encourages a reduction in the manhole events and improved maintenance of the structures.

2. Con Edison's Response

Con Edison states that Local 1-2's position concerning the internal staff levels, the use of outside contractors and mutual aid workers is a self-serving attempt to use the ratemaking process to obtain benefits for its membership that should be negotiated in the collective bargaining process. The Company asserts that its internal staffing levels are adequate and a single instance of shoddy work performed by an outside contractor would not prove otherwise. It also maintains that the Union's allegations concerning the number of trouble-shooter crews, and the skills of contractor labor and mutual assistance workers, are unsubstantiated.

The Company believes that it uses a proper mix of contractor labor and internal workers to maintain the electric system in a cost-effective manner. It notes that the proportion of outside contractors to internal workers will vary depending upon the scope of the construction projects that are planned.

Con Edison believes that it should be allowed the flexibility to use either workforce. It points out that the bulk of the work on the distribution system is performed by internal employees and additional workers are being hired on an accelerated basis. The internal workforce is slated to increase by 300 positions a year in 2008 and 2009.

Addressing the number of troubleshooters, Con Edison states that it maintains the right number of crews and if more are needed at any location they can be provided by other regions. The Company also asserts that it has adequate crews to address and repair the secondary electric system and it is proper to use outside contractors for the stray voltage testing program. Con Edison does not believe that it is prudent to staff permanent, full-time positions to perform sporadic work when an economic analysis would not support such action.

As to the use of mutual assistance workers from other utility companies, the Company asserts that its practice conforms with the Commission’s policy and a single instance of poor work performed by a mutual assistance crew, and other unsupported allegations, are insufficient to alter the current practice.

With respect to security and safety concerns, the Company states that it is living up to its responsibilities to secure the electric grid by working closely with the U.S. Department of Homeland Security and other federal and state agencies. It also details the process that is used to qualify vendors who work on the electric system which ensures that only skilled professionals, with proper credentials, perform the work. According to the Company, it has not had any problems with undocumented workers or its compliance with immigration laws.

3. Discussion

The Commission’s standard regulatory practice in major rate proceedings has been to avoid governmental interference in the collective bargaining process and in matters that are best addressed by management and unions across the bargaining table. We believe that the Commission should continue to adhere to this approach and it should not attempt to influence any matters that the collective bargaining process is best capable of resolving. In any event, the Union's position on various ratemaking matters has been addressed in this recommended decision as they pertain to the issues raised by it and the other active parties that have participated in this proceeding. At this point, several matters remain.

The amount of, and the basis for, the rate increase that will be allowed in this case is a function of a thorough and rigorous evaluation of the public utility operations, one that balances properly the ratepayer and investor interests in the provision of safe and reliable service at just and reasonable rates. Rates should be designed to support a well-run, good-functioning and prudent operation. However, no attempt should be made to determine any precise ratio of in-house workers and outside contractors that should be allowed in rates.

We also believe that the Company should make the best possible use of mutual assistance crews during times of system outages and emergencies. This matter is independent of the prudent and cost-effective approach that should be used to properly staff the utility operations at all times and under all conceivable operating conditions.

On the record established in this case, no specific or particular problems have been detailed concerning system security or any vulnerabilities due to activity by illegal aliens or any practices related to the use of outside contractors.

East River Science Park

A biotechnology and life science research and development facility, know as the East River Science Park, is being established on the Bellevue Hospital Campus in Manhattan. This project began in 2005 when a developer was selected and negotiations began for a ground lease. In October 2006, the New York City Economic Development Corporation authorized for the project a nine megawatt allocation of reduced-price electricity to be provided through Con Edison's Business Incentive Rate (BIR). In November 2007, Con Edison formally approved the nine megawatt allocation. This electricity will be used to operate electric chillers.

Con Edison's tariff filing in this case proposes to change the terms of the Business Incentive Rate program. The proposed change would not allow as a much of a BIR discount for electric chillers in buildings that are within 250 feet of a steam main. This change would apply to customers who apply for service after April 1, 2008. According to the representatives for the East River Science Park, the tariff change would reduce the BIR benefit for the Park by about $1.3 to $1.9 million.

The East River Science Park requests that the Commission "grandfather" or exempt this project from the proposed tariff change and allow it to receive reduced-price electricity for the electric chillers that will be delivered in April 2008 and are expected to become operational in 2009. According to the Park, it is not economic for it to use steam chillers due to the equipment, installation, operational, maintenance and energy costs that the steam chillers would require. The Park also states that Con Edison has been aware of its selection of electric chillers since December 2006.

Con Edison acknowledges that it has proposed to reduce the delivery service kW and kWh amounts eligible for a BIR bill reduction during the summer months of June to September for electric and/or hybrid electric chillers. The Company will determine the amount of the reduction on the basis of the name plate rating of the chilling equipment and the equipment efficiency information supplied by the customer. The electric chiller reduction would be deducted from the customer's BIR allocation to determine the load eligible for BIR bill reductions. According to the Company, the purpose for this change is to remove the disincentive for customers to use steam for cooling. It is willing to grandfather existing BIR customers using electric chillers within 250 feet of a steam main but any new customers commencing service on and after April 1, 2008 would be subject to the proposed reduction.

Specifically with respect to East River Science Park, Con Edison states that this party has provided new, non-record evidence about its circumstances. In any event, the Company does not deny that the East River Science Park has obtained from New York City a comprehensive package of benefits and it has asked Con Edison to hold a BIR allocation for it. However, according to the Company, a BIR allocation reservation does not reserve a particular BIR discount for a customer. The customer receiving a BIR allocation should pay the rate in effect at the time that the service commences. From its review of the extra-record material provided by the East River Science Park, the Company states that the expected commencement of the service for this facility is not until January 2010. Therefore, Con Edison does not believe it can reasonably be expected to guarantee a specific rate for the East River Science Park that would be in effect 19 months after the new tariff goes into effect. According to Con Edison, the East River Science Park should be placed in the same position as any other customer commencing service on or after April 1, 2008.

New York City does not object to the BIR tariff revisions that Con Edison has proposed; however, it believes that customers who applied for BIR before April 1, 2008 should be grandfathered. The City states that the process for applying and receiving economic development grants is time consuming and it believes it is unfair to disadvantage the current applicants who have been relying on the amount of the discount that is currently available. New York City is opposed to Con Edison's restrictive application of a grandfathering provision which it believes will cause significant economic harm to customers who relied on the BIR as part of their economic development package. The inequity of the Company's position, according to the City, is demonstrated by Con Edison's position concerning the East

River Science Park. New York City believes that this project should be grandfathered.

We find that BIR tariff provisions that Con Edison has proposed to implement are not generally opposed and should be allowed to go into effect. The period for accepting applications for BIR service should be extended by a year from March 31, 2008 to March 31, 2009. Also, it is desirable to encourage the use of the steam system for cooling purposes and the proposed tariff provision provides a useful signal to developers that would apply to the City for an economic development package that contains a BIR. The issue that must be resolved here is whether there are any existing applicants who should be grandfathered on the basis of the application activity that they have accomplished to date. In this rate proceeding, only the East River Science Park has sought relief from the Commission and no others. New York City may be aware of other applicants whose projects may or may not be sufficiently developed to qualify for grandfathering. However, it has not identified any others.

We recommend, on the basis of the East River Science Park's participation in this case and its explanation of its circumstances, that it receive grandfathering from the new tariff provision. The record in this case does not support grandfather status for any additional or other projects.

Astoria Generating Company

The Astoria Generating Company, L.P. (Astoria Generating) owns and operates electric generation facilities in New York City that provide 2200 MW. It has addressed two matters in this case: the meteorologist Con Edison has proposed to hire and the Company's transmission system project at East 13^{th} Street in Manhattan.

Astoria Generating supports Con Edison's proposal to hire an in-house meteorologist for the reasons given by the Company. It believes that the meteorologist would be able to provide localized and up-to-date data of the weather affecting the Con Edison system. This information, Con Edison asserts and Astoria concurs, could be used to provide better predictions of the electric, gas and steam system demands, and it would indicate whether electric and steam generators located in New York City would be needed to meet such demands.

Astoria Generating believes that Con Edison should post the weather data it obtains from its in-house meteorologist and share it with the local generators. According to Astoria Generating, this data could provide in-city generators additional time to schedule their natural gas deliveries in response to the localized weather effects.

Astoria Generating is particularly concerned about natural gas nominations that are made after 5:00 p.m. which it states are usually rejected by local natural gas delivery companies, Con Edison and KeySpan Energy Delivery New York. When the nominations are rejected, dual-fuel generators must switch to fuel oil. According to Astoria Generating this is undesirable for economic, environmental and system reliability reasons.

Fuel oil can be more expensive than natural gas and ratepayers will ultimately pay for the cost of the energy that is used to produce electricity and steam. Also, fuel oil produces greater amounts of air emissions which reduce the available emission allowances that could be used at other times to provide reliable service.

Con Edison objects to Astoria Generating’s proposal. It states that the Company should not be required to share its meteorologist and weather forecasting services with third parties.

We have recommended against the Company’s proposal to incur the additional costs for an in-house meteorologist. In the event that the Commission were to rule otherwise, we would agree with Con Edison that it has no duty or responsibility to provide meteorologist services either to Astoria Generating or to any other participants in the in-city, wholesale market.

With respect to Astoria Generating's interest in the timely completion of the East 13th Street transmission system project, we have addressed this matter above.

Street Lighting Billing System

Con Edison states that it plans to complete the installation of an electronic register of the street lighting facilities before the start of the upcoming rate year. According to it, work on the electronic register was delayed due to changes made after at the City of New York's request after the project was begun.

According to the City, work on the new street lighting billing system stalled in May 2007 and the project is now more than two years behind schedule. The City wants the new system and more accurate street lighting bills. The old register contains inaccurately identified items and its use produces billing errors. The City requests that the Commission assist in resolving this matter by assigning an administrative law judge who could ensure that the street lighting billing system receives prompt attention.

The City also believes that the street lighting service incentives adopted in the 2005-08 rate plan should continue to apply during the upcoming rate year. According to it, four performance metrics should be maintained (repair of poles, removal of temporary shunts, re-energization of "no current" streetlights and traffic signals, and replacement of circuit breakers with high fault current levels) and a time metric used to re-energize new streetlights and reduce the annual burning hours for streetlights equipped with light sensitive control devices. The street lighting incentives, according to the City, have provided a material improvement in service and should therefore be continued.

According to Con Edison, if everything goes well and the new street lighting billing system becomes operational in early 2008, there would not be any need for the Commission to assign an administrative law judge as the City has proposed.

We recommend that the parties address this matter and provide current information in their briefs on exceptions. At that time, the parties can advise the Commission whether Con Edison's work on the new billing system for street lighting facilities remains incomplete or has been completed.

Low-Income Assistance Program

Con Edison proposes to continue the low income customer program from the 2005-08 rate plan that is still in effect. Qualified customers pay a reduced customer charge. Program funding is currently set at $12.5 million a year and about 245,000 customers received a $4.25 monthly reduction in their customer charge.

DPS Staff has proposed that the funding for this program be increased to $24.9 million to provide qualified customers an $8.81 customer charge reduction that would freeze the customer charge that they pay at $6.50. Staff asserts that it is reasonable to freeze the customer charge for these customers in light of the amount of the rate increase that will result from this case. According to Con Edison, there is nothing in the record to demonstrate that the Staff-proposed funding level is related to energy costs in the service area or that it pertains to the use of electricity for heating purposes.

The issue here does not concern the provision of a reduced customer charge for low-income customers. It only addresses the level of the customer charge and the amount of assistance to be provided to these customers. The record does not contain very much guidance on this matter and it has been addressed as a general matter of public policy given the amount of the rate increase that electric service customers are apt to incur. We have recommended that the Commission accept CPB's proposal not to increase the customer charges that any residential customers pay. Accordingly, there is no need to provide any additional funding for the low-income assistance program were the Commission to reject our recommendation and the

CPB proposal, the merits of Staff's proposal should be re-evaluated.

MISCELLANEOUS MATTERS

Other Tariff Changes

The Company proposes to update the charges for special services. These are services that the Company is not otherwise required to perform but agrees to render to a specific customer. In order that the whole customer population does not bear the costs for activities that are needed by one customer, the Company imposes fixed charges for these special services. The charges for such services are based on the Company's cost to perform the service, as determined by reference to the list of cost components in the tariff and the average time necessary to perform the work. Four such charges would be updated/increased.

The Company also proposes to modify the availability of the non-residential heating rate discount provided under Special Provision D of the SC 4 and 9 tariffs. It would grandfather existing customers who receive service under Special Provision D of SC 4 and 9 for as long as they continue to rely on electricity for all their heating requirements. New, additional or successor customers would not be permitted to take service under this Special Provision on or after April 1, 2008. The Company explained that Special Provision D was established in 1970 to promote higher winter demand on the Company's electric system. It, however, has recently reconsidered the rationale for promoting off-peak demand because it diminishes the Company's flexibility to perform routine maintenance and replacement work on the distribution system in order to meet peak summer demand requirements. Moreover, the Company witness testified that the majority of the customers benefiting from this discount were not induced to use electric space heating because of the existence of the rate but rather for convenience and financial considerations.

The Company proposes other miscellaneous tariff changes, including tariff changes to recognize the unbundling of competitive services; modifications to MAC provisions to continue recovery of the Company's costs associated with Demand Management Programs (including marketing costs and incentives) and recovery of net revenue shortfalls resulting from laws that would permit NYPA to serve non-governmental customers in the Company's service area; modifications to MAC/MSC tariff provisions to implement the changes previously described related to transferring recovery of several supply-related cost components from the MAC to the MSC; and deletion of obsolete tariff language, including other clarifying tariff changes.

The Company asserts that no party raised objections to any of the above proposals.[169]

We find that the Company has provided record support for the above uncontested proposals and therefore recommend their adoption.

Mandatory Hourly Pricing (MHP)

The Company proposes to expand the MHP program to all customers whose maximum demand is greater than 500 kW in any month during an annual period ending September 30.[170] Its stated purpose is to increase the number of customers that will have access to both hourly price and hourly usage information, consistent with Commission policy.[171] The Company plans to begin billing customers in the over 1,000 kW group beginning with

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[169] Con Edison Initial Brief at 433-436.

[170] There are currently 1,570 customers with demand greater than 500 kW and up to and including 1500 kW. Tr. 772.

[171] The Company is referring to Case 03-E-0641, Proceeding on Motion of the Commission Regarding Expedited Implementation of Mandatory Hourly Pricing for Commodity Service, Order Denying Petitions for Rehearing and Clarification in Part and Adopting Mandatory Hourly Pricing Requirements (issued April 24, 2006) ("MHP Order"). The Company projects expenditures of about $6.1 million for meter and meter installations and nearly $ 1 million in O&M expense for ongoing associated communication requirements.

bills having a "from date" on or after January 1, 2009 and the over 500 kW group beginning with bills having a "from date" on or after January 1, 2010. It also states that it plans “an extensive outreach and education program so the affected customers may fully understand and benefit from the implementation of MHP.” If the Commission approves the MHP expansion, the Company would file tariff changes and mail copies to parties in this case, no less than 90 days before the effective date of the MHP change. The Company also proposes adding a $1000 charge to the bills of customers who deny the Company access to change the meter.[172]

Staff recommends several additional, “enhanced” O&E measures, including live seminars to provide information on MHP to customers, consultants and ESCOs and Company communication with customers and vendors to determine if there are ways to make the energy management software package more customer friendly. As to the costs associated with its proposal, Staff refutes the claim that an estimated additional cost of the Staff proposal ($100,000) is excessive, arguing that relative to the Company’s proposed expenditures for meters and meter installation (about $6.1 million) it is only a small fraction and is fully warranted in that it will give customers the necessary tools and information to effectively use the technology.

Staff also disagrees with the Company’s proposed implementation schedule, asserting that it should be modified to allow customers to receive at least 6 months of hourly interval load data for the over 1000 kW customers and at least one year of hourly interval load data for customers with demand between 500 kW and 1 MW. Staff states that this is consistent with the MHP Order in that it would enable customers to see how their load is affected by season, production patterns, weather, etc, so they could effectively make adjustments to their load patterns in an anticipation of the new Hourly Pricing Tariff.

[172] Con Edison Initial Brief at 155-156; Tr. 772-775.

Staff argues that the customers targeted for the proposed expansion are different from the customers that were previously exposed to “expedited” MHP transition in that they have had no previous exposure to time sensitive rates. Staff therefore concludes that these customers will therefore have a steeper learning curve and will benefit from the Staff’s proposed delay. It adds that any concern about delay is outweighed by the customers’ increased opportunity for a better understanding of the MHP tariff and more effective demand reduction response.

Staff opposes the Company’s proposal to amend its tariff to include a special charge that it would assess in the event the Company is denied access to eligible customers’ meter(s). It argues that past experience does not support the need for such a charge. It also urges that all MHP costs be recovered via delivery rates, stating MHP is deemed to benefit all customers and that such an approach comports with the MHP Order.[173]

RESA supports the Company’s proposal, stating that rapid implementation is critical to the development of a competitive NYS energy efficiency market and the attainment of the State’s energy efficiency goals. RESA urges rejection of Staff’s proposal, asserting that it creates a level of delay that is “unnecessary and unacceptable” and is fully avoidable by simply approving the Company’s schedule which allows sufficient time for all the necessary steps to occur.[174]

Citing to its myriad concerns with customers transferring from conventional to real time meters, NYC’s witness Rosenberg testified that the Commission should initiate a collaborative to address whether Con Edison’s existing or proposed rate design is consistent with expanded real-time pricing. It argues that the proposed collaborative could easily be conducted in parallel with the AMI installations and that there is ample time for it given the Company’s scheduled

[173] Staff Initial Brief at 282-289; Reply Brief at 117-123.

[174] RESA Initial Brief at 19-21.

expansion of January 2009 “at the earliest.” It finds Con Edison’s opposition to its recommendation incomprehensible, especially given the magnitude of the Company’s planned expenditures on MHP-related items. It states that if price signals are not correct, then the desired results (i.e., improved customer ability to reduce demand and increase energy efficiency) will not be achieved and the expenditures will be a waste. It argues that the proposed collaborative will avoid such an outcome and, as a result, the Company’s opposition should be dismissed.[175]

The Company responds that the NYC witness has not provided any example of a deficiency or defect in the Company’s existing rate structure that warrants the time or expense of the undertaking it proposed.[176] The Company also opposes the Staff proposals. It asserts that Staff’s proposed delay in the implementation schedule is not required by the MHP Order and would have detriments that do not outweigh any associated, “minimal” benefits. The Company adds that Staff failed to include any additional rate relief for its “excessive” costing O&E proposal. The Company also contends that Staff failed to provide an adequate response to its “real-world” concern regarding the importance of and need for a special charge that will encourage customers to provide meter access in compliance with this “mandatory” program. Finally, the Company states that Staff’s position regarding the recovery of MHP costs is not required by the NHP Order.[177]

We find that insufficient record support was provided by NYC for the collaborative that it suggests. It would appear that the interests of the customers for whom the expansion is proposed and the parties commenting on this issue may be better addressed by adoption of the Staff proposal for enhanced O&E.

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[175] City Initial Brief at 93-95; Reply Brief at 31-33.

[176] Con Edison Initial Brief at 424-425; Reply Brief at 153-154.

[177] Con Edison Initial Brief at 157-161.

Therefore, for the reasons cited by Staff, we recommend that Staff's proposed "enhanced" O&E plan be adopted and incorporated as part of the Company's proposed expansion of its MHP program. With respect to approval of the Company's proposal, including its proposed schedule, we defer to the Commission decision in the MHP proceeding.

First Avenue Proceeds

Con Edison has proposed to pass back to ratepayers the gain it obtained from selling its properties on First Avenue in Manhattan. Staff does not object to the Company's ratemaking proposal in this case but it notes that the final amount due ratepayers has not been determined. If the Commission ultimately determines that ratepayers are entitled to a larger amount than was used in this case, Staff proposes that the Company be required to defer the additional benefit.

The Commission should address the all of the accounting necessary for the First Avenue property sale when it specifically addresses the Company's proposals that pertain to this transaction. To the extent that the final accounting for the sale differs with the calculations that have been used in this case, we recommend that any additional amounts due ratepayers should be preserved for them.

Deferral Accounting and Netting of Regulatory Assets and Liabilities

The Company proposes to continue to net outstanding deferred balances at the end of each rate year, whether there is a one-year rate determination or a multi-year rate plan is adopted. The Company witness testified that the ability to net deferrals simplified external reporting requirements and made the Company's financial statements more meaningful to investors. Staff opposed continuation of the netting provision in the context of a one-year rate case, and instead recommended that the Commission determine the disposition of any deferred balances in the Company's next rate case.

The Company characterizes Staff's position as unreasonable, reiterating that netting is important financially as a means to avoid the impact of accumulated deferrals on the Company's external reporting requirements and financial statements. It states that that netting deferrals at the end of a one-year rate determination is no different from the operation of the current mechanism. The Company also asserts that the netting mechanism could contribute to its decision to delay seeking rate relief.

The Company observes that it has made two annual filings with the Commission's Office of Accounting and Finance pursuant to the netting provision of its current rate plan, resulting in $406 million in total regulatory assets and regulatory liabilities netted. It continues that the same procedure would be followed under its proposal and the netting would, again, be subject to Staff's audit and prudence review. The Company argues that a netting mechanism is especially appropriate given its proposal to use TCC revenues above the proposed $60 million rate level imputation, along with any other available transmission revenues, to recover any total net deferrals. It argues that using these revenues to recover net deferrals, and to mitigate any other deferrals that arise (such as from a revenue decoupling mechanism), would help to minimize the potential build up of large net deferrals that would be collected from or passed back to customers at some time in the future.

Staff contends that the Company witness conceded that a clearer understanding of the Company's true financial assets and liabilities could be just as easily achieved by a simple note in publicly issued financial statements as by netting. Staff argues that the Company's balance sheet housekeeping preferences are not a legitimate basis for the requested treatment.

Staff also states that the current netting mechanism was the result of negotiations among various parties in the last electric rate proceeding and the Joint Proposal in that proceeding explicitly bars parties from relying on it as precedent. Staff adds that the Company witness acknowledged that netting was not traditionally available to the Company and was first permitted in the current electric rate plan.

Staff refutes the Company's suggestion that deferrals could be the sole reason for the Company to file a rate case by noting the Company witness indicated that the level of a Company's earnings is more determinative factor in the Company's decision to file for rates. Staff further states that Con Edison has filed a rate case every time it has been not been precluded from doing so under a multi-year rate plan or the PSL for at least the last 20 years.

Staff argues that the Company's netting request should be rejected in view of the level of supporting documentation for deferred balances that the Company has been providing under the currently allowed netting approach, stating that the information Con Edison has been providing is "patently insufficient" for Staff to determine its accuracy and as compared to the level of information provided and required in rate cases.

Finally, Staff asserts that the netting of deferred costs and credits limits the Commission's options in rate cases. Staff argues that, traditionally, the Commission has determined the time frame for addressing deferred balances in the context of a rate filing and that netting prevents the Commission from using its discretion to determine the disposition and timing of such regulatory assets and liabilities.

We find that netting would provide little, if any, benefit here. We are not convinced that it will minimize the potential build up of large net deferrals or enhance the regulatory auditing function. In addition, we are not persuaded that it would encourage the Company to delay filing a future rate request or that is it the only reasonable means for the Company to clearly communicate with its investors. We therefore recommend that the Company's proposal not be adopted.

January 8, 2008
WB, MLP, RS/emn

Consolidated Edison Company of New York, Inc.
Electric Service
Operating Income, Rate Base & Rate of Return
For the Twelve Months Ending March 31, 2009
($000's)

	As Adjusted By Staff	Ref.	ALJ Recommended Adjustments	As Adjusted By ALJ	Revenue Increase	Per ALJ After Increase
Operating Revenues						
Sales Revenues	$ 6,662,814	1a	$ 9,412	$ 6,672,226	$ 601,443	$ 7,273,669
Other Operating Revenues	149,714	1b	37,597	187,311		187,311
Total Operating Revenues	6,812,528		47,009	6,859,537	601,443	7,460,980
Operating Expense						
Fuel	3,041,326			3,041,326		3,041,326
Operation & Maintenance Expenses	1,628,629	Sch. 2	(18,382)	1,610,247	3,308	1,613,555
Depreciation Expense	566,548	1c	461	567,009		567,009
Taxes Other Than Income Taxes	1,007,008	Sch. 3	55	1,007,063	17,442	1,024,504
Gains from Disposition of Utility Plant	(30,812)			(30,812)		(30,812)
Total Operating Expenses	6,212,699		(17,867)	6,194,832	20,750	6,215,582
Operating Income Before Income Taxes	599,829		64,876	664,705	580,693	1,245,398
New York State Income Tax	14,042	Sch. 4	4,262	18,304	41,229	59,533
Federal Income Tax	34,394	Sch. 5	19,679	54,074	188,812	242,886
Utility Operating Income	$ 551,393		$ 40,934	$ 592,327	$ 350,652	$ 942,979
Rate Base	$ 12,768,944	Sch. 6	$ 166,294	$ 12,935,238		$ 12,935,238

Consolidated Edison Company of New York, Inc.
Electric Service
Operation & Maintenance Expenses
For the Twelve Months Ending March 31, 2009
($000's)

	As Adjusted By Staff	Ref	ALJ Recommended Adjustments	As Adjusted By ALJ
Admin & General Expenses Capitalized	$ (11,374)			$ (11,374)
Asbestos Removal	813			813
Bowline and Roseton Charges	373			373
Bank Collection Fees	230			230
Benefit Cost - Program Change Labor	7,082			7,082
Betterment Program	-			-
Boiler Cleaning	612			612
Building Services / Facilities	30,574			30,574
Central Engineering - Administrative	1			1
Central Engineering - Distribution	1,145			1,145
Collection Agency Fees	458			458
Communications - Telephone	14,503			14,503
Company Labor - Program Change	-			-
Company Labor	555,779	2a	557	556,336
AMR / AMI Saturation Savings	-			-
Consultants	10,517			10,517
Contract Labor	1,601			1,601
Corrective Maintenance	4,258			4,258
DC Incentive Program	-			-
Disposal of Obsolete M&S	8,051			8,051
DSM	20,356			20,356
Duplicate Misc. Charges	(19,970)			(19,970)
EDP Equipment Rentals & Maintenance	3,769			3,769
Electric and Gas Used	215			215
Employee Pension / OPEBs	81,151			81,151
Employee Welfare Expense - Net	100,338	2b	(744)	99,594
Environmental Affairs	2,379			2,379
Environmental Programs	1,064			1,064
ERRP - Major Maintenance	7,442			7,442
Exec. and Mgt. Incentive Plan	-			-
Facilities Maintenance	4,448			4,448
Financial Services	6,096			6,096
Gas Turbines	3,108			3,108
Grounds and Buildings	331			331
Information Resources	24,098			24,098
Informational Advertising	8,976	2c	(4,499)	4,477
Injuries and Damages Reserve	39,601			39,601
Institutional Dues & Subscriptions	1,421			1,421
Insurance Premiums	25,612			25,612
Interference	91,985			91,985
LIC Outage	1,064			1,064
Corporate and Fiscal Expenses	3,607			3,607
Major Maintenance Projects	-			-
Manhour Expense	33,298			33,298
Marshall's Fees	1,345			1,345
Materials and Supplies	14,934			14,934
MGP / Superfund	24,739			24,739
NY Power Pool	21			21
Other (Fossil)	2,576			2,576
Outside Legal Services	1,877			1,877
Paving	271			271
Plant Component Upgrade	292			292
Plant Inspection and Repair	-			-
Postage	13,554			13,554
Preventive Maintenance	2,356			2,356
Promotional Advertising	-			-
RCA - Pension	-			-
RCA - Amortization of Hudson-Farragut	477			477
RCA - Interference	-			-
RCA - Amortization of Hudson Avenue	-			-
System Benefit Charge / Renewable Portfolio Standard	118,287			118,287
Real Estate Expenses	2,070			2,070
Regulatory Commission Expenses	27,247	2d	(816)	26,431
Rents	54,433			54,433
Rents (ERRP)	71,162			71,162
Rents (Interdepartmental)	4,834			4,834
Research and Development	19,000			19,000
Routine Maintenance	-			-
Scheduled Overhauls	1,273			1,273
Security	2,278			2,278
Shared Services	(7,989)			(7,989)
Steam Transfer Credit (Fossil)	(1)			(1)
Storm Costs	8,000	2e	(2,400)	5,600
Transformer Installations	55			55
Tree Trimming	20,900	2f	(4,001)	16,899
Trenching	7,963			7,963
Uncollectible	37,124			37,124
Water	744			744
Water Chemicals	88			88
Waterside (includes labor)	-			-
Other	133,707	2g	(6,480)	127,227
Total O & M Expenses	$ 1,628,629	Sch. 1	$ (18,382)	$ 1,610,247

Consolidated Edison Company of New York, Inc.
Electric Service
Taxes Other Than Income Taxes
For the Twelve Months Ending March 31, 2009
($000's)

	As Adjusted By Staff	Ref	ALJ Recommended Adjustments	As Adjusted By ALJ	Effect of Revenue Increase	Per ALJ After Increase
Property Taxes						
New York City	$ 671,930			$ 671,930		$ 671,930
Westchester	81,572			81,572		81,572
Property Tax Reconciliation Deferral	-			-		-
Total Property Taxes	753,502		-	753,502	-	753,502
Revenue taxes	178,149			178,149	17,442	195,591
Payroll Taxes	54,371	3a	55	54,426		54,426
Subsidiary Capital Tax	4,228			4,228		4,228
Receipts Tax	15,079			15,079		15,079
All Other Taxes	1,679			1,679		1,679
Total Taxes Other Than Income Taxes	$ 1,007,008	Sch. 1	$ 55	$ 1,007,063	$ 17,442	$ 1,024,504

Consolidated Edison Company of New York, Inc.
Electric Service
New York State Income Tax
For the Twelve Months Ending March 31, 2009
($000's)

	As Adjusted By Staff	Ref	ALJ Recommended Adjustments	As Adjusted By ALJ	Revenue Increase	Per ALJ After Increase
Operating Income Before Income Taxes	$ 599,829	Sch. 1	$ 64,876	$ 664,705	$ 580,693	$ 1,245,398
Flow Through Items:						
Deduct: Non-Taxable Income and Additional Deductions:						
Interest Expense	386,233		4,848	391,081		391,081
Medicare Part D Subsidy - Post-Employment Benefits	15,824			15,824		15,824
Total Deductions	402,057		4,848	406,905	-	406,905
Normalized Items:						
Add: Additional Income and Unallowable Deductions						
Book Depreciation	566,548	Sch. 1	461	567,009		567,009
Contributions in Aid of Construction	1,855			1,855		1,855
Capitalized Interest	10,055			10,055		10,055
Pension and OPEB Expenses Per Books	81,151			81,151		81,151
Total Additions	659,609		461	660,070	-	660,070
Deduct: Non-Taxable Income and Additional Deductions						
NYS Depreciation	585,810			585,810		585,810
Removal Costs	160,688			160,688		160,688
Repair Allowance	14,553			14,553		14,553
Amortization of Capitalized Interest	3,881			3,881		3,881
Loss on MACRS Retirement	44,763			44,763		44,763
Pension / OPEB Expense - Funding	141,739			141,739		141,739
Westchester Property Tax Adjustment	597			597		597
Correction of ADR Tax Amortization	16,059			16,059		16,059
Interest on Federal Income Tax Audit Adjustments - Net	7,404			7,404		7,404
New York State Tax Law Changes	9,207			9,207		9,207
Interest on First Avenue Properties	2,752			2,752		2,752
WTC Expenses	(14,000)			(14,000)		(14,000)
Carrying Charges on T&D Expenditures	(49,883)			(49,883)		(49,883)
Gain on the Sale of First Avenue Properties	30,812			30,812		30,812
Total Deductions	954,382		-	954,382	-	954,382
Total Adjustments to Income	$ (696,830)		$ (4,387)	$ (701,217)	$ -	$ (701,217)
Taxable Income - New York State	$ (97,001)		$ 60,489	$ (36,512)	$ 580,693	$ 544,181
Tax Computation						
Current NYS Income Tax Payable @ 7.1%	(6,887)		4,295	(2,592)	41,229	38,637
Deferred NYS Income Tax @ 7.1%	20,929		(33)	20,896	-	20,896
Total New York State Income Tax	$ 14,042	Sch. 1	$ 4,262	$ 18,304	$ 41,229	$ 59,533

Consolidated Edison Company of New York, Inc.
Electric Service
Federal Income Tax
For the Twelve Months Ending March 31, 2009
($000's)

	As Adjusted By Staff	Ref	ALJ Recommended Adjustments	As Adjusted By ALJ	Revenue Increase	Per ALJ After Increase
Operating Income Before Income Taxes	$ 599,829	Sch. 1	$ 64,876	$ 664,705	$580,693	$1,245,398
New York State Income Tax	14,042	Sch. 4	4,262	18,304	41,229	59,533
Operating Income Before Federal Income Tax	585,787		60,614	646,401	539,464	1,185,865
Flow Through Items:						
Add: Additional Income and Unallowable Deductions						
Book Depreciation	566,548	Sch. 1	461	567,009	-	567,009
Hudson-Farragut Amortization - Per Books	477			477		477
Capitalized Interest	10,055			10,055		10,055
Total Additions	577,080		461	577,541	-	577,541
Deduct: Non-Taxable Income and Additional Deductions						
Interest Expense	386,233		4,848	391,081		391,081
Statutory Depreciation - at Current Book Rates	268,443			268,443		268,443
Statutory Depreciation - Change at Proposed Book Rates	21,367			21,367		21,367
Statutory Depreciation - Change with Reserve Deficiency	1,648			1,648		1,648
Removal Costs	160,688			160,688		160,688
Medicare Part D Subsidy - Post-Employment Benefits	15,824			15,824		15,824
Amortization of Capitalized Interest	2,039			2,039		2,039
Westchester Property Tax Adjustment	597			597		597
Dividends Paid on $5 Cumulative Preferred Stock	3,327			3,327		3,327
Total Deductions	860,166		4,848	865,014	-	865,014
Normalized Items:						
Add: Additional Income and Unallowable Deductions						
Contributions in Aid of Construction	1,855			1,855		1,855
Pension / OPEB Expenses - Rate Year	81,151			81,151		81,151
Deferred NYS Income Tax	20,929	Sch. 4	(33)	20,896	-	20,896
Total Additions	103,935		(33)	103,902	-	103,902
Deduct: Non-Taxable Income and Additional Deductions						
Statutory Depreciation - at Current Book Rates	366,332			366,332		366,332
Statutory Depreciation - Change at Proposed Book Rates	(21,367)			(21,367)		(21,367)
Statutory Depreciation - Change with Reserve Deficiency	(1,648)			(1,648)		(1,648)
Repair Allowance	14,553			14,553		14,553
Amortization of Capitalized Interest	1,842			1,842		1,842
Loss on MACRS Retirement	26,426			26,426		26,426
Pension / OPEB Expense - Funding	141,739			141,739		141,739
Correction of ADR Tax Amortization	16,059			16,059		16,059
Interest on Federal Income Tax Audit Adjustments - Net	7,404			7,404		7,404
New York State Tax Law Changes	9,207			9,207		9,207
Interest on First Avenue Properties	2,752			2,752		2,752
WTC Expenses	(14,000)			(14,000)		(14,000)
Carrying Charges on T&D Expenditures	(49,883)			(49,883)		(49,883)
Gain on the Sale of First Avenue Properties	30,812			30,812		30,812
Total Deductions	530,228		-	530,228	-	530,228
Total Adjustments to Income	(709,379)		(4,420)	(713,799)	-	(713,799)
Taxable Income - Federal	$ (123,592)		$ 56,194	$ (67,398)	$ 539,464	$ 472,066
Tax Computation						
Current Federal Income Tax @ 35%	(43,257)		19,668	(23,589)	188,812	165,223
Deferred Federal Income Tax @ 35%	149,203		11	149,214	-	149,214
Amortization of Previously Deferred Federal Income Tax						
Depreciation - ADR/ACRS/MACRS - at Current Book Rates	(38,759)			(38,759)		(38,759)
Depreciation - ADR/ACRS/MACRS - at Proposed Book Rates	(1,436)			(1,436)		(1,436)
Depreciation - ADR/ACRS/MACRS - Reserve Deficiency	(2,539)			(2,539)		(2,539)
Loss on MACRS Retirements	(3,232)			(3,232)		(3,232)
Repair Allowance	(9,617)			(9,617)		(9,617)
Capitalized Overheads	(11,197)			(11,197)		(11,197)
Investment Tax Credit	(4,771)			(4,771)		(4,771)
Total Federal Income Tax	$ 34,394	Sch. 1	$ 19,679	$ 54,074	$ 188,812	$ 242,886

Consolidated Edison Company of New York, Inc.
Electric Service
Rate Base
For the Twelve Months Ending March 31, 2009
($000's)

	As Adjusted By Staff	Ref	ALJ Recommended Adjustments	As Adjusted By ALJ
Utility Plant:				
Book Cost of Plant	$ 17,320,229	6a	$ 17,632	$ 17,337,861
Accumulated Reserve for Depreciation	(3,780,880)	6b	(182)	(3,781,062)
Net Plant	13,539,349		17,450	13,556,799
Non-Interest Bearing CWIP	349,858			349,858
Preferred Stock Expense	2,366			2,366
Unamortized Debt Discount Premium and Expense	135,947			135,947
Deferred Fuel - Net of Tax	37,008			37,008
FIT Refund Deficiency - Include Interest - Net of Tax	18,971			18,971
Unamortized Balance - Hudson Farragut	1,800			1,800
Customer Advances for Construction	(206)			(206)
MTA Surtax - Net of Tax	1,789			1,789
Working Capital	542,491	Sch. 7	(2,298)	540,193
Excess Rate Base Over Capitalization Adjustment	184,509			184,509
Early Retirement Termination Benefit (1993) - Net of Tax	-			-
Early Retirement Termination Benefit (1993) - Net of Tax	9,095			9,095
Low Income Fund - Net of Tax	-			-
Arrears Avoidance Program - Net of Tax	-			-
DC Service Incentive - Net of Tax	(5,808)			(5,808)
System Benefits Charge/Retail Portfolio Standard - Net of Tax	(3,845)			(3,845)
Amounts Billed in Advance of Construction - Net of Tax	(5,218)			(5,218)
BIR Discounts - Recovery - Net of Tax	-			-
Emergency Demand Response Program - Initial Costs - Net of Tax	-			-
Direct Load Control Program - Net of Tax	-			-
NOX Emissions Allowances - Net of Tax	-			-
Sale of NOX Emissions Allowances - Net of Tax	-			-
Cogen Technologies - Reimbursement for O&M - Net of Tax	-			-
Sale / Appropriation of Property	-			-
CATV Pole Attachment Revenue - Net of Tax	-			-
Partial Pass Thru Fuel Adjustment - Net of FIT	-			-
Washington Heights & WTC Security Initiative - Net of Tax	-			-
Customer Refund Associated with Divested Plants - Net of Tax	-			-
Customer Refund Associated with Waterside - Net of Tax	-			-
Electric Reliability Penalty - Net of Tax	-			-
Rate Case Pension Deferral - Net of Tax	-			-
Rate Case OPEB Deferral - Net of Tax	-			-
Expiring Amortization of Deferred Costs - Net of Tax	-			-
Forgoing Rental Income - West 24th Street - Net of Tax	-			-
Rate Case Reconciliations - Net of Federal Income Taxes				
Refund of Gain From Sale of First Avenue Properties	(46,315)			(46,315)
Refund of Customer Benefits From the Correction of ADR Taxes	(23,758)			(23,758)
Refund of Interest on ADR Tax Benefits	-	6c	(831)	(831)
Refund of Interest on Federal Income Tax Audit Adjustments	(11,129)			(11,129)
Refund of Over Collection of NYS Tax Law Changes	(12,632)			(12,632)
Recovery of Carrying Charges on T&D Expenditures	74,969			74,969
Recovery of WTC Costs	-	6f	156,508	156,508
Recovery of DC Conversion Incentive Program	(2,800)	6d	(1,700)	(4,500)
Recovery of ERRP Major Maintenance Unexpended Fund	(2,622)	6g	(2,622)	(5,244)
Accumulated Deferred Income Taxes				
ADR / ACRS / MACRS Deductions	(1,643,505)			(1,643,505)
Change of Accounting Section 263A	(298,381)			(298,381)
Vested Vacation	12,101			12,101
Prepaid Insurance Expenses	(1,729)			(1,729)
Unbilled Revenues	105,914			105,914
Contributions in Aid of Construction	14,231			14,231
Capitalized Interest	4,861			4,861
Advanced Refunding of Mortgage Bonds	-			-
Repair & Maintenance Allowance - 2002-2006 IRS Audit	6,193			6,193
Customer Deposits	33,799			33,799
Call Premium	(20,307)			(20,307)
Excess Deferred SIT (2007)	6,263	6e	(213)	6,050
Deferred SIT	(234,315)			(234,315)
Total Rate Base	$ 12,768,944	Sch. 1	$ 166,294	$ 12,935,238

Consolidated Edison Company of New York, Inc.
Electric Service
Working Capital Allowance
For the Twelve Months Ending March 31, 2009
($000's)

	As Adjusted By Staff	Ref	ALJ Recommended Adjustments	As Adjusted By ALJ
Materials & Supplies				
Liquid Fuel Inventory	$ 5,715			$ 5,715
Materials & Supplies, Excluding Fuel	86,787			86,787
Total Materials & Supplies	92,502		-	92,502
Prepayments				
Insurance	10,747			10,747
Rents	15,138			15,138
Property Taxes	166,119			166,119
PSC Assessment	7,949			7,949
Interference	1,694			1,694
EPRI	173			173
Other	12,012			12,012
Total Prepayments	213,832		-	213,832
Cash Working Capital				
Total Operations & Maintenance Expenses	4,669,955	Sch. 2	(18,382)	4,651,573
Less:				
Purchased Power Expenses	2,781,137			2,781,137
Gas Portion of Fuel	232,879		-	232,879
Recoverable Fuel Costs	25,382			25,382
Interdepartmental Rents	4,834		-	4,834
Uncollectibles	37,124		-	37,124
Pensions / OPEBs	81,151		-	81,151
Subtotal	3,162,507		-	3,162,507
Cash Working Capital Subject to 1/8th Allowance	1,507,448		(18,382)	1,489,066
Cash Working Capital @ 1/8th	188,431		(2,298)	186,133
Add: Cash Working Capital @ 1/12th on Recoverable Fuel	2,115		-	2,115
Total Cash Working Capital	190,546		(2,298)	188,248
Total	496,880		(2,298)	494,582
Add: Working Capital Related to Purchased Power @ 1.64%	45,611			45,611
Total Working Capital	$ 542,491	Sch. 6	$ (2,298)	$ 540,193

Consolidated Edison Company of New York, Inc.
Electric Service
Explanation of ALJ Recommended Adjustments
For the Twelve Months Ending March 31, 2009
($000's)

Adj. No.	Explanation			Amount
	Operating Revenues - Schedule 1			
1a	**Sales Revenues**			
	Sales			
	To reflect the revised sales forecast.		$ (2,988)	
	Low Income Program			
	To reflect the removal of Staff's proposed low-income increase due to CPB/ALJ rate design.		12,400	
	Total adjustment to Sales Revenues			$ 9,412
1b	**Other Operating Revenues**			
	Late Payment Charges			
	To reflect the LPC on the rate increase to residential sales (.2704%).	$ 629		
	To reflect the LPC on the rate increase to non-residential sales (.4417%).	1,360		
	Total adjustment to Late Payment Charges		1,989	
	ADR Deferred Tax Benefit			
	To reflect the Commission's directives in case (Case 06-E-0990).		298	
	Direct Current (DC) Incentive			
	To reflect a three year amortization period for estimated $9 million surplus.		(6,000)	
	Excess Deferred SIT			
	To reflect the revised calculation of the net benefit.	(8,722)		
	To reflect a three year amortization period the benefit.	(8,015)		
	Total adjustment to Excess Deferred SIT		(16,737)	
	Transmission Congestion Credits Revenues			
	To reflect a rate year revenue imputation of $150 million.		90,000	
	ERRP Major Maintenance Unexpended Funds			
	To reflect Company retention of funds to finance future major maintenance expenses.		(8,683)	
	Recovery of WTC Costs			
	To reflect Company's requested recovery level of deferred WTC costs.		(23,270)	
	Total adjustment to Other Operating Revenues			37,597
1c	**Depreciation Expense - Schedule 1**			
	To reflect the increase in annual depreciation expense.		461	

Consolidated Edison Company of New York, Inc.
Electric Service
Explanation of ALJ Recommended Adjustments
For the Twelve Months Ending March 31, 2009
($000's)

Adj. No.	Explanation			Amount
	Operation and Maintenance Expenses - Schedule 2			
2a	Company Labor			
	To reflect the allowance of 12 additional positions in the Finance and Auditing Departments.	$ 1,024		
	To reflect the allowance of one half of the requested 19 Customer Service Representatives for the Call Center.	521		
	To reflect the allowance of 15 requested Customer Service Representatives for Field Operations.	390		
	To reflect the allowance of 24 requested Trouble Shooters for Control Center Emergency Screening.	613		
	To reflect the removal of 15 new hires for the Energy Efficiency Program.	(2,024)		
	Tracking adjustment to reflect escalation on incremental allowed employee salaries.	33		
	Total adjustment to Company Labor		557	
2b	Employee Welfare Expense			
	Tracking adjustment to reflect increases in allowed employee levels.	100		
	To reflect forecast of Group Life Insurance premiums including historic average dividend/deficit factor.	(844)		
	Total adjustment to Employee Welfare Expense		(744)	
2c	Informational Advertising			
	To reflect Commission's practice in Case 27029 to limit rate allowance to .06% of the operating revenues.		(4,499)	
2d	Regulatory Commission Expense			
	To reflect known change in PSC Assessment level.	284		
	To reflect four year average 5.25% PSC Assessment refund level.	(1,100)		
	Total adjustment to Regulatory Commission Expense		(816)	
2e	Storm Costs			
	To reflect the forecast for storm reserve.		(2,400)	
2f	Tree Trimming			
	To reflect Company's 2007 budget of $9.5 million for distribution line clearance program plus inflation.		(4,001)	

Consolidated Edison Company of New York, Inc.
Electric Service
Explanation of ALJ Recommended Adjustments
For the Twelve Months Ending March 31, 2009
($000's)

Adj. No.	Explanation			Amount
2g	Other			
	To reflect Company revised fuel cost update of $366,000.	(542)		
	To reflect 60,000 underground inspections at $319.20 per inspection in the rate year.	(15,849)		
	To reflect allowance of $1.0 million for double wood program in the rate year.	(4,235)		
	To reflect allowance of stock-based Deferred Compensation Plan.	14,146		
	Total adjustment to Other O&M		(6,480)	
	Total adjustment to Operations and Maintenance Expenses			$ (18,382)
	Taxes Other Than Income Taxes - Schedule 3			
3a	Payroll Taxes			
	Tracking adjustment to reflect increases in allowed employee levels.		55	
	Rate Base - Schedule 6			
	Net Plant			
6a	Book Cost of Plant			
	To reflect the revised capital expenditures.		$ 17,632	
6b	Accumulated Reserve for Depreciation			
	To reflect the revised capital expenditures.		(182)	
	Total adjustment to Net Plant			$ 17,450
	Rate Case Reconciliations			
6c	ADR Deferred Tax Benefit			
	To reflect balance omitted in error in the original Company filing.	$ (380)		
	To reflect the Commission's directives in case (Case 06-E-0990).	(451)		
	Total adjustment to ADR Deferred Tax Benefit		(831)	
6d	Direct Current (DC) Incentive			
	To reflect a three year amortization period for estimated $9 million surplus.		(1,700)	
6e	Excess Deferred SIT			
	To reflect the revised calculation of the net benefit.	(2,633)		
	To reflect a three year amortization period the benefit.	2,420		
	Total adjustment to Excess Deferred SIT		(213)	
6f	WTC Costs			
	To reflect WTC costs in rate base.		156,508	
6g	ERRP Unexpended Funds			
	To reflect ERRP unexpended funds in rate base.		(2,622)	
	Tracking adjustment in Working Capital - Schedule 7.		(2,298)	
	Total Adjustment to Rate Base			148,844