STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE

Case 10-E-0362 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Orange and Rockland Utilities, Inc. for Electric Service

STAFF REPLY BRIEF

BRANDON F. GOODRICH
Staff Counsel

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STAFF INITIAL BRIEF

I. INTRODUCTION

A review of the Initial Briefs filed in this case demonstrates the great importance the parties attach to the impact of Orange and Rockland Utilities Inc. (O&R, Orange and Rockland or the Company) requested revenue requirement increase.[1] The Initial Briefs filed by the intervenors, while perhaps exhibiting an overabundance of zeal, certainly seek to shield ratepayers, already burdened in the current tough economic climate, from additional burdens in the form of higher electric bills. In comparison, the Company's Initial Brief, while often paying lip service to concerns about ratepayer impacts, expectedly hues more closely to the Company's shareholder interests than those of its ratepayers.

We are uniquely positioned in this case in that our responsibility is to propose a rate plan that balances the

[1] In addition to those filed by Orange and Rockland and the Department of Public Service Staff, three intervenors filed Initial Briefs (Cited as "IB"): The New York State Consumer Protection Board (CPB), The Town of Ramapo (Town or TOR), and the Municipal Consortium in Support of Reasonable Electric Rates (MC).

interests of the Company's ratepayers and those of its shareholders as well, resulting in a proposal for rates that are just and reasonable and that allow O&R to provide safe and adequate service.

In an effort to moderate the impact of the Company's requested rate increase on ratepayers, we recommend amortizing deferred costs over five years, whereas the Company would prefer that the amounts be amortized over three years. The Company attempts to frame its preference for three-year amortization periods as an "extension of the cost recovery periods for various costs", even though in many instances O&R's current rate plan provides for recovery of the same deferred cost categories over five-year periods (O&R IB 7).[2] Indeed, though it frames these three-year amortization periods as "extended" in the introduction to its Initial Brief, when discussing the details, the Company retreats, describing the use of a three-year period as "customary."[3]

Another theme O&R repeatedly returns to is the "cash flow implications of delayed recovery and impacts on future rates of long term amortizations" (O&R IB 6). Although the Company

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[2] The Commission set the Company's current rates in Case 07-E-0949, Orange and Rockland, Order Establishing Electric Rate Plan (July 23, 2008).

[3] However, a review of past cases shows that for many of these deferred costs, there is nothing "customary" about a three-year amortization period, *e.g.*, Storm Restoration costs and MGP & Environmental Costs, discussed below.

opines about the cash flow implications of extending amortization periods from three to five years, the Company proposes a multi-year rate plan under which much of the Company's proposed first year rate increase would be deferred, with interest, until the second and third years of the plan (O&R IB 7). Such an inconsistent attitude undermines the seriousness of the Company's concern about the cash flow impacts of moderately lengthened amortization periods. As explained in our Initial Brief, the impact on ratepayers of the Company's requested rate increase can be greatly ameliorated simply by reasonably lengthening the amortization periods for certain deferred costs.

Over the past few years, the Commission has required the utilities under its jurisdiction to seek and detail austerity savings in their rate filings. O&R feigned compliance with this requirement by pointing to "holistic" actions it had taken and opines that our very modest recommendation of $825,000 in austerity savings is unreasonable and arbitrary (O&R IB 48-49). However, the Company's rate filing is riddled with unnecessary costs.

For example, the Company seeks to increase its outreach and education budget by 29% – 45%, depending on the baseline to which one compares the requested additional funding. O&R also seeks a new position in the rate year to perform outreach and

education functions. While we do not consider our recommendation that these costs be removed from the Company's revenue requirement related to austerity, they do show that in this time of economic hardship, the Company's priority does not seem to be minimizing additional costs. Additionally, the existence of such requests undermines O&R's assertion that our proposed austerity adjustment may force the Company "to cut back on necessary operational expenditures" (O&R IB 49). It is apparent that after further review, O&R could find additional programs and expenses that it could delay for at least one more year to provide a modicum of rate relief to its ratepayers.

In sum, although O&R takes issue with many aspects of our proposed rate plan, as explained in our Initial Brief and below,[4] these attacks rarely undermine the sound foundations supporting the positions we have recommended, and continue to recommend in this case. Our recommendations should be adopted because, in total, they will provide the Company with sufficient revenue to safely and adequately operate its electric system, access needed capital at reasonable costs, while at the same time moderating the impact of the rate increase on the Company's ratepayers.

[4] We note that this brief will not discuss each litigated issue that was presented in the Initial Briefs of the other parties. This is not intended to signify, and should not be construed as, Staff's concession of those issues; rather, Staff's silence on the issues in this brief merely indicates our belief that further clarification or discussion of those issues is not needed.

II. SALES REVENUES

E. Peak Load Forecast

Though the Municipal Consortium's arguments regarding the sales forecast are muddled at best (as portions of the discussion of "peak load" in the corresponding section of MC's Initial Brief relate to recommending that the Commission stop O&R from continuing its infrastructure investments rather than attempting to relate peak load to the sales forecast), it seems that MC believes we should have considered the Company's peak load forecast when determining our forecast of sales volumes for the rate year (MC IB 22). However MC's assertion lacks any foundation. MC does not provide any argument for how the peak load should be incorporated into the sales volume forecast. Additionally, MC fails to provide a reason for the Commission to suddenly depart from its long line of decisions in past electric rate cases which accepted sales forecasts developed without using the unrelated peak load forecasts.

IV. OPERATING EXPENSES

C. Staffing Adjustments

1. The Project Management Group Positions

In its Initial Brief, Orange and Rockland states that "[t]he effectiveness of proactive project and construction management is not subject to debate" (O&R IB 22). However, the Company conflates this statement of concept with proof that its

newly created Project Management Group should be rapidly expanded during the rate year. Additionally, the Company asserts that we ground our opposition to expanding the Project Management Group in a belief that "the current PM Group is not being used to its full potential" (O&R IB 22). However, simply put, neither of the Company's assertions are true.

First, while we agree with the Company that it should be more proactive in managing its major projects, the Company only created this Project Management Group in early 2010 (Tr. 40). Almost immediately, it proposes to more than double the size of the group, by adding five new positions in the rate year to the existing four positions (Tr. 772). We believe that the efficacy of the Company's chosen method should be fully evaluated before additional positions are funded by ratepayers (Staff IB 31). Additionally, as stated in our Initial Brief, logically, if the new Project Management Group proves to be a worthwhile endeavor, it will produce efficiencies and savings which should at least equal the $147,000 costs of the Company's proposed expansion (Staff IB 31). For example, prior to the institution of this group, the engineers charged with carrying out a project also had to manage the project, since at least some of these management tasks have already been lifted from the shoulders of the engineers assigned to a particular project, some of those engineers' time must be available for other assignments.

4. Community Outreach and Education Administrator Position ($48,000)

The Company requested two Community Outreach and Education Administrator positions, one in the rate year, and another in the following year. The Company supported these positions in large part by stating that it could not attend events to which it was invited. The Company, however, cannot support this assertion with any list or even examples of event invitations it was forced to turn down (Tr. 1479). The Company incongruously asserts that to reject its requested positions because it cannot provide documentation of the missed events is "misplaced" because the Company needs to fill the position in order to have staff available to track invitations (O&R IB 34). Such an argument fails due to circular logic. If we were to credit this argument, the Company would be able to support any position, simply by arguing that the new position is necessary in order to gather the information necessary to support the necessity of the new position.

D. Annual Team Incentive Plan

Orange and Rockland claims that its Annual Team Incentive Plan (ATIP) benefits customers by setting goals and targets linked to customer interests. (O&R IB 24). Indeed, the record reflects the Company's bald assertion that "[t]hese goals are established to *enhance* particular areas of customer service,

safety, and reliability…" (emphasis added)(Tr. 249). However, upon taking a closer look, it becomes clear that many of these goals are merely the thresholds set by the Commission as part of its Reliability Performance Mechanism and Customer Service Performance Incentive for the Company (Tr. 531). As explained in our Initial Brief, the thresholds in those performance mechanisms are specifically set below the Company's historical performance, simply to ensure that the Company's performance in the area measured does not decline (Staff IB 129). In light of this fact, it becomes clear that, at least many of the Company's ATIP goals require, not enhancement of the level of service provided to ratepayers, but merely the achievement of bare minimum service levels. To require ratepayers to foot the bill for an incentive to encourage the Company's employees to achieve the bare minimum standards required by the Commission is truly perverse.

Additionally, O&R claims to have "addressed concerns raised by Staff" by agreeing that "the Company will defer for the benefit of customers any unspent amounts included in rates resulting from the Company's failure to meet its ATIP performance goals" (O&R IB 24). However, O&R's proposal does not fully address our concerns, which are also the concerns raised by the Commission in Case 08-E-0539. As clearly explained in the Commission's Order in that case:

> On the other hand, providing funding subject to a downward-only reconciliation could lead management to be less than rigorous in evaluating performance and making variable pay awards. To be acceptable, a variable pay plan would have to solve this dilemma (Tr. 527).

O&R's ATIP proposal leaves this dilemma unresolved and we maintain that its ATIP program should not be funded by ratepayers.

F. T&D Non-Labor Expense Adjustments

1. Inspection and Repair Program

On page 30 of the Company's Initial Brief, O&R argues that "[A]dopting Staff's position would penalize the Company for failing to anticipate a future Commission recordkeeping requirement." Plainly stated, this assertion simply is not true. Staff's adjustment (reducing the anticipated expense in the rate year for transmission repairs by $1.25 million and for distribution repairs by $12,000) accounts for the best estimate of the portion of the repairs that will now be included in the Inspection and Repair program that had been historically occurring. In other words, the entire amount the Company requested for the Inspection and Repair Program was not truly incremental, and our adjustment merely accounts for this fact.

2. Transformer Sampling Program

O&R asserts that "Staff proposes no funding for either the proposed sampling program or for transformer replacement." (O&R

IB 31). While true, it willfully ignores the fact that the Company sought no funding for transformer replacement. The Company did include an estimate of the replacement costs, however those costs were not included in its revenue requirement (Exh. 148, p. 15). We stand by our reasons for rejecting the Company's proposed sampling program, as fully explained in Initial Brief (Staff IB 49-51)

G. Outreach and Education

O&R claims that we have "failed to explain how the Company is to perform" outreach and education as urged by the Commission "absent adequate staffing or funding" (O&R IB 35). While an artful phrase, the Company's complaint is nonetheless riddled with inaccuracies.

First, although admittedly O&R disagrees, we believe that the Company's current level of outreach and education funding is adequate. The Company has not identified concrete failings in its current outreach and education efforts, and while it states its intention to pursue a more proactive outreach and education effort, it has not sufficiently detailed why such an effort should require an incremental $100,000, approximately a 29% increase in annual electric and gas outreach and education expenses over the three year historical average, particularly in the current distressed economic environment (O&R IB 36). Indeed, looking at the $100,000 increase as a percentage of just

the Company's electric operations share of its outreach and education budget demonstrates the staggering percentage increase requested: 46% (O&R IB 36).

Second, although the Company attempts to frame the issue so that one would believe that we have not met our burden of proof, it is the Company that must prove the necessity and reasonableness of its requested rate increase.[5] In this case, O&R has not sufficiently explained why it cannot adequately perform its necessary outreach and education functions without the requested dramatic increase in funding and new staff positions, particularly in these difficult economic times.

H. Employee Benefit and Other Insurance Expense

2. Asbestos Claims

Orange and Rockland seems to found its requested rate year allowance for asbestos claims on what it terms the "customary approach of basing projected claims on a historic three-year average" (O&R IB 39). However, there is no customary approach. To the extent the method used most recently in setting rates for the Company would necessitate the outcome in this case, the asbestos claim allowance proposed in a Joint Proposal and adopted by the Commission in Case 07-E-0949 utilized our proposed methodology, settling on an amount to be included in rates based on the latest estimate of the Company's remaining

[5] Public Service Law (PSL) §66(12)(i).

liabilities. Additionally, as a second issue, O&R rejects our proposal for amortizing existing asbestos claim deferrals (O&R IB 40). However, as noted in our Initial Brief, this statement overlooks the fact that our proposed allowance provides for continuing the same existing annual amortization of $170,000, as the Company requested (Staff IB 55-57).

J. Storm Restoration

In its Initial Brief, O&R attempts to cloud the issue of storm restoration costs. The Company claims that because of normal fluctuations from year-to-year, there is no basis for our assertion that the two storms which pummeled the Company's service area in the first quarter of 2010 were unusual and should not be considered in ascertaining the level of projected annual storm costs. The annual storm restoration costs incurred by O&R from 2003 through 2009 ranged from a low of $1.04 million to a high of $5.47 million (Exh. 22, schedule 11).[6] In comparison, for just the first quarter of 2010, the Company incurred $7.4 million in storm restoration costs (Exh. 22, Schedule 11). These costs exceed the highest annual costs incurred in all the other years for which we have data in the record by approximately $2 million. Arguing over whether the restoration costs related to the storms that impacted O&R's

[66] For each year the costs were as follows (in millions): $1.23 in 2003, $1.63 in 2004, $2.20 in 2005, $4.12 in 2006, 1.04 in 2007, $5.47 in 2008 and $1.17 in 2009.

service territory in the first quarter of 2010 were unusual defies credulity. Given that the extraordinary magnitude of those restoration costs is realistically beyond debate, and for the reasons set forth in our Initial Brief, we remain steadfast in our recommendation that the storm restoration costs from the first quarter of 2010 should not be included in the calculation of the projected annual storm costs going forward.

K. MGP & Other Environmental Costs

O&R's Initial Brief raises two issues concerning MGP and other environmental costs that call for our reply. First, regarding our recommendation to defer the costs of the Travelers Indemnity Company litigation until that litigation has concluded, the Company asserts that our "position also ignores the inconvenient fact … that even if the Company is successful, only a portion of the litigation costs are potentially recoverable" (O&R IB 46). However, we have only sought to defer recovery of the projected litigation costs allocated to electric operations from the second quarter 2010 through the fourth quarter 2011 (Tr. 550). This only represents a portion of the Company's litigation costs. O&R has already recovered from customers the portion of its litigation costs incurred prior to the second quarter of 2010.

Second, O&R asserts that our proposal to utilize a five-year amortization period for recovery of MGP costs will actually

result in even longer recovery periods for previously deferred amounts that have not been fully amortized yet, and "raises serious intergenerational equity issues" (O&R IB 47). Regarding the previously deferred amounts that the Company asserts have not yet been fully amortized, the Company ignores the inconvenient fact that actual environmental expenditures were far less than projected in Case 07-E-0949. Currently, the projected deferred MGP balance as of June 30, 2011 shows an over-recovery, or credit balance (Tr. 583-584; Exh 13, Schedule 3, p. 2).

Regarding the Company's concern about "serious intergenerational equity issues" being raised by utilizing a five-year rather than three-year amortization period, O&R can hardly be serious that lengthening the amortization period by two years raises issues of intergenerational equity. As an initial matter, in general, different length amortization periods have been utilized for a variety of deferred costs across myriad rate cases, many significantly longer than the five years we propose to use in amortizing various deferred amounts in this case.[7] Second the idea that the use of a five-year amortization period for recovery of MGP site investigation and remediation costs in particular raise intergenerational

[7] For example, in Case 07-E-0523, Con Edison – Electric Rates, the Commission provided for a ten-year amortization of SIR costs.

equity issues, serious or otherwise, is patently absurd. The subject costs result from contamination caused in serving customers many decades ago. It is unlikely that any current customers benefited from the provision of manufactured gas that caused the contamination now being ameliorated.

Our recommended five-year amortization period should be adopted. What we propose is nothing more than a continuation of the existing recovery period for these costs in a manner that serves to moderate the bill impact of the Company's requested rate increase on ratepayers in these difficult economic times. As such a five-year amortization period is consistent with the Commission's Statement of Policy Concerning evidence of Economic Impact in Rate Cases, issued January 14, 1980, page 3.

L. Imputed Savings

O&R takes issue with our recommended management audit and austerity imputations as being "additive" to the traditional 1% productivity adjustment and asserts that we discount "the financial reality that certain savings can be obtained only once" (O&R IB 49). However the Company fails to comprehend the different purposes and savings sought to be captured in each of these three distinct savings imputations. First, as the Company well understands, the 1% productivity adjustment reflects savings resulted from the increased productivity that can be expected based on the increased investments and operation and

maintenance activities provided for in the rate increase that will likely result in this case.

Second, a management audit was recently conducted of O&R's sister utility, Con Edison, and O&R is in the process of applying many of the lessons learned in that audit to its own operations. To put it succinctly, the purpose of a management audit is to assess how the Company is conducting its business and to identify ways in which the Company can operate more efficiently. It is difficult to argue that an updated process or outcome is more efficient if it does not use less resources. Accordingly, the implementation of the recommendations of a management audit logically should result in savings. It only makes sense that these resulting savings are separate and in addition to the regularly anticipated savings captured in the Commission's traditional productivity adjustment.

Third, as rehashed repeatedly, due to the ongoing poor economic conditions affecting New York State, including O&R's service territory, the Commission has required utilities to operate austerely, by finding discretionary expenses that can be delayed so as to lessen the burden of utility bills borne by ratepayers. The savings associated with these delayed discretionary expenses, as with the management audit savings, are meant to be in addition to the expected traditional 1% productivity adjustment. We understand that these savings

imputations, taken individually and together, are not necessarily easy for O&R to achieve; however, they are achievable and reasonable.

3. Austerity

The Company decries that in making our recommended austerity adjustment, we have "lock[ed]-in an austerity target of $825,000 based on a "plan" filed more than two years before the start of the rate year" (O&R IB 48). However, we note that when compared to the austerity adjustments the Commission has adopted for other utilities under its jurisdiction, the $825,000 austerity adjustment we recommend is minimal. This amounts to approximately 0.5% of O&R's O&M expense, adjusted for purchase power costs. Additionally, based on our review of what the Company put forth as austerity savings, we reduced the amount of additional austerity savings for which the Company should be responsible by $187,000 (Tr. 768). In comparison, for Con Edison electric, the Commission imputed an austerity adjustment of $60 million, or approximately 3.6% of non-fuel O&M, although Con Edison was allowed to defer up to half of that amount upon a showing that it was unable to identify sufficient savings.[8] For Central Hudson, the Commission imputed savings of 1.8% of non-

[8] Case 08-E-0539, Con Edison, Order Establishing Rates for Electric Service (issued April 24, 2009).

fuel O&M expenses, or $2.4 million for its electric operations.[9] Most recently, for National Grid, the Commission imputed $7.382 million, calculated based off of 1.8% of non-fuel O&M.[10] Our recommended austerity adjustment is, if anything lower than that imputed for other utilities and takes account of permanent and temporary savings achieved by O&R. Accordingly, it is a reasonable adjustment and should be adopted.

V. TAXES OTHER THAN INCOME TAXES

A. Property Taxes

Consistent with the testimonies of Company witness Hutcheson (Exh. 147, p. 12) and the Staff Accounting Panel (Tr. 567-568), the Company provided the parties with the now known SCT taxes for calendar year 2011 and also the settlement of a property tax challenge pursued by the Company in the Village of Hillburn resulting in reduced assessments and refunds (O&R IB 52). Taking into account the known SCT taxes for 2011 and the Village of Hillburn reduced assessments, our reported property tax forecast of $27.740 million (Staff IB 78) is $356,000

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[9] Case 08-E-0887, Central Hudson – Electric Rates, Order Adopting Recommended Decision with Modifications (issued June 22, 2009).

[10] Case 10-E-0050, National Grid, Order Establishing Rates for Electric Service (issued January 24, 2011). The final austerity imputation was calculated as follows (all amounts in millions): 3.6% of non-fuel O&M = $20.995, divided by 2 = $10.478, less $.635 in identified austerity savings = $9.843, multiplied by 75% to ensure that savings were not double counted = $7.382.

greater, or $28.096 million. The associated change to prepaid property taxes increases Rate Base by $198,000. The resulting increase in revenue requirement is an additional $379,000 or an adjusted revenue requirement of $28.888 million.

The Company also reports that as a result of two refunds, a savings of $52,000 is available to reduce revenue requirement in this proceeding. Recognition of these refunds will increase other operating revenues. Our adjusted revenue requirement, $28.888 million, would be reduced by $53,000 to $28.835 million.

1. Reconciliation of Property Taxes

The Company repeatedly draws attention to the fact that we oppose providing the Company with a reconciliation of property taxes in this one year case (O&R IB 57). While property tax reconciliations are appropriately included in multi-year rate plans, such as O&R's current rate plan, the Commission has not generally provided companies with such reconciliations in one year cases such as this one. Orange and Rockland has not provided any reason to deviate from this general practice in this case. Accordingly, the Company's request for a property tax reconciliation should be rejected.

VI. COST OF CAPITAL

Throughout the section of its Initial Brief on the cost of capital, O&R frequently returns to the idea that "investors will differentiate between the risks they assume" (O&R IB 60). The

Company highlights that "[c]apital, both debt and equity, will be priced and rationed with more care going forward" and opines that "we can expect the heightened sensitivity towards risk to persist for a significant period" (O&R IB 59-60).

At this time when investors are so sensitive to the riskiness of an investment, they have flocked to the stock of O&R's parent, Consolidated Edison Inc. (CEI), which has traded above book value and has performed quite well relative to the S&P 500 (Tr. 1125). This demonstrates that even though O&R did not achieve its authorized rate of return in rate years one and two of its current rate plan,[11] O&R and CEI's other affiliates have had no lack of success in encouraging investors to buy CEI's stock. As succinctly stated in O&R's Initial Brief, "[t]he cost of equity is the rate of return component that must be offered to investors to encourage them to buy a company's stock" (O&R IB 61).

As we demonstrated in our Initial Brief, our recommended 9.0% return on equity and 48% equity ratio are reasonable and should be adopted. Below we address those points raised in the

[11] The Company's Initial Brief states two different values as the Company's currently authorized return on equity (O&R IB 6, 85). To ensure that there is no confusion, the Commission authorized a return on equity of 9.4% for O&R's electric operations in Case 07-E-0949. The Company states that it earned a cumulative 8.04% return on equity in rate years one and two of its current rate plan (O&R IB 85).

Company’s Initial Brief which most loudly cry out for a response.

A. Cost of Equity

O&R attempts to present our recommended return on equity as unreasonably low by comparison to the “authorized ROEs for [our] own proxy group, *i.e.* 10.59%” (O&R IB 62). However, the Company makes an inapt comparison. First, the 10.59% ROE for our proxy group is not an “authorized” ROE. Rather, it is a forecast of the proxy group companies’ actual ROEs in 2014 (Exh. 86, p. 2). Second, none of the proxy group companies themselves have “authorized” ROEs, as all are electric utility holding companies, whose leverage and corresponding return requirements will naturally reflect the riskiness of their average 13.3% unregulated activities (Tr. 1072).

On page 63 of its Initial Brief, O&R asserts that adoption of our recommended 9.0% ROE would “have the immediate and deleterious impact of increasing the cost and difficulty of financing the Company’s proposed critical investments… .” Such a bleak statement is counterintuitive given that the Company currently has an authorized ROE of 9.4% and has achieved an actual ROE of 8.04% cumulatively for the first two rate years of its current rate plan, and yet has been able to access the capital markets at reasonable rates.

1. Proxy Group

The Company asserts that by utilizing a 32 member proxy group, as opposed to the Company's 16 member proxy group, we have placed too much emphasis on the proxy group's size, to the detriment of comparability to O&R. The Company points to Staff witness Augstell's admission on cross-examination that "the use of the median substantially mitigates the risk of outliers in a small proxy group, thereby undercutting one of the purported justifications for a larger sized proxy group" (O&R IB 65). However, highlighting this statement is counterproductive, since it is the Company that utilizes a small proxy group and yet relies on the mean, or average, rather than the median. Though O&R makes much of this statement, it does not choose to change its methodology and rely on the median.

O&R claims that Mr. Augstell also admitted on cross-examination that removing companies with a Moody's rating of Baa3 from our proxy group would "significantly reduce if not eliminate the need to make a credit quality adjustment" (O&R IB 66). However, Mr. Augstell's response was conditional, and as explained in our Initial Brief, even using the Company's proxy group, a credit quality adjustment would still be required, as the Company's proxy group has a credit rating of approximately three quarters of a notch lower than Orange and Rockland's credit rating (Staff IB 89, 108).

2. Discounted Cash Flow

On page 67 of the Company's Initial Brief, O&R states that "Mr. Hevert used analysts' long-term growth forecasts…" It is important to note that these forecasts are of earnings growth, not dividend growth as we used in our DCF analysis. Although O&R makes much of Mr. Hevert's regression analyses that purport to show that earnings growth estimates had a stronger statistical relationship than dividend growth estimates, the Company cannot escape the fact that the cash flows being discounted in the DCF analysis are dividends. Company witness Hevert acknowledges the importance of dividends to investors by specifically excluding companies that do not pay dividends from his proxy group (Tr. 921). In spite of this, the Company has provided no evidence that short run earnings growth estimates will equal long run dividend growth and the results of Mr. Hevert's regression studies cannot make an otherwise unreasonable prediction reasonable.

O&R also claims that our use of a two-stage market based DCF model "unreasonably assumes that growth will transition from the first stage to the long-term estimate in a single year" (O&R IB 68). As a supposed remedy for this flaw, the Company's multi-period model includes a "transition" stage (O&R IB 68). However, this "multi-period" model more closely approximates a single stage model than a useful representation of investor's

expectations over multiple time periods due to the strikingly similar, not to mention astronomical, growth rates used for each stage: 5.72%, 5.74% and 5.77% (Staff IB 94).

Additionally, O&R tries to make hay out of the inclusion of two companies in our proxy group with sustainable growth estimates that are below 2.3%, the current Blue Chip projected rate of inflation (O&R IB 69). However, this argument is a red herring, as our proxy group also includes companies with growth rates that are outliers on the upper end of the range as well (Exh. 86, p. 2). Our use of the median moderates the impact of such outliers while not requiring that we ignore their existence. Comparatively, Mr. Hevert believes it necessary to screen his proxy group companies to require positive short-run earnings growth rates because his model assumes that the company’s short run earnings growth rate equates to its expected long run dividend growth rate (O&R IB 64). Meanwhile, he does not make a similar judgment excluding companies with short-run earnings growth rates, such as Wisconsin Energy with a 10.02% short-run earnings growth rate, even though it would be equally unreasonable to assume that an investor will equate this high short run earnings growth rate to an expected long run dividend growth rate as Mr Hevert’s DCF analysis dose.

Finally, the Company argues that its DCF result is reasonable as it approximates Value Line’s 10.59% average 2014

expected return of our proxy group (O&R IB 70). First, we explained above why the comparison of a potential "authorized" ROE and this expected future return value is not appropriate. Second, as explained in our Initial Brief, the reasonableness of the Company's 10.62% DCF result is undermined by its implication that, based on the Company's other assumptions, the proxy group companies would have to earn an ROE in excess of 17.0% on average (Staff IB 95).

3. Capital Asset Pricing Model

O&R's discussion of the Capital Asset Pricing Model (CAPM) can be broken down into two parts, a discussion of the market risk premium (MRP) input and a discussion of the beta input.

Regarding the MRP, the Company claims that it uses two forward looking estimates; however this is, at best, an exaggeration (O&R IB 71). The Sharpe Ratio MRP is based upon a relationship between Morningstar's calculation of an historical MRP of 6.7% for the period 1926-2008 and an historical average of market volatility which Mr. Hevert calculated to be 20.40% (Tr. 941). Not only is this MRP not truly forward looking, as explained in our Initial Brief, it produces exceptionally volatile results (Staff IB 103).

The Company's second MRP is similar to ours in that both are calculated by subtracting an assumed risk free rate from an estimated market return. The risk free rate used by the Company

is the current 30-year Treasury bond yield, which, asserts O&R, approximates the roughly 25 year equity duration of utility stocks (O&R IB 73). O&R criticizes us for using an average of the 10 and 30-year Treasury bond yields because the equity duration of utility stocks is longer than 10 years (O&R IB 72). While we fully explain and support the incorporation of the 10-year Treasury bond yield into our assumed risk free rate in our Initial Brief, at this time it is worth noting that by utilizing an average of the 10 and 30-year bond yields, we essentially approximate the yield on a hypothetical 20-year Treasury bond. The duration of such a bond and a 30-year Treasury bond are equidistant from the equity duration of utility stocks posited by the Company.

The estimated market return used in this second MRP is calculated based upon a constant growth DCF model for the companies in the S&P Index for which earnings projections are available (Tr. 940). This calculation is subject to the same criticism levied against the Company's DCF analysis in this case, it seeks to extrapolate short-term earnings estimates into long-term dividend growth rates. Such a simplistic approach ignores market to book ratios and other factors which are needed to develop a true sustainable long-term growth rate.

Regarding beta, the Company criticizes our reliance solely on Value Line for our beta estimate, arguing that because Value

Line calculates beta over a period of five years it does not properly capture current expectations of the proxy group's volatility relative to the broader market (O&R IB 74). However, this argument simply does not stand against even a cursory review. The Company's own witnesses contradict the assertion, as Mr. Perkins states, "[t]he market has improved from one of the most volatile and uncertain times in its history" (Tr. 859). The use of a beta premised on five years of data fully incorporates the recent historical period of high volatility while not over emphasizing that period, which recognizes that the market has improved from its recent peaks in volatility.

Importantly, the Company's Initial Brief plasters over the seismic change in its witness's method of calculating his beta from when he filed his initial testimony to when he filed his rebuttal testimony. From O&R's brief, one would not guess that there was any change at all, as the brief simply states that Mr. Hevert uses a beta of .81 (O&R IB 71). However, as explained on pages 100 through 102 in our Initial Brief, Mr. Hevert's initial testimony utilized a beta of .66 and, without any explanation of changes in the market, financial theory, or even changes in the direction of the wind, Mr. Hevert abruptly reworked his methodology for calculating beta so that on rebuttal his beta increases by .15, or 22% over his initial value. Mr. Hevert went from using a beta calculated in a transparent manner to one

whose calculation is murky at best, or completely opaque at worst.

4. Adjustments

a. Credit Quality

The Company asserts that a credit quality adjustment is a "punishment" for "Mr. Augstell's lack of rigor in assembling his proxy group" (O&R IB 78). The credit quality adjustment is in no way punative, but merely ensures that O&R's ratepayers pay only the return on equity required by investors to invest in O&R specifically. Additionally, as explained in our Initial Brief, the Company's preferred proxy group has only a marginally smaller difference between the group's credit rating and O&R's credit rating, and thus its results should be adjusted for credit quality differences as well (Staff IB 108).

O&R claims that the performance matrices and associated potential negative revenue adjustments we propose in this case undercut our assertion that O&R operates in a less risky environment than other utilities (O&R IB 78-79). As we have already discussed, in our proposed performance matrices, we have endeavored to set thresholds that the Company should reasonably expect to meet (Staff IB 129-130).

b. Issuance Expense

Although O&R asserts that "flotation costs are borne by the utility in each year after the issuance of common stock," the

costs described by the Company are one-time "out-of-pocket" costs "associated with the sale of new issues of common stock" (O&R IB 75). If these one-time, as opposed to ongoing, costs are recovered in a single rate year, as we recommend allowing O&R to do, the Company's request to continue recovering these costs on an ongoing basis defies logic and should be rejected.

The Company added an additional section labeled "Incompatibility with Allowed Returns" in which the O&R attempts to disparage our recommended ROE based on an implied equity premium (O&R IB 80). This argument should be rejected. Such analyses have been offered before and the Commission has rejected them stating that implied equity premium analyses have not been shown to be relevant to the Company's level of risk and that the significant differences among utilities and among the ways that allowed returns are set by regulatory commissions render such comparisons unreliable.[12]

O&R added yet another section, in which it needlessly repeats the comments it made merely pages earlier asserting that our recommendations in this case increase the Company's regulatory risk (O&R IB 80-81). The Company's arguments are hyperbolic at best, and disregard the support for the reasonableness of our positions provided throughout the record, our Initial Brief and in this Reply Brief as well. The Company

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[12] Case 08-E-0539, *supra* at 133.

bemoans that our recommended 9.0% ROE is “bond-like”; however it ignores the fact that it just secured long-term debt, *i.e.*, through issuing actual bonds, at a rate of 5.5% (O&R IB 81; Staff IB 115).

B. Capital Structure

In claiming that he “readily acknowledges that there is no double-leverage in the case of CEI’s investments in O&R,” the Company misstates the testimony of Staff witness Augstell. Mr. Augstell never affirmed that there was no double-leverage in CEI’s investments in O&R, he merely stated that it does not *appear* to be the case (Tr. 1065). Additionally, O&R claims that the average equity ratio for the companies in our proxy group is 49.6% (O&R IB 83). However, this value is derived from Value Line and can be misleading because it does not account for preferred stock, the current portion of long term debt as well as any other short term debt, and as such tends to overstate the actual percentage of common equity supporting these companies. Furthermore, as shown on page 3 of Exhibit 83, the average common equity ratio for regulated U.S. shareholder-owned electric utilities in 2009 was 43.6% according to the Edison Electric Institute. Finally, the Company’s discourse on capital structure conveniently ignores our argument that O&R’s ratepayers should not be required to pay for a higher equity ratio than that of the O&R’s parent, CEI. CEI’s equity ratio is

approximately 48.3%, accordingly our recommended equity ratio of 48% is reasonable and should be adopted (Exh. 80).

VII. RATE BASE

A. Capital Expenditures

2. Rate Year

In its Initial Brief, MC casts unfounded aspersions on our review of the Company's capital expenditure forecast. MC asserts that "Staff, knowing of the permitting problems [experienced by the Company in its capital projects], accepted the Company's cost estimates and schedules." Indeed, MC asserts that there are seven projects with slipped expected in-service dates already, and it cites six examples (MC IB 39, 41-42). Of those six examples, two still have expected in-service dates during the rate year and three were never expected to close to service until after the rate year (MC IB 39).[13] MC has failed to explain how revisions to expected in-service dates that are beyond the rate year support an adjustment to the rate year revenue requirement.

Additionally, MC states that "[t]here is no evidence that Staff independently checked the load growth forecast", implying

[13] As evidence of the Company having slipped expected in-service dates since making its initial filing, MC points to the Hartly Road and Little Tor Road substations, which had initial expected in-service dates of December 2012, and the West Warwick substation which had an initial expected in-service date of the end of 2013.

that the forecasted peak load growth may be defective without actually pointing to any even theoretical defects in those forecasts (MC IB 44). Again MC tries to tie localized increases in peak load to the sales forecast without actually providing a reason for the linkage. To determine the need for new infrastructure, forecasts of peak load are done annually, based on the previous summer's peak demand on individual transformers and local area infrastructure. The need for individual infrastructure projects are not based on system-wide peak load forecasts. Though we did not believe it necessary to include each of the interrogatory responses in the record, as we had no adjustments to make based on those responses, we conducted a significant amount of discovery, to which MC was privy, that confirmed the reasonableness of O&R's forecasts underlying its proposed capital expenditures.

B. Infrastructure Project Adjustments

1. Smart Grid Expansion Blanket

As fully explained in our Initial Brief, we believe that the Company should complete its existing smart grid pilot program and evaluate the results of that program before ratepayers fund an expansion of smart grid (Staff IB 117-118). While the Company asserts that our adjustment is simply a "recipe of delay" and should be rejected, even the language in its own Initial Brief supports our position. The Company states

that "[t]he results from these pilots are expected to" lead to improvements and that "[t]he Company is proposing to build off the information learned… from these existing pilot projects" (O&R IB 88). Note that even O&R admits that these pilots are "expected to" lead to improvements. Simply put, these pilot projects have not been completed yet, and while both we and the Company expect the pilots to result in improvements, until the pilot projects are completed and analyzed, an expansion building off of the information learned from them is quite frankly premature.

C. Net Plant Reconciliation

Regarding our view of the Company's proposed symmetrical net plant reconciliation mechanism, O&R asserts that "the Company is not proposing to have customers pay for carrying charges on investments that are not made due to delays in approvals reprioritization or additional projects being scheduled" (O&R IB 92). However, this plainly contradicts the Company's proposal which would provide the Company with 50% of the "avoided carrying charges" in the rate year in which the cost is avoided." Although Orange and Rockland asserts that "net plant under-runs that are the result of direct actions by the Company to reduce costs and provide savings to customers," it fails to recognize that, over the Company's most recent three year history, the extensive under-runs in the Company's net

plant were the result of delays and not the Company's concerted efforts. Had the O&R's proposed reconciliation mechanism been in place during the last three years, the Company indeed would have had ratepayers paying for carrying charges on investments that were not made because of such delays. Thankfully, ratepayers were not in that position for the last three years, and should not be put in that position in the future either.

VIII. REVENUE ALLOCATION/RATE DESIGN

D. Block Rate Structures

1. Service Classification 1 Inclining Block

Although O&R asserts that "there is an inherent cost basis to the Company's proposal" (O&R IB 106) for an additional rate block for residential usage over 1,000 kWh per month, the record clearly evidences that the Company has not done, nor come across any study supporting this assertion (Tr. 669-670). We continue to recommend rejecting this proposal for the reasons set forth in our Initial Brief, namely that in addition to the proposal not being cost based, the Company has failed to seriously consider or understand the impacts of its proposal on the Company's ratepayers, including those enrolled in the Company's low income program (Tr. 671-675, 680).

E. Lighting Service Classifications

The Town of Ramapo makes an unsupported request "to subdivide the Municipal lighting class into major and minor

users based upon the number of fixtures in its jurisdiction." With this division, the Town maintains, "a change in delivery rates should be reflected" (TOR IB 21). This proposal has no basis in the record, and as is evident from the language of the Town's request, that it "should" result in a change in delivery rates, there is no understanding of the actual impacts of such a change at this time. Staff recommends that this proposal be rejected.

IX. OTHER ISSUES

A. Performance Matrices

2. Reliability Performance Matrix

With respect to the reasons for the Company's recently declining CAIDI performance, the Company asserts that it has taken measures to change its workforce strategy and outage restoration efforts, and that these measures undercut our assertion that the Company's worsening CAIDI might be the result of something other than the asserted fact that the Company has fewer short duration outages (O&R IB 112). However, we note that the Company took many of the measures, such as a modification to its work rules allowing additional flexibility to line crews and the establishment of a "Restoration Team" *after* its CAIDI performance had declined (Tr. 85).[14] Therefore, the Company's assertion in its Initial Brief that O&R's CAIDI

[14] Both of the referenced measures were instituted only in 2010.

declined in spite of these measures does not hold water, and indeed supports our assertion that the Company should focus more on improving its CAIDI. Furthermore, although it is true that a downsized workforce has not contributed to O&R's recently declining CAIDI, this fact does not support a shift from SAIFI and CAIDI measures to a single SAIDI measure which is the product of the two. The point is that if the Company were subject only to a SAIDI measure, it could downsize its workforce responsible for outage restoration without any fear of incurring a negative revenue adjustment because its contemporaneously improved outage frequency maintains a constant SAIDI measure.

3. Customer Service Performance Mechanism

The Company's explanation of when it would receive a positive incentive under its proposal only serves to underscore our reasons for rejecting the proposal. Though O&R describes it as "superior performance," the Company requests that it be awarded with a positive incentive if it achieves a score on its Customer Contact Satisfaction Survey (CCSS) higher than 90.6 percent, which is its "historical level" of performance. O&R apparently believes that any improvement above historical levels is worthy of reward. In our opinion, achieving such an easy target should not result in a reward.

c. Call Answer Rate

The Company asserts that implementing this measure subjects

the Company to potential double penalties because, according to O&R, a decline in the Company's call answer rate will be captured in the results of the CCSS (O&R IB 118). However, this is not necessarily accurate. If a caller has to wait longer than 30 seconds, but is satisfied with the outcome achieved once his or her call is answered, that customer may still rate his contact with the Company as satisfactory.

Additionally, we note that the Company's assertion regarding the CPB's proposed PSC complaint rate threshold, that a too strict threshold "could result in a perverse incentive in that unjustified acquiescence to customer demands could be prompted" (O&R IB 116, n. 52). Similarly, if the only manner in which to measure whether the Company has an adequate call answer rate is through the results of its CCSS, the Company may be incented to acquiesce to the demands of customers who waited longer to have their calls answered in order to mask the effects of a lower call answer rate.

B. Revenue Decoupling Mechanism

In response to our proposed thresholds and recovery periods for interim RDM surcharge/credits, O&R argues that our position in this case is inconsistent with the position taken by Staff in other cases (O&R IB 123). We note that the positions taken in other cases do not and should not require that we take the same position in this case. First, the interim RDM adjustments are

new to the subject utilities in the cases cited by O&R.[15] Indeed, RDMs and the workings of interim RDM adjustments are new to O&R as well, having first been implemented in Case 07-E-0949.

Second, O&R points to the 1.25% threshold for interim RDM adjustments in place for NYSEG/RG&E. However, O&R fails to note that NYSEG/RG&E are limited to making interim RDM adjustments only once per rate year,[16] whereas O&R is under no such limitation, having instituted two interim RDM adjustments in the second rate year of the Company's current rate plan (O&R IB 121-122).

Currently, there is no uniform procedure for implementing interim RDM adjustments, and there need not be one, at least at this time. We believe that our proposal, as set forth in our Initial Brief represents a reasonable method for allowing the Company to implement interim RDM adjustments that minimize the rate volatility perceived by ratepayers.

D. Three-Year Rate Plan

O&R asserts that "[n]o party to this proceeding has provided any evidence that the Company's [three year rate plan] proposal is unreasonable" and therefore claims that the

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[15] Case 10-E-0050, Niagara Mohawk Power Corporation d/b/a National Grid – Electric Rates, Order Establishing Rates for Electric Service (issued January 24, 2011); Cases 09-E-0715 and 09-E-0717, New York State Electric and Gas and Rochester Gas and Electric – Electric Rates, Order Establishing Rate Plan (issued September , 2010).

[16] Cases 09-E-0715 and 09-E-0717, *supra* at 66.

Commission should be free to adopt the Company's proposal (O&R IB 129). However, O&R's assertion plainly ignores the reality of the parties, including our, positions.

As the Company explains, "[g]enerally, a three-year rate plan starts with the revenues, expenses and rate base from the first rate year" (O&R IB 128-129). As evidenced by the record and Initial Briefs in this case, the parties have a great deal of disagreement over what would be the first rate year revenues, expenses and rate base. Accordingly, the Company's assertion that no parties have provided evidence against the Company's proposed multi-year rate plan is illogical and cannot be supported.

E. Deferral Accounting/Reconciliations

In addition to the disagreement over the propriety of a property tax reconciliation in a one year case, discussed above, the Company requests reconciliations for the impact of changes in legislation and new tax laws (O&R IB 130). While reconciliations for these two items are normally provided in the context of multi-year plans, such reconciliations are not routinely provided in one year rate cases. The Company has not shown any unique circumstances that warrant a deviation from this general rule in this case. Accordingly, the Company's request for these to reconciliations should be rejected. We do note that, for the reasons stated in our Initial Brief, we

support the Company's specific request to reconcile the actual cash flow benefits related to the new tax legislation, effective December 20, 2010, increasing bonus deprepiation (Tr. 341-342, Staff IB 158).

H. Targeted Demand Side Management Incentive

The Company's Initial Brief implies that its sister utility, Con Edison, was awarded incentives for targeted DSM in Case 07-E-0523; however, this is plainly inaccurate. The Commission did adopt a Joint Proposal in Case 04-E-0572, which allowed Con Edison to seek incentives for targeted DSM efforts. However, in the fully litigated Case 07-E-0523, although Con Edison sought the continuation, and indeed the aggrandizement, of those incentives, the Commission decided the incentives were not warranted going forward.[17] The Commission has not provided Con Edison, or any other utility with targeted DSM incentives since.

Orange and Rockland continues to disagree with our statement that "targeted DSM is a basic part of the Company's responsibility to provide safe and reliable service at just and reasonable rates" (Tr. 1435). The Company's stance is hard to reconcile with the Commission's Order Concerning Utility Financial Incentives, which stated that "Con Edison/O&R are

[17] Case 07-E-0523, Con Edison, Order Establishing Rates for Electric Service (issued March 25, 2008) at 155-159.

incorrect when they state that efficiency services are not part of their statutory obligation."[18]

Additionally, O&R asserts that "targeted DSM results are measurable as a determination of the program's effectiveness, as the MW reductions will either occur or not and the infrastructure investment will either be delayed or deferred or not" (O&R IB 137). However, the Company also admits that "[b]y their nature, both [capital reinforcement projects and targeted DSM] are dependent on forecasts which may change over time" (O&R IB 136). These two statements inherently contradict each other. If, as is undeniably true, forecasts may change over time, then measuring the effectiveness of targeted DSM against a baseline of these forecasts can never be as simplistic as the Company asserts. Even if we could be certain that targeted DSM efforts resulted in *some* delay of infrastructure investment, it would be difficult if not impossible to identify with certainty the quantifiable impact of the targeted DSM efforts, when myriad factors may cause changes to the original forecasts.

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[18] Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard, Order Concerning Utility Financial Incentives (issued August 22, 2008) at 33.

X. UNCONTESTED ISSUES COVERED BY STIPULATION

F. Depreciation Rates

CPB expresses its objection to adopting the proposed changes to depreciation rates. CPB, and MC both wish to delay changes to the depreciation rates, not because the parties question the accuracy of the proposed changed rates, but solely to avoid the increased costs (approximately $1.1 million annually) at this time. Throughout our proposals, we have endeavored to provide every accommodation and mitigation of the Company's proposed rate increase. However, the useful life of electric plant should be reflected in the applicable depreciation rate. It goes against basic principles of cost recovery to ignore the accurate deprecation rates proposed in this case.

XI. CONCLUSION

For the reasons stated herein,and in Staff's testimony and its Initial Brief, Staff's proposals and adjustments should be adopted.

Respectfully submitted,

Brandon F. Goodrich
Staff Counsel

Case 10-E-0362

Orange and Rockland Utilities Inc.
Staff's Revenue Requirement Per Reply Brief
For Rate Year Ending June 30, 2012
($000's)

		Amount of Adjustment	Revenue Requirement
Staff Revenue Requirement Amount as filed December 10, 2010			**$ 26,562**
1	**Sales Revenue - Schedule 1**		
	To eliminate Billing and Payments Processing charges included in sales and other operating	$ 600	$ 606
2	**Other Operation Revenues - Schedule 2**		
	1) To reflect the Company's amortization of deferred Pole Attachment Rent	66	67
	2) To reflect the refund of Interest on Repair Allowance	(32)	(32)
8	**Rate Base - Schedule 7**		
	Deferred Income Tax -Bonus Depreciation /Repair Allowance	(7,875)	(793)
	Total Adjustment reflecting Staff's Adoption of Company's January Update		(152)
Staff Adjusted Revenue Requirement Amount Per Exhibit 22. Schedule 1A			$ 26,410
	Change in Initial Brief		
1	**Other Operation Revenues - Schedule 2**		
	1) To reflect Staff's as corrected pole attachment revenues	$ 175	$ 177
	2) To update Late Payment Charge revenues	3	3
2	**Operation and Maintenance Expenses - Schedule 3**		
	1) To update Staff's PENSION & OPEB expense allowance	1,266	1,279
	2) To update Uncollectibles as of November 2010	82	83
3	**Taxes Other Than Income Taxes - Schedule 4**		
	1) To adjust Staff's Property Tax allowance	513	518
4	**Rate Base - Working Capital Schedule 8**		
	1) To adjust Cash Working Capital allowance for items above	158	17
	2) To adjust Prepaid Property Tax	210	22
	Total Staff's Initial Brief Adjustments		2,099
Staff Revenue Requirement Amount Per Initial Brief			$ 28,509
	Changes in Reply Brief		
1	**Other Operation Revenues - Schedule 2**		
	To reflect update for Hillburn Property Tax Refund	(52)	(53)
2	**Taxes Other Than Income Taxes - Schedule 4**		
	To refelct January 2011 Property Tax and Assessment change Update	356	360
3	**Rate Base - Working Capital Schedule 8**		
	To reflect changes to Prepaid Property Tax based on Jan.,2011 update	198	19
	Total Staff's Reply Brief Adjustments		326
Staff Revenue Requirement Amount Per Reply Brief			$ 28,835