

Brief 05-S-1376

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August 7, 2006

**VIA AIRBORNE EXPRESS**

Hon. Jaclyn Brilling  
Secretary  
New York State Public  
Service Commission  
Three Empire State Plaza  
Albany, NY 12223

**Re: Case Nos. 05-S-1376  
Con Edison Steam Rate Case**

Dear Secretary Brilling:

Enclosed for filing are an original and fifteen copies of the Post-Hearing Brief of Consolidated Edison Company of New York, Inc. ("Con Edison" or the "Company").

Very truly yours,

MLK/md  
Enclosures

Cc: Hon. Rafael A. Epstein,  
Administrative Law Judge

All Active Parties by  
e-mail and Regular Mail

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**STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION**

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| Case No. 05-S-1376 | Proceeding on Motion of the           | : |                     |
|                    | Commission as to the Rates, Charges,  | : | Before              |
|                    | Rules and Regulations of Consolidated | : | Hon. Rafael Epstein |
|                    | Edison Company of New York, Inc.      | : |                     |
|                    | For Steam Service                     | : |                     |

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**POST-HEARING BRIEF OF  
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.**

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Dated: August 7, 2006  
New York, New York

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STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

CASE 05-S-1376 – Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Steam Service.

**POST HEARING BRIEF OF  
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.**

**A. INTRODUCTION**

On June 2, 2006, a number of active parties to these proceedings entered into a Joint Proposal (“Proposal”) establishing steam rates for Consolidated Edison Company of New York, Inc. (“Con Edison” or the “Company”) for a two-year period, from October 1, 2006 through September 30, 2008. Eight parties, including Con Edison and Staff of the Department of Public Service (“Staff”), signed the Proposal (“Signatory Parties”).

Statements or testimony supporting or opposing the Proposal were filed on June 19, 2006, and reply statements or rebuttal testimony were filed on June 30, 2006. In addition, an evidentiary hearing addressing certain contested issues was conducted on July 12, 2006, resulting in a transcript of 414 pages and 24 exhibits that were entered into evidence.<sup>1</sup>

During the evidentiary hearings, the Statements and Reply Statements in Support of the Proposal filed by Con Edison, Staff, the City of New York (“City”), the New York Energy Consumers Council, Inc. (“NYECC”), and the Consumer Power Advocates (“CPA”) were adopted by their respective witnesses as sworn testimony and subjected to or made

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<sup>1</sup> References to the stenographer’s minutes will be set forth in parentheses, without prefix. Exhibits will be designated by the prefix “Exh.”

available for cross-examination. In addition, Con Edison submitted testimony rebutting the testimony opposing the Proposal's allocation of the costs of the East River Repowering Project ("ERRP") between the electric and steam departments submitted by Westchester County ("Westchester"), the only party to the proceeding that submitted evidence opposing a provision of the Proposal. TransGas Energy Systems ("TransGas") submitted a Statement in Opposition to the Proposal, but declined to submit that Statement into evidence so that it can be validated through cross-examination.<sup>2</sup> Upon completion of the hearing, the Administrative Law Judge ruled that participating parties would be permitted to file post-hearing briefs, limited to the facts and arguments raised at the evidentiary hearings with respect to the contested issues only (404-07).

At the outset, we would note that Westchester and TransGas complain about two discrete elements of the Proposal, without addressing the Proposal in its entirety. As we noted in our Statement in Support, however, those complaints must be measured against the numerous compromises that were negotiated by the Signatory Parties in order to reach an agreement. Thus, notwithstanding the complaints voiced by Westchester and TransGas, the Proposal is clearly reasonable when taken in its entirety and should, therefore, be approved in its entirety.

Moreover, as will be demonstrated below, Westchester's objections to the Proposal's continuance of the allocation of ERRP costs between the steam and electric departments based on the "incremental cost" allocation method were each considered and rejected by the Commission less than two years ago in the Company's last steam rate

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<sup>2</sup> TransGas did, however, take the opportunity to cross-examine witnesses for the Company, Staff and the City on the issue raised in TransGas's Statement.

proceeding.<sup>3</sup> Indeed, the circumstances in this case have changed little from those the Commission considered long ago in adopting the “incremental cost” allocation method in its Opinion 78-27<sup>4</sup> and again, more recently, in Opinion 00-15.<sup>5</sup> (185-86). And, none of the oft-repeated arguments advanced by Westchester provides a basis for the Commission to alter its policies on this matter.

**B. STEAM-ELECTRIC COST ALLOCATION**

**1. The Proposal’s Treatment of the Costs of ERRP is Consistent With Commission Policy**

In Con Edison’s steam system, steam is generated in either steam-only plants (producing “live” steam) or in steam-electric plants, which produce steam and electricity from the same heat source. In conventional plants, the heat source is a boiler that produces high-pressure steam. The steam is used to make electricity in a turbine-generator and is then exhausted to the steam distribution system. This joint use of facilities requires the allocation of capital and O&M costs and property taxes as well as the allocation of fuel savings from the cogeneration process (i.e., the fuel required to produce electricity and steam together is less than the total fuel required to produce equivalent electricity and steam in separate facilities).

Until the late 1990’s, the Company’s steam-electric stations included East River, Waterside, 74<sup>th</sup> Street, 59<sup>th</sup> Street and Hudson Avenue. The electric production facilities at the latter four stations have been retired, leaving only East River as a steam-electric station. At each of these plants, the capital costs were assigned to the electric department, with the steam department paying to the electric department interdepartmental rents to cover

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<sup>3</sup> Case 03-S-1672, Order Adopting The Terms of a Joint Proposal, Sept. 27, 2004 (“2004 Rate Order”).

<sup>4</sup> Case 27276, Con Edison Steam Rates, Opinion No. 78-27, 18 NYPSC 1764, 1768-70 (1978).

<sup>5</sup> Case 99-S-1621, Con Edison Steam Rates, Opinion No. 00-15, December 1, 2000, pp. 18-20.

steam's allocated share of capital costs (e.g., for water treatment facilities necessary for steam production, but not for electric production). The steam department also paid the electric department processing charges to cover steam's allocated share of O&M costs, which consist primarily of the costs of water and water treatment chemicals and associated labor, required for steam production. Fuel has been charged to each department based on a "heat rate" contribution, which represents the portion of the heat input to the boiler that is assigned to the production of steam or electricity, respectively. These allocation procedures continue to be used at the East River plant today.<sup>6</sup>

Under the Proposal, this longstanding method for allocating costs is continued for ERRP. Under the methodology approved by the Commission in the 2004 Rate Order (p. 16), capital costs and related property taxes for the heat recovery steam generator ("HRSG") and their associated piping, water treatment plant, and steam-related interconnections are allocated to the steam system. All other costs, which would be required for electric production absent any steam production, are allocated to the electric department. It should be noted that ERRP differs from the other steam-electric plants in that it uses a gas turbine ("GT") and HRSG instead of a conventional boiler and steam turbine. Thus, electricity is generated in the GT and its waste heat is captured in the HRSG and used to produce steam (257). Additional steam is produced in the HRSG by means of duct burners. Nevertheless, as explained by Company witness Shansky, differences in plant design or technology can be taken into account when applying the incremental cost method and the Proposal does just that (133, 257-58).

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<sup>6</sup> Unlike the other steam-electric plants, whose capital costs were included in Electric Plant with rents charged to steam production to cover incremental capital costs, ERRP's capital costs are included in Steam Plant, with rents charged to electric production to cover all but the incremental capital costs. However, the result is the same.

While there is no single unique method for allocating joint costs, the Commission has since 1978 (and prior to 1975) used the “incremental cost” method to allocate costs to steam; i.e., only incremental costs required for the production of steam are allocated to the steam department, while common costs or those only required for the production of electricity are allocated to the electric department. Since its re-adoption of the incremental cost method in 1978, the Commission has, on several occasions, expressly considered the reasonableness of continuing this allocation method and consistently required electric customers to pay the common costs of the steam-electric plants. See, e.g., Case 27877, Con Edison Steam Rates, Opinion No. 81-16, 21 NY PSC 2065, 2075-2076 (1981); Case 90-S-0938, Con Edison Steam Rates, 1991 NY PUC LEXIS 42 (1991); Case 99-S-1621, Opinion No. 00-15, supra, p. 18.

Significantly, Westchester challenged in New York’s courts the Commission’s use of the “incremental method” in allocating costs of jointly-used facilities, but the courts found no reason to disturb the Commission’s decisions. After considering the issue of whether it was proper for electric customers to bear the costs that would be required for electric production in an electric-only plant, the Appellate Division concluded:

Since 1978, the PSC’s rate orders have mandated that certain costs related to the production of steam within Con Ed’s Manhattan steam plants be apportioned among electrical consumers elsewhere in the Con Ed service area. Petitioners contend that the continuation of this practice is unfair and should be eliminated. . . . Since, as previously stated, the PSC “can validly set differential rates based upon considerations other than cost, as long as they are otherwise rationally based,” . . . we find no reason to disturb this determination.

County of Westchester v. Helmer, 296 AD2d 68, 74 (3d Dept 2002). Westchester’s request for leave to appeal was denied by the Court of Appeals. County of Westchester v. Helmer, 99 NY2d 502 (2002).

Finally, in the Company's last steam rate case, the County raised the very same arguments it raises here and each of those arguments was rejected by the Commission. The Commission concluded as follows with respect to the ERRP allocation (2004 Rate Order, pp. 26-28):

Contrary to Westchester's allegations, we find that the ERRP was selected and is being constructed for the substantial benefits it will provide for both the electric and steam systems. Westchester is incorrect to assert that the facility's primary or exclusive benefits only extend to the steam system. . .

We also reject Westchester's claim that electric ratepayers would incur any economic harm from the ERRP cost allocations as compared to the cost allocations for the Waterside facility. While the prevailing market prices for electricity in New York City do not match, or cover entirely, the amount of ERRP-related costs allocated to the electric department, they do, in fact, eliminate a substantial portion of them from further consideration. Moreover, the portion that is not covered is roughly matched by the amount of Waterside related costs that Consolidated Edison will be able to avoid. On these bases alone it is fair to conclude, and we find, that the cost allocations are fair.

Beyond this, any suggestion that the ERRP does not make economic sense for electric customers is entirely eliminated by the fact that electric customers will share in the net gain and proceeds obtained from the sale of the utility property located on First Avenue, and they will obtain this electricity from a new, efficient facility that produces a low level of environmental emissions. We find that the sale of this real property provides an important opportunity for East Side redevelopment that offers substantial societal benefits for the greater metropolitan area. Moreover, the continued operation of the steam system means that Consolidated Edison will not construct (or incur the costs for electric transmission and distribution system reinforcements) that would be needed to serve the energy loads of the customers who would switch. This too amounts to a sizable savings for the electric department obtained by adopting the incremental approach to the steam system that is supported by virtually all the interested parties except for Westchester.

In short, the Proposal's methodology for allocating the ERRP costs properly

continues the Commission's well-established methodology for allocating the costs of steam/electric plants.

**2. The Proposal Properly and Reasonably Allocates  
The Costs of ERRP Between The Steam and Electric  
Departments**

There can be no question that the Proposal properly applies the incremental cost method and the resulting allocated costs continue to be reasonable. Westchester erroneously claims that several new factors compel the Commission to revisit the allocation of ERRP costs adopted in the 2004 Rate Order. However, as explained in detail below, none of Westchester's arguments withstand scrutiny.

First, Westchester claims that the current allocation method is unfair to electric customers because, in its first year of operation, the ERRP costs allocated to the electric department exceeded the market value of electricity generated at the plant. However, as explained in unchallenged testimony by Company witness Shansky, Westchester's cost/benefit analysis is biased and omits several significant benefits of ERRP which have been, and will continue to be, enjoyed by electric customers, including those in Westchester County (261).<sup>7</sup> Westchester's analysis is biased because it focuses on a short-term cost-benefit analysis using market data that reflects a pronounced divergence between natural gas and electric energy prices (133-34, 262), which coincided with the anomalous weather pattern that severely interrupted the production of natural gas (133). At the same time, Westchester ignored a phenomenon described by Mr. Shansky, confirmed by Staff witness Padula (309), and acknowledged by the County's own

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<sup>7</sup> Company witness Shansky also identified incorrect data used by Westchester in its analysis (261) and, during cross-examination, Westchester's witness admitted that he computed the market prices in his analysis using unadjusted ISO bills and estimated sales, but did not reconcile either with actual, final data (367-73). In short, Westchester's analysis was in the nature of a back-of-the-envelope calculation.

witness (369-370), that the observed energy prices must have reflected a reduction due to the additional 150 MW produced by ERRP (as compared to Waterside). Such price reductions accrue to all the energy purchased from the market. Clearly, the difficulty in estimating precisely how much higher the market prices would have been absent ERRP is not a reason to deny that customers received some benefit (288-289). Using Westchester's data and a methodology presented by New York City in the Company's last steam rate proceeding, Mr. Shansky estimated this benefit to be \$46 million (262-263). Westchester's cost-benefit analysis is also misleading in that the "costs" reflect "front-loading" that is typical for recovery of a new investment, whereas the benefits accrue more evenly over time. That is why the economics of ERRP (or any project) should be measured on a life-cycle basis (261).

In addition, reprising a stance that was rejected by the Commission in the 2004 Rate Order, Westchester's cost-benefit analysis omits a number of electric system benefits. Most glaringly, Westchester witness Radigan failed to account for the significant and quantifiable direct benefits electric customers received through the sale of Waterside: namely, the recovery by the Company of \$145 million in remaining book costs, more than 93 percent of which would otherwise continue to be recovered in electric rates (256, Exh. 19). Mr. Radigan also failed to recognize that the replacement of Waterside with ERRP enabled the Company to avoid significant future capital investments in that plant that would have been borne by electric customers (263). Finally, and perhaps most importantly, Mr. Radigan simply ignored the system reliability, regional air quality, and economic development benefits that ERRP produces for all consumers (263). In sum, Westchester's near-term cost-benefit analysis is seriously flawed and can hardly be used as a basis to

revisit the ERRP cost allocation (131).<sup>8</sup>

Second, Westchester claims that the Commission's adoption of the ERRP allocation in the 2004 Rate Order was premised on electric customers' realization of significant benefits from the sale of Waterside which, Westchester claims, turned out to be "minimal" (334-35). Westchester further claims that the Company received no added value, "as promised by the Company," for the other First Avenue properties by including Waterside in the sale (335).

Once again, however, Westchester relies on erroneous data as a basis for justifying a Commission reversal of its determination in the 2004 Rate Order. Indeed, the benefits to electric customers from the sale of Waterside were significant and far from "minimal." As explained above, the significant benefits from the sale alluded to by the Commission in the 2004 Rate Order (p. 27) included the proceeds received from the sale of Waterside, which enabled the Company to recover the \$145 million in remaining book costs.<sup>9</sup> In addition, \$12 million of the proceeds from the sale of the First Avenue properties were used to pay for environmental and community enhancements allocable to electric customers (263). Furthermore, Westchester ignores the fact that the Company may receive additional proceeds that will benefit consumers depending on the re-zoning ultimately approved for the properties (263). Finally, with respect to his conclusion that there was no "added value" to the other properties from including Waterside in the sale, the uncontroverted evidence in the record shows that Mr. Radigan is just plain wrong (256-57).

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<sup>8</sup> Significantly, as Mr. Shansky demonstrated and the County did not dispute, the costs of ERRP that were charged to electric customers turned out to be consistent with the expectations of the parties in 2004. Not only were the fixed costs virtually the same as predicted in 2004 (\$318/kW-yr), but the heat rate for electric customers was 3% better than predicted (264).

<sup>9</sup> Ironically, Mr. Radigan acknowledges these significant benefits in his response to a Company interrogatory (Exh. 19).

There is also no merit to Westchester's claim that \$120 million in ERRP fuel costs have been misallocated to electric customers because the method used to allocate fuel at ERRP is different from the method used by the Company for its other steam-electric plants (338-39). As explained above, ERRP differs from the other steam-electric plants in that it uses a GT and a HRSG instead of a conventional boiler and steam turbine. Thus, electricity is generated in the GT and its waste heat is captured in the HRSG and used to produce steam (257). Since, in the case of ERRP, all of the mechanical energy produced by the GT is converted to electricity, it is proper under the incremental method to assign all of its fuel to electric generation (258, 291).<sup>10</sup>

Lastly, notwithstanding the flaws in Westchester's analysis of ERRP costs and benefits, the County is also wrong in its contention that the mere fact ERRP costs allocated to electric ratepayers were above market costs is proof that the allocation is unjustified (345). As the Commission has stated on occasions and expressly re-affirmed in the 2004 Rate Order (p. 28), one of the fundamental justifications for the incremental method for allocating costs for steam/electric facilities (even where the application of that method requires a subsidy to steam customers, in order for steam rates to be competitive) is to ensure that, in the long term, electric customers, including those in Westchester County, would not be required to incur even higher costs that would be caused by the transfer of customers from steam service to electric service (132, 260). Indeed, as Westchester's witness agreed under cross-examination, there have been other precedents where the Commission appropriately approved charging customers above-market costs to support public policy objectives, such as for renewable energy resources (374).

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<sup>10</sup> No additional fuel is required to make steam to the extent "waste heat" is recovered from the GT exhaust and any fuel consumed by the duct burners to produce steam has been properly treated as an incremental steam cost (258).

In the final analysis, Westchester provides no basis for the Commission to abandon its longstanding methodology for allocating joint costs between the electric and steam departments, much less to change the allocation of ERRP costs approved less than two years ago in the 2004 Rate Order.

**3. The Commission Should Reject Westchester's Proposal Related to the Production Studies**

Westchester proposes that the Commission issue a determination now that any future steam resource needs be procured solely from third parties, rather than be produced in facilities constructed by Con Edison. Westchester's proposal would preclude the Company from seeking the least-cost option and, thus, severely harm steam customers (191). Moreover, the Proposal requires the Company to file with the Commission a Steam Resource Plan (Exh. 1, p. 34) that will address future steam resource needs, and Westchester will have ample opportunity to question or object to the recommendations of the Resource Plan (193, 266). Westchester's proposal would, in effect, have the Commission prejudice the results of this planning process and, therefore, is unjustified (266).

The County also objects to the continuation of the confidentiality provisions, approved in the 2004 Rate Order, with respect to an investment-grade evaluation of repowering options (Exh. 1, pp. 32-33). The County suggests that allowing "full input from all interested parties, including Westchester" would prevent excessive costs and disproportionate allocations to the electric system (336). Again, since the investment grade evaluation must be considered in the development of the Steam Resource Plan (Exh. 1, p. 33), Westchester will have ample opportunity to challenge a recommendation in the Resource Plan should the underlying justification be based on an allocation method

to which Westchester objects (266). Thus, no change to the Proposal is necessary to address Westchester's concerns.

**C. TRANSGAS'S PROPOSED MODIFICATION OF THE PROPOSAL IS NOT SUPPORTED BY RECORD EVIDENCE OR OTHERWISE.**

TransGas requests that the Proposal be amended to add a new section that would mandate Con Edison to negotiate potential steam purchase terms with TransGas and any other "interested" potential steam supplier "based upon Con Edison's full avoided steam production and capacity costs." In addition, the inserted provision would require Staff to commit now to participate in any such "negotiations;" and also require Con Edison to include the results of any such "negotiations" in the Steam Resource Plan that it is required to file with the Commission. TransGas's proposed amendment is unnecessary and unjustified.

As demonstrated by Con Edison in its direct testimony, nothing in the Proposal precludes the Company from considering offers from third parties and, in fact, the Company has every intention to consider third party suppliers in the Resource Plan (63-66). And, again, under cross-examination, Con Edison affirmed that it would give good faith consideration to any offer from a third-party supplier and that it would discuss the potential for third party suppliers in the Resource Plan (76-77, 80-81). In short, the record is clear that the TransGas proposed modification to the Proposal is unnecessary and, therefore, it should be rejected.<sup>11</sup>

Significantly, TransGas had the opportunity to sponsor its proposal on the record so

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<sup>11</sup> TransGas's proposed amendment is also contrary to Commission policy. As Staff explained with respect to the Company's steam production planning, "The decision is Con Edison's; the role of the Commission is to evaluate the prudence of that decision, and the parties' involvement is limited to providing information to Con Edison and the Commission to assist them in making their respective evaluations and decisions" (130). The proposed TransGas amendment, however, would require the Commission to involve itself in Con Edison's resource planning from the outset by requiring it to commit its Staff now to participate in any potential negotiations between Con Edison and a third-party supplier.

that its merits can be tested under cross-examination. TransGas opted not to sponsor a witness to defend its proposal and there is, accordingly, no evidence in the record to support TransGas's proposed modification of the Proposal. Con Edison, on the other hand, provided a witness to support its opposition to TransGas's proposal and TransGas's attorney had a full and fair opportunity to challenge that witness under cross-examination. This distinction is important because the TransGas request insinuates that, absent a requirement in the Proposal, Con Edison would not fairly evaluate offers for the sale of steam from third parties. But, the only evidence in the record demonstrates unequivocally that Con Edison will act in good faith when it receives offers from third-party suppliers.

Indeed, at the hearing, Ronald Bozgo, Con Edison's Vice President for Steam Operations, expressly stated that if a third party supplier makes a proposal to Con Edison, "We will in good faith evaluate the proposal" (81). However, that commitment obviously does not mean that every proposal will, or should, lead to negotiations. As pointed out by Mr. Bozgo, "if a person gives you a proposal that doesn't make any sense, fit your operational needs, why negotiate? There has to be some criteria that has to go along with the negotiations" (81).

Moreover, TransGas has ample means of redress if it believes that Con Edison is not acting in good faith. As explained by Staff, TransGas may either file a complaint with the Commission or address its complaint to Staff (130, 157).

There is also no basis for TransGas's concern that third-party suppliers would not be considered in the Resource Plan to be filed with the Commission. The Proposal already provides that (Exh. 1, p. 34):

The Resource Plan will examine and discuss various resource options (e.g., maintain and/or rebuild existing boilers, construct a new boiler(s), construct cogeneration, or seek competitively procured capacity).

And, Mr. Bozgo affirmed the Company's commitment to examine third-party supplies as part of that plan (91). In addition, as noted by Staff, "Con Edison's eventual burden in this matter is not to justify why it did not select certain options; it is to demonstrate that it made a reasonable and prudent decision regarding the option it selected" (130).

Finally, the Company demonstrated that it should not be required to provide TransGas or any other potential supplier with the Company's avoided cost of steam production, nor to negotiate with a potential supplier on the basis of the Company's avoided costs. As Mr. Bozgo explained, it would undermine the Company's ability to obtain for customers the most competitive, if not the lowest, price from that potential supplier if the supplier knew the Company's avoided costs (83, 194). This is precisely why the 2004 Rate Order (p. 54) expressly precluded potential suppliers from having access to Con Edison's steam production costs (65).<sup>12</sup> Furthermore, given that there is no competitive market for steam supply (161-62), it would make no sense to provide a potential third-party steam supplier with additional leverage by providing it with knowledge of, and allowing it to negotiate against, Con Edison's avoided costs (65).

In sum, as demonstrated by uncontroverted evidence submitted in this proceeding, TransGas's proposed addition to the Proposal is unnecessary, unjustified and contrary to

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<sup>12</sup> Noteworthy, an analogous issue was raised in Con Edison's 1994 electric rate proceeding regarding access to elements of the Company's production cost projections that were used to calculate buy-back rates. In that proceeding, Judges Epstein and Yohalom determined that "... disclosure would undermine Con Edison's ability to negotiate ..." Case 94-E-0334, Ruling on Requests for Trade Secret Status and Motion for Preclusion, August 26, 1994, p. 8.

Commission policy. It should, therefore, be summarily rejected.

**D. CONCLUSION**

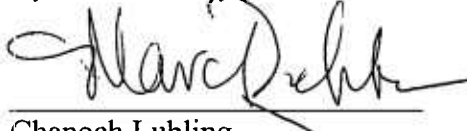
For all the reasons set forth in the Company's Statement and Reply in Support of the Proposal, and in this brief, the Proposal balances the interests of a variety of parties and produces results within the range of reasonableness that would have been achieved through a fully-litigated proceeding, reflects agreements by normally adversarial parties and comports with the Commission's policies. No evidence adduced at the hearings alters this conclusion. As such, the Commission should approve the Proposal in its entirety as in the public interest.

Dated: New York, New York  
August 7, 2006

Respectfully submitted,

Consolidated Edison Company  
of New York, Inc.

By: Its Attorneys



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