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2007 DEC 14 PM 4:03

December 14, 2007

Honorable Jaclyn A. Brilling, Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, New York 12223-1350

Re: Case 07-E-0523 – Consolidated Edison Company of New York, Inc. – Electric Rates.

Dear Secretary Brilling:

Please find enclosed copies of the Department of Public Service Staff's (Staff) Reply Brief in the above-referenced proceeding. Pursuant to discussion among the parties, Staff is serving electronic copies on the active parties via e-mail. Please contact me should you have any questions.

Respectfully submitted,

Steven Kramer
Staff Counsel

Attachment

cc: Judge Bouteiller
Judge Phillips
Judge Stegemoeller
Active Parties

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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

REPLY BRIEF OF THE DEPARTMENT OF PUBLIC SERVICE STAFF

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Table of Contents

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REPLY BRIEF OF THE
DEPARTMENT OF PUBLIC SERVICE STAFF

I. INTRODUCTION

Department of Public Service Staff (Staff) respectfully submits this reply brief to the Administrative Law Judges in the Con Edison electric rate case. As noted in our initial brief, we believe Con Edison rates should be set for one year and that the rate increase should be no more than $642 million. As with Staff's initial brief, this brief is organized by topic, and not by party. Where Staff does not speak to an issue, either here in reply or in our initial brief, neither opposition against, nor support for, any parties' positions should be inferred.

Staff's revenue requirement supports the vast majority of Con Edison's infrastructure and incremental Operation and Maintenance programs. Our disagreements with the Company are largely centered on it requests for excessive incentives, both for energy conservation and executive bonuses, an excessive rate of return with excessive financial support, unnecessary Staffing increases in certain areas, and the timing of capital recovery. While we are convinced that the Company needs to increase it rates to pursue necessary programs, we find the request is still laden with excesses and unsupported claims of financial stress. Con Edison has one of the highest credit ratings of any utility in the country and has received incredible financial support from the Commission over the years. We ask the Judges to not countenance the Company's unsupported claim in its introduction about the "tremendous strain on the Company's ability to raise and borrow money" (Company Initial Brief, p. 12). The Company will be able to finance its capital needs on reasonable terms with Staff's recommended revenue requirement increase. Con Edison has inflated its rate request enough, and its attempt to add a fear element of financial distress should be ignored.

II. REVENUE REQUIREMENT

A. Cost Drivers of Existing Rate Plan

Con Edison claims that the modest increase authorized in the current electric rate plan for the Company was substantially understated and was not reflective of current cost levels (Company Initial Brief, p. 9). The Company claims that, all else being equal, its rates would have to be increased by $515 million to reflect ongoing recovery of costs that were approved in the last rate case. According to the Company, $515 million of its $1.2 billion request is driven by the following: $250 million relates to expiring customer credits; $90 million is attributable to recovery of costs that were deferred during the past three-years under the current electric rate plan; and $195 million relates to carrying costs for incremental plant additions. The three identified components actually sum to $535 million.

The Company's derivation of the $515 million related to the current rate plan is over-stated by $60 million. Con Edison failed to recognize that its rate plan permitted two rate increases (Rate Year (RY) 1 and RY3) in lieu of three annual rate increases. Under the current rate plan, the second year rate increase was relatively small and therefore was deferred and collected in the RY3 increase. The effect of this approach is higher rates at the end of the rate plan. The Commission recognized this effect and indicated that the larger rate increase in RY3 would help minimize (by $60.1 million) the magnitude of any needed rate increase at the end of the plan.[1]

This clarification has no impact on the Company's required revenues. It simply refines Con Edison's characterization of the overall drivers of its required increase.

B. Other Operating Revenues

1. World Trade Center (WTC) Costs

In its initial brief, the Company claims that it has deferred incurred September 11th restoration, rebuilding and interference costs "(p)ursuant to the associated Commission orders". Con Edison claims that the uncertainty raised by Staff and other parties to this proceeding is speculative and it should be permitted to recover the amounts requested. The Company's posture is misleading and clarification is necessary.

The Commission has not authorized deferred accounting for WTC costs. Con Edison initially sought authority for deferred accounting treatment of such costs in Case 01-M-

[1] Case 04-E-0572, Consolidated Edison Company of New York, Inc. -Rates, Order Adopting Three-Year Rate Plan (issued March 24, 2005), p. 14.

1958.[2] In that proceeding, the Commission explicitly deferred ruling on the Company's deferred accounting request for WTC related costs.[3] The Commission held that it was premature to consider the WTC related costs due to their unsettled nature and because all avenues of recovery had not been exhausted (Tr. 3564, Lns. 2-11). Therefore, Con Edison does not have Commission authority to defer WTC related costs and is doing so at it own risk. All of the Commission's standards for approving deferrals, such as materiality and the level of the Company's earnings, can still be considered by the Commission.

The current electric rate plan for Con Edison provides for recovery and amortization of $14 million per year of deferred WTC costs.[4] However, such recovery must be in accordance with and reconciled to the Commission's determination in Case 01-M-1958.[5] As of now, Con Edison has authority, subject to full true-up, to recover $14 million per year of deferred costs. The level of deferrals the

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[2] Case 01-M-1958, Consolidated Edison Company of New York, Inc. - Petition Regarding Costs Related to Emergency Response and the Restoration of Service Related to the World Trade Center Disaster, Order on Treatment of Electric Interference Costs (issued January 30, 2004).

[3] Id. at 3, 7.

[4] Case 04-E-0572, supra, p. 11, footnote 27.

[5] Id., Joint Proposal (attachment), p. 15.

Commission will ultimately authorize, the level of federal reimbursements, the level of insurance reimbursements and as well as the Commission determined recovery period for deferred capital and expense costs all remain unknown. Despite Con Edison's claims to the contrary, significant uncertainty remains as of this date. As such there is no reason to change the recovery level previously approved by the Commission. Staff's recommendations to continue the $14 million annual recovery level and exclude the deferred balance from rate base should be adopted.

C. Operations & Maintenance Expenses

1. Company Labor

a. Meteorologist

Con Edison seeks $150,000 salary allowance to hire a meteorologist. In the Company's initial brief, it continues to tout two unsupported assumptions. The first assumption is that hiring an in-house meteorologist will provide increased weather forecasting accuracy. The second assumption is that an in-house meteorologist would be able to quickly update local area weather pattern changes before the subscription weather services' meteorologists could (Company Initial Brief, p. 204; Tr. 1856-1857).

The Company alleges that the weather service updated forecasts lag weather patterns by several hours, but a review of the record in this proceeding shows that contention is not supported by any facts, research or supporting documentation. The Company could obtain information in real time simply by using weather subscription services. If it was so critical to its electric operations that this position be filled, it is obvious that the Company would have done so and assimilated the position into its operations already.

This is one of many unnecessary staffing requests that Con Edison has thrown into this request for rate relief. The Company has not supported its contention that an in-house meteorologist's forecast would be more accurate or timelier than subscription services. Additionally, Con Edison has not identified any productivity gains that would result from theoretically improved forecasting it has claimed. Based on this, Staff recommends that the Commission deny the proposed $150,000 for the Meteorologist position.

b. Tax Department Labor

In our Initial Brief, Staff addressed the Company's proposal to create and fill positions for the Tax Department (Staff Initial Brief, pp. 22-27). Con Edison's initial brief refers to KPMG's expertise in understanding the resources required for a corporate tax function as "substantial" and "unquestioned" (Company Initial Brief, p. 199). Staff believes that the KPMG benchmarking comparisons are unreliable because 80% of the peer group, on which KPMG relied, are "manufacturers" and the study used 2002 data (Staff Initial Brief, p. 24).

The Company indicates that we provide no basis for departing from positions taken by Staff in Case 06-G-1332 (Company Initial Brief, p. 199).[6] One reason that Staff's position differs in this proceeding is that the Company did not provide the entire KPMG report in Case 06-G-1332, thus Staff was not provided an opportunity to review the benchmarking analysis on which the Company relies to support its proposed Tax Department hiring.

The second reason for our change in position is that the Company's hiring intentions have proven unreliable. In Case 06-G-1332, Con Edison indicated that it planned to fill the same number of positions in the Tax Department by July 2007 (Case 06-G-1332, Staff Accounting Panel Direct Testimony, p. 21, Lns. 15-17; Company Initial Brief, p. 27). According to the Company's Accounting Panel's Rebuttal Testimony, currently, four of these positions remain unfilled. The Company claims that it is now

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[6] Case 06-G-1332, Consolidated Edison Company of New York, Inc. - Gas Rates.

pursuing the hiring of five tax professionals because of an announced retirement. The Company further indicated that is experiencing difficultly hiring tax professionals (Tr. 1400, Lns. 15-20).

Staff originally recommended that funding for all seven Tax Department positions be denied for the reason stated in Staff Accounting Panel's Testimony (Staff Initial Brief, pp. 24-25). If the Commission decides to fund the augmentation of the Company's tax department, the funding should be limited to the three positions that are presently filled. Given the Company's track record and its problems attracting qualified candidates, there is no credible reason to believe these positions will be filled in the rate year. Funding the Vice President position and the two other positions would reduce Staff's recommended disallowance by $350,000 to $364,000.

c. Finance and Auditing Labor Adjustments

The Company continues to support five (5)[7] positions in the Finance and Auditing Department by stating that "…Staff did not pursue additional information as to these positions through the discovery process…" (Company Initial Brief,

[7] The five positions are: a financial reporting accountant, a regulatory filings accountant, two (2) treasury department senior analysts and a treasury department lease administrator.

p. 203). For each of the five positions, Staff recommended disallowances in our testimony and Initial Brief based on information the Company provided in support of its requests (Staff Initial Brief, pp. 25-28).

Con Edison's reliance on Staff to support its case is entirely misplaced. The burden of proof is on the utility proposing to change its rates.[8] Furthermore, if a utility proposes changes in expenses which should be considered in determining reasonable rates, it must present competent testimony to support its case.[9] Since the Company has failed in its burden of proof, the Commission should adopt Staff's positions and adjustments regarding these five positions.

D. Employee Welfare Expense

1. Health Care Benefits

Arguing that Staff did not disagree with the Company's assertion that health care costs are rising at a rate greater than inflation (Company Initial Brief, p. 229), Con Edison continues to assert that separate inflation factors of 8.0% for medical plan costs and 9.5% for prescription

[8] Public Service Law §72 and §66(12)(g); 16 NYCRR §61.1; St. Lawrence Gas Company, Inc. v. PSC, 42 N.Y.2d 461, 464 (1977); New York Edison Co. v. Maltbie, 244 A.D. 436, 445 (3rd Dept. 1935).

[9] 16 NYCRR §61.4.

drug costs should be applied and not a general inflation factor (Company Initial Brief, pp. 228-231). Oddly, after making this assertion, the Company then goes on to list Staff's arguments as to why the general inflation factor should be used (Company Initial Brief, p. 229 (citing Tr. 3578)).

As Staff has rejected the Company's arguments and applied a general gross domestic product (GDP) price deflator to this cost, so should the Commission reject the Company's arguments and adhere to its long-standing precedent. The Commission has stated its position on the application of a general inflator to health care benefits:

> the dispute between the parties over this issue has not been productive and that including this item in the pool of expense to which an inflation factor is applied will save time and effort, avoid unnecessary litigation, and provide a reasonably accurate estimate of this expense. In the future we expect RTC--<u>and all other jurisdictional utilities--to treat this expense in a manner consistent with this Opinion</u>.[10]

While Con Edison attempts to color the issue by claiming that the Commission's long-standing precedent is outdated, the Company fails to note that the Commission

[10] Case 28695, <u>Rochester Telephone Corporation - Rates</u>, Opinion and Order Determining Revenue Requirement and Rate Design (issued October 12, 1984) (emphasis added).

recently revisited this issue in a fully litigated rate proceeding and determined that this standard ratemaking practice remains valid in "today's circumstances and prevailing conditions".[11] The Company fails to provide any rational as to why circumstances have changed since the 2006 NYSEG Rate Order, which require that this standard ratemaking practice of using one inflation factor to inflate a pool of costs be rejected.

In forecasting the level of operations and maintenance expense, the Company claims that it did not apply the 4.7% general inflation factor to all costs in the "pool". Con Edison argues that certain costs were forecast at current levels or decrease levels. The Company indicates that only 38% of costs were escalated using the general escalation rate and that medical plan costs and prescription drug plan costs were inflated at 8% and 9.5%, respectively (Company Initial Brief, p. 230). However, it must be recognized that the rate year aggregate operations and maintenance expenses, excluding fuel and purchased power, are forecast by Con Edison to increase by 28% over the historic 12 months ending December 31, 2006 (Exhibit 84 (AP-5),

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[11] Case 05-E-1222, New York State Electric & Gas Corporation - Rates, Order Adopting Recommended Decision With Modifications (issued August 23, 2006) (2006 NYSEG Rate Order), pp. 54-55.

Schedule 9 ($1,709,257 - $1,334,486 = $374,771 / $1,334,486 = 28%)). In the aggregate, Con Edison forecasts its non-fuel operations and maintenance expenses to grow at a rate that is nearly six times the current GDP inflation rate. New programs and higher than GDP inflation growth rates are contributing to Con Edison's composite 28% operations and maintenance expenses increase. The application of inflation factors other than the general GDP deflator for employee welfare expenses should be rejected by the Commission.

The Commission's policy recognizes that within a pool of dollars, some cost elements will exceed the rate of inflation, while other costs will fall below that rate. Con Edison boldly claims that if the Commission does not adopt its proposal regarding inflating of medical benefits, the Company's revenue requirement will be understated. However, acceptance of Con Edison's flawed and highly biased method would result in exactly the kind of cherry picking of inflation rates the Commission wanted to avoid by using a general GDP deflator. A list of studies indicating that medical expenses will rise at a rate greater than the "general inflation rate" (Company Initial Brief, pp. 230-231) provides no basis for the Commission to abandon its policy. It *may* merely show that one cost, out of many to be inflated, may rise at a rate greater than inflation. The Commission policy recognizes this. Staff's adjustments conform to Commission policy and should be adopted.

2. Group Life Insurance Costs

Con Edison provides group life insurance for management employees equal to their annual base salary and, pursuant to collective bargaining agreements, for members of Local 1-2 and Local 3 of $30,000 (Company Initial Brief, p. 231 (citing Tr. 1124)). During cross examination, Company witness Reyes stated that the rate year forecast of group life insurance did not include either a dividend or deficit assumption because, in any given year, a dividend is not guaranteed and an additional payment may be required instead (Company Initial Brief, p. 231; Tr. 1165, Lns. 3-8).

According to Con Edison, dividends are not a certainty and in 2004 it was required to pay the full premium amount plus an additional payment of $3,700. Therefore, the Company claims that since there is no certainty that a dividend will be received or additional costs will not be incurred, it is inappropriate to include either a refund or additional payment in the projected expense (Company Initial Brief, pp. 231-232). The Commission should reject the Company's methodology of forecasting group life insurance costs.

Ignoring the fact that the Company has routinely received dividends of substantial amounts would result in rates reflecting group life insurance costs that do not truly reflect the actual cost of group life insurance premiums (Exh. 66). It is unreasonable to overcharge customers during the rate year by using Con Edison's myopic methodology.

In addition, Staff is concerned with the Company's characterization of the "overcharge" in its initial brief as a "dividend" and "refund" (Company Initial Brief, pp. 231-232).[12] While Con Edison may simply have been sloppy in its choice of words, the imprecise language does raise a question as to whether the payment from MetLife is a "refund" which falls under the ambit of Public Service Law §113(2), which requires a hearing and Commission disposition of a refund. Staff respectfully recommends that the Recommended Decision require that the Company address this matter fully and explain the character of the

[12] According to Company witness Reyes, dividends applicable to a particular year are offset against premium costs in the following year (Tr. 1148, Lns. 11-17). The Company's initial brief is confusing on this issue and raises question as to whether this is indeed how the "refund" is passed back to Con Edison.

"refund" and the manner in which it is made to the Company in its brief on exceptions.

Staff's recommendation of applying a five-year average ratio of dividends or deficits to premiums (46.01%) to the rate year forecast of group life insurance premiums should be adopted. This approach ensures that customers do not pay more than the Company's expected net cost for group life insurance (Staff Initial Brief, pp. 34-35). In contrast, Con Edison's forecast methodology would continually result in customers paying 100% of expected gross premium costs.

The Company's forecast method is self-serving in light of the fact that the Company's actual net cost averaged 54% of the gross premium over the last five years. We note that the five-year average includes the year in which an incremental payment was required. Staff's recommended forecast method forecasts the Company's true cost and, as such, should be adopted.

E. Miscellaneous

1. East River Repowering Project (ERRP) Major Maintenance Expenses

Staff fully addressed issues related to ERRP major maintenance expenses in our testimony and initial brief. Nonetheless, there are a few points raised in the Company's initial brief that need to be replied to, particularly those arguments that are incongruous.

Con Edison disagrees with Staff's claim that the Company can reasonably estimate the ERRP major maintenance costs and that it has control over the timing of major maintenance activities (Company Initial Brief, p. 250). However, the Company indicates that it expects to spend $24.1 million over the next three years on ERRP major maintenance and claims that, absent reserve accounting and residual funding from the current rate plan, it will not have sufficient funding in rates to meet the three-year maintenance schedule (Company Initial Brief, p. 249). If the Company can not reasonably estimate the timing and amount of ERRP major maintenance expenditures Staff questions how it can estimate the $24.1 million of ERRP major maintenance expenditures over the next three years. The ERRP units have supported the Company's steam system operations for more than two years. During this time, Con Edison has gained experience in operating the turbines, along with data such as the accumulation of actual factored fired hours (FFH), which is a prime indicator of when the turbines require major maintenance. Reserve accounting for routine maintenance activity is not justified, especially when establishing rates in a one-year rate case.

Furthermore, Con Edison owns, operates and maintains other production assets for its electric and steam businesses. Reserve accounting has not been authorized by the Commission to account for maintenance costs on those assets.

Claiming that Staff's criticism that customers do not benefit from reserve accounting is in error, the Company notes that, under its plan, customers would benefit since the $8.7 million over-collection would be set aside to defray future maintenance costs (Company Initial Brief, p. 250). The Company's argument confuses the attributes of reserve accounting with the application of the over-collection funds.

Reserve accounting, as proposed by Con Edison, provides significant protection to the Company and limited protection to customers. When actual maintenance costs exceed the reserve balance, Con Edison will seek to increase collections from customers in the following rate proceeding. However, Con Edison has no apparent intention to ever return surplus funding to customers. This is evidenced by the fact that the Company seeks to fund the reserve with $16.2 million ($8.7 million of over-collection + $7.5 million proposed rate allowance) while the rate year expense forecast is only $7.8 million.

The Company's reserve accounting proposal is akin to a "blank check" from the Commission for maintenance costs. Con Edison's incentive to manage and minimize maintenance costs would be eliminated if the request is approved by the Commission. This would result in customers bearing the entire risk of the Company spending more than it forecasted for ERRP maintenance.

The Company's proposed disposition of the $8.7 million is tied with its proposal regarding reserve accounting (Tr. 1506, Lns. 6-14). It is important to note that Staff's support to continue the current $7.5 million annual funding of ERRP major maintenance is based on our review of actual maintenance expenses to date and the Company's rate year forecast (Staff Initial Brief, pp. 35-36). Staff's proposal should be considered in its entirety, including refunding to customers the $8.7 million unexpended funds and disallowance of reserve accounting. If the Commission elects to authorize reserve accounting, it should also eliminate the Company's proposed rate allowance for major maintenance since the $8.7 million of unspent maintenance funds is more than adequate to fund the Company's forecast rate year expense.

2. Fuel Update

The Company's Accounting Panel included an update to fuel expense of approximately $1 million based on changes in fuel prices (Tr. 1382, Lns. 13-20). Relying on the testimony of Company counsel, Mr. Richter, Con Edison's initial brief claims the corrected update of $300,000 is due to a larger fleet as well as an increase cost of fuel in the rate year (Tr. 5545-5547). Staff addressed the serious deficiencies related to this updated and more importantly actual fuel costs per gallon in our Initial Brief (Staff Initial Brief, pp. 39-42).

The Company's claim that the increase is necessary due to a larger fleet is completely without record basis. This claim is perplexing since the Company's update did not include any request for additional funding to procure a larger fleet. Therefore, Con Edison's fuel update is wholly improper and should be rejected.

3. Public Awareness and Energy Information Programs

Con Edison attempts to bring extra-record evidence to support its corporate goodwill advertising campaign by relying on the Vantage Report (Company Initial Brief,

p. 194).[13] Nonetheless, Con Edison's citations to the Vantage report in its initial brief were taken out of context. For example, in support of the Company's claimed need for its proposed advertising program, it cites the Vantage report for the proposition that it "should make the need to report outages more prominent in its advertising and customer outreach".

The full passage from the Vantage Report states:

> Con Edison should make the need to report outages more prominent in its advertising and customer outreach. This message does not need to be elaborate or complicated nor does the message delivery mechanism. Simple enhancement to the web sites and additions to bill inserts could do much to raise the recognition among customers of the need to report all outages."[14]

Con Edison's selective quoting of this section of the Vantage Report in its initial brief is misleading to the reader. Indeed, the complete text actually undermines the Company's request for its $18 million advertising campaign.

Staff introduced two illustrative examples of Con Edison public affairs advertisements into the record (Exhs. 107 and 108). The Company's experts testified that these examples were representative of components of the proposed

[13] We also note that the Commission has put the report out for public comment and has yet to take official action on the content of the report. Therefore, the Company's reliance on this report is inappropriate.

[14] Vantage Report, p. 152.

public affairs energy education program (Tr. 1520, Lns. 5-20). In its initial brief, Con Edison suggests that the advertisements are somehow not representative of the program (Company Initial Brief, p. 195). Moreover, the Company faults Mr. Scherer and the other members of Staff's Accounting Panel for not having appropriate credentials to comprehend and evaluate the merits of an advertising campaign.

The advertisements in evidence speak for themselves (Exhs. 107 and 108). No particular credentials are required to see the true intent and purpose of this campaign --to promote electric consumption and rebuild Con Edison's damaged reputation resulting from its recent service failures. Further evidence that the intent of this campaign is corporate relations focused, and not intended to educate customers about energy efficiency and the importance of outage notification is borne out of Company witness Kane's testimony. He testified that this program is administered by Con Edison's corporate communications department which is "separate and apart from the outreach and education programs that are run by our consumer service department" (Tr. 1519, Lns. 8-13). This campaign is nothing more than corporate self-promotion and should not be funded by customers.

Appropriate messages can be delivered within the consumer services department's existing outreach and education budgets. The Commission should strictly enforce its advertising policy and limit the Company's rate allowance to no more than $4.472 million.

4. Insurance Expense

The Company flippantly states there is an "indisputable reality that insurance costs are increasing every year" despite the fact that over the past three years its total insurance costs have continually declined (Company Initial Brief, p. 208). In fact, Con Edison's total insurance costs for the years 2004-2006 were $27,220,800, $24,931,200 and $24,071,400, respectively. This indicates a declining trend, based upon the numbers alone (Tr. 3584, Lns. 1-4). The Company claims that Staff's historic average of insurance cost increase levels fails to take into account that costs in every year are different (Company Initial Brief, p. 207). This characterization is misleading for two reasons. First, Staff did not use a historic average of insurance increase levels. Second, if a simple trending of insurance was used, Staff would have reflected a decrease based on the declines in Con Edison's total insurance costs over the past three years. Staff relied on the actual 2.9% increase in Excess Liability Insurance premiums as a proxy for the total insurance cost as it is the single largest premium, representing over one-third of the Company's total annual insurance cost and it is the latest available information (Staff Initial Brief, pp. 47-48). The Company's forecast has no sound basis. Therefore, Staff's recommendation should be adopted because it is based on actual known changes in insurance costs.

5. Incentive Compensation

In an effort to find a legal basis for the $14.146 million in incentive compensation it proposes, Con Edison cites in its initial brief Commission Opinion. No. 92-8, which it argues indicates that incentive compensation, should be recovered in rates.[15] Con Edison's reliance on Opinion No. 92-8 is misplaced. In Opinion No. 92-8, the Commission adopted a settlement proposal by a number of parties in that proceeding for a three-year electric rate plan.[16] Such proposals to the Commission have no precedential effect.

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[15] Case 91-E-0462, Consolidated Edison Corporation of New York, Inc. - Rates, Opinion and Order Adopting Settlement (issued April 14, 1992).

[16] "Settlements" are more properly referred to as joint proposals.

The Commission has consistently determined that management incentives should not be recovered from customers, absent clear productivity savings that flow to customers as a result of them. In another order, the Commission took issue with the cost of incentive compensation in the form of stock options.[17] The Commission stated:

> stock options could introduce a number of complications into the rate setting process if accounting for the option(s) were to increase compensation expense. This complication is avoided if costs arising from the SOP are booked below-the-line, and do not enter the rate-making equation. Below-the-line treatment allows the petition to be in the public interest because companies' goals are achieved without cost or impact to the ratepayers. This is consistent with the intent, as expressed in the supporting memorandum, of the 1991 amendment to Section 101 allowing for the issuance of stock options. Therefore, we will approve the companies' petition with the condition that the companies record all related costs below-the-line to ensure such costs are not recovered from the ratepayers.[18]

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[17] Case 03-C-0975, Ontario Telephone Company Inc. and Trumansburg Telephone Company, Inc. - Stock Options, Order Authorizing Issuance Of Securities (issued December 23, 2003).

[18] Id. at 6 (citing Cases 02-E-0198 and 02-G-0199, Rochester Gas & Electric Corporation - Rates, Order Adopting the Recommended Decision with Modifications (issued March 7, 2003) 2003 RG&E Rate Order).

In the 2003 RG&E Rate Order the Commission stated "[t]here is no precedent for recovery of executive incentive payments in a litigated rate case. They have been approved only twice in settlements, with associated productivity offsets. This is an expense that should not be charged to customers."[19]

The Company's citations concerning incentive compensation are misleading and its rationale is not convincing. Our adjustment to incentive compensation expense is based upon the facts presented in this proceeding and is consistent with Commission practices and fair ratemaking.

6. Water Expense

In its initial brief, Con Edison acknowledged the double counting of inflation effects in its rate year forecast of water expense and the Company did not object to Staff's $35,000 adjustment to rate year water expense (Company Initial Brief, p. 167). However, the Company claims that the City of New York (City) announced, after rebuttal testimony was filed, a double digit increase in water rates. The Company claims that the unstated increase proposed by the City is greater than the increase the

[19] Cases 02-E-0198 and 02-G-0199, supra, p. 13).

Company originally forecast. Moreover, the Company's states its current forecast is "closer" to its original request (Company Initial Brief, p. 167).

Con Edison offers no details regarding the claimed water rate increase proposed by the City, such as the proposed rate change and proposed effective date of the rate change. Therefore, the parties and the Commission cannot assess the impact the City's proposal will have on the Company's rate year water expense, if any. Con Edison has not offered any evidence to support its claims. Staff's adjustment is factually supported by the record in this proceeding and should be adopted.

7. <u>Property Tax Expense</u>

Staff and Con Edison are in agreement on the overwhelming majority of the property tax expense forecast methodology. Staff and the Company disagree, however, on the development of the growth rate for property tax rates. Both Staff and the Company use historic a five year average tax rate changes to forecast 2008-2009 tax rates. The difference in growth rates results in a $1.8 million difference the rate year expense which is approximately $750 million in total.

As explained in our Initial Brief, Staff used a straight average of the most recent five consecutive tax rate changes, starting with the rates in effect at the end of the 2002-2003 fiscal year through 2007-2008. Staff's forecast method reflects the most recently available data which the Commission has long held is the most reliable for forecast purposes.

Con Edison characterizes our forecast methodology as "cherry-picking" as we did not consider the impact of an 18.5% mid 2002-2003 year tax rate change (Company Initial Brief, pp. 221-222). The Company itself excluded the effects of the mid-year increase from its growth determination indicating that it was not representative of a normal tax increase (Company Initial Brief, p. 221). The company's arguments are incongruous.

Con Edison developed its growth rate using a truncated five year average starting with the rates in effect in 2001-2002 (prior to the 18.5% increase), skipping the 2002-2003 to 2003-2004 variation, and continuing with the rate change to date. If any party can legitimately be accused of picking and choosing in the development of a growth rate it would be Con Edison. The Company is simply attempting to inflate the tax growth rate by relying on stale 2001 vintage data.

Staff's five year average growth rate computation is straightforward, relies on the most recent contiguous data and produces a reasonable proxy of the forecasted tax rates. Accordingly, Staff's adjustment should be adopted.

8. Reconciliations - Interference and Property Tax Expenses

Con Edison continues to argue in support of its request to fully shed the risk of interference and property tax expenses (Company Initial Brief, pp. 311-312). As discussed below, Staff recommends a one-way true-up of interference expense and no true-up of property tax expense for the reasons stated in the Staff Accounting Panel's Testimony and our Initial Brief.

Con Edison claims that property taxes and interference costs are outside its direct control (Company Initial Brief, p. 311). While these costs are not directly controlled by the Company, it certainly can take actions to mitigate cost levels. Company witness Gencarelli testified as to the efforts Con Edison has undertaken to minimize interference expenses (Tr. 1197-1199). Moreover, the Company seeks to continue the 86%/14% sharing of property tax refunds and assessment reductions achieved through Con Edison's efforts in disputing tax assessments (Tr. 2435). Cleary, Con Edison's positions are inherently inconsistent and the Company does have the ability to mitigate interference and property tax expenses.

The full true-up protection the Company seeks would completely eliminate any incentive for the Company to minimize costs. Customers would inappropriately bear the risk of Company inaction and the Commission should ensure that Con Edison has the appropriate regulatory incentives to mitigate these costs. Staff's recommendations are reasonable and should be adopted.

Turning to the abnormal 18.5% mid-year property tax rate hike, Con Edison suggests that property taxes can not be reasonably forecast in view of this substantial increase (Company Initial Brief, p. 314). Staff notes that a portion of the rate year property tax expense is known (Staff Initial Brief, p. 65). If such an unlikely event did reoccur (an extremely high mid-year property tax increase) the Company, could file a petition to defer the known incremental cost. It is not necessary to pre-authorize true-up accounting to protect the Company from such an unusual and unlikely event. Con Edison's statements regarding the actions of taxing authorities in the absence of a property tax true-up are nothing more than speculation (Company Initial Brief, p. 314). There is no evidence in the record to support this claim. Accordingly, the argument should be ignored.

In its initial brief, Con Edison references previous multi-year rate plans under which the Company has operated and the fact that they contain true-ups for property tax and interference expenses (Company Initial Brief, pp. 311, 314). The Company's attempt to rely on joint proposals adopted by the Commission to support its proposed continuation of true-ups should not be given any weight by the Commission. Joint Proposals may not be relied on as establishing precedent.

Staff has properly supported its recommendations on reconciliations and they should be adopted. Utilities are to be afforded a reasonable opportunity to recover their costs. Utilities are not entitled to a guarantee that they will be completely protected from all forces outside their direct control. If costs rise to a level above what rates provide, the Company may seek appropriate relief.[20]

F. Rate Base

1. Prepaid Pension Expense

Con Edison suggests that Staff's proposed adjustment to exclude from rate base non-cash benefits retained by shareholders constitutes a form of retroactive rate making

[20] Property taxes and interference costs represent over $850 million of the Company's revenue requirement. If the Commission decides to provide true-up protection for these costs, it should also consider the risk reduction in establishing the appropriate rate of return.

(Company Initial Brief, pp. 103-104). The adjustment proposed by Staff affects rate base and ultimately rates for the 12-month period commencing April 1, 2007 and ending March 31, 2008. Staff is not proposing that the Commission order reparations or refunds to customers of amounts previously recovered through rates. Staff's adjustment has no impact on the rate period covered by the term of the current electric rate plan, which expires on March 31, 2008. Staff's proposed adjustment is prospective in nature and has been properly developed and supported in this record. Accordingly, the Company's retroactive ratemaking claims are completely without merit.

Con Edison rebuts, without any record evidence, Staff's claim that customers received no benefit from incremental pension credits other than through shared earnings (Company Initial Brief, pp. 104-105). The Company argues that performance (earnings) of pension investments while off the Pension Policy Statement provides benefits to customers by reducing current pension expenses. As we explain below, this argument is true; however, it is imperative that it not be accepted on its face.

Expected (forecast) earnings on pension plan assets do offset current pension costs. It is appropriate that customers receive this benefit since customers, not shareholders, fully funded Con Edison's pension plan. Con Edison's pension costs are determined annually based on a number of actuarial assumptions. One such assumption is the expected return on the plan's assets. In this case, Con Edison has assumed an 8.5% return on pension plan assets (Tr. 1298, Lns. 8-9). The difference between the actual and expected return on the plan assets is referred to as an actuarial gain or loss. Actuarial gains and losses are not recognized immediately because the Commission's Pension Policy Statement allows the companies to amortize actuarial gains and losses to its pension expense over fifteen years.[21] This long-term amortization is a smoothing technique that minimizes the immediate impact of gains and losses on the annual pension expense levels. The amortization of past gains and losses is a component of the annual pension cost determination.

During the period Con Edison was off the Pension Policy Statement, the performance of its pension plan

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

assets was poor.[22] In fact, the market value of pension plan assets declined from a high of $7.4 billion in 1999 to a low of $5.5 billion in 2002. This effect of this performance is reflected in the relative value of unrecognized gains and losses when the Company went off the Pension Policy Statement and when it returned. In the Company's last electric rate case, Staff testified that Con Edison had total company unrecognized actuarial gains of $565 million on pension and OPEB plan assets.[23] Amortization of these gains reduced annual pension and OPEB expense while the Company was off the Policy Statement. When the Company "came back on the Pension Policy Statement", it had unrecognized losses of $1.3 billion.[24] The amortization of losses increases the annual pension and OPEB expense. The Company's updated Pension work papers in this proceeding indicate that the effect of the amortization of prior losses increase the Company's pension costs in 2008 by $141 million.

Now that the Company is back on the Pension Policy Statement, customers bear the risk of pension plan asset

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[22] Case 04-E-0572, supra., Exh. 16 (Direct Testimony of Robert Burke and John Scherer, p. 11).

[23] Id. at 31.

[24] Id. at 32.

performance including losses while off the Statement. The below expectations performance of pension plan assets while Con Edison was off the Policy Statement resulted in substantial increased pension costs for customers. There is no doubt that the benefits related to growth in pension plan investments are offset many times by the actuarially losses the Company amassed while off the Policy Statement.

In its initial brief, Con Edison faults Staff's computation of its proposed adjustment claiming that Staff misinterpreted the excess earnings provision in the rate order in Case 00-M-0095 and that Staff failed to consider the excess earnings impact of the Commission decision in Case 06-E-0990. The Company's claims are baseless.

The rebuttal testimony of Con Edison's Accounting Panel claimed that Staff misinterpreted the terms of the rate plan established in Case 00-M-0095 (Tr. 1393, Lns. 17-20). Con Edison is correct that the Commission modified the terms of the Joint Proposal to reflect an earnings sharing ratio of 65/35%.[25] Our Accounting Panel reflected this fact in its revised testimony and made appropriate corrections to its proposed adjustment. Therefore, Staff's

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[25] Case 00-M-0095, et al., Joint Petition of Con Edison and Northeast Utilities for Approval of a Certificate of Merger, Opinion 00-14 (issued November 30, 2000), p. 28.

proposed adjustment is properly calculated and should be adopted by the Commission.

Staff anticipated Con Edison's arguments with respect to the customer benefits stemming from Case 06-E-0990 as well as the $100 million credit in our initial brief (Staff Initial Brief, p. 76). Therefore, we incorporate our positions by reference and do not reiterate them here.

For all of the reasons presented in the Staff Accounting Panel testimony, our Initial Brief and those contained herein, Staff's recommended $141.9 million rate base adjustment is appropriate, necessary to avoid customer harm and should be adopted by the Commission.

2. Excess Deferred State Income Tax (SIT)

Staff proposed to return to customers in the rate year certain tax benefits resulting from a statutory change in New York State corporate income tax rates (Staff Initial Brief, pp. 78-81). Our adjustments were reflected as an increase to other operating revenues of $20.745 million and a related $6.263 million adjustment to rate base and were based on the excess deferred SIT data provided by the Company during discovery (Tr. 3624, Lns. 23-24) and in consultation with Company's personnel regarding ratemaking impacts. Subsequent to the filing of initial briefs, the Company identified some errors in the data as well as federal income tax effects related to the benefit pass back to customers. Con Edison provided corrected data for Staff's review. The corrections included a previously omitted excess deferred SIT expense balance of approximately $1.4 million (Company Initial Brief, p. 215) and the Federal income tax (FIT) effects related to deferred SIT balances. Con Edison claims that these corrections reduce Staff's adjustment to other operating revenues by $8.722 million and the rate base adjustment by $2.633 million (Company Initial Brief, footnote 132, pp. 215-216). Staff has reviewed the Company's analysis and accepts the revisions to our adjustments to other operating revenues and rate base. The customers' benefit, as corrected, is $12 million, not $21 million as we originally believed (Staff Initial Brief, p. 80).

We proposed that the entire excess deferred SIT benefit be passed back to customers in the rate year to mitigate the Company's large rate increase request. Con Edison proposes a three year pass back period. Con Edison faults Staff's proposal to pass back the excess deferred SIT in rate year as being inconsistent with our position in support of the Company's three-year pass back of the ADR tax benefit (Company Initial Brief, p. 216).

It is important to keep in mind that the ADR benefit is a much larger benefit, so a longer amortization period may be appropriate. As such, in Staff's view, this comparison is irrelevant. The Commission has the authority to determine the amortization periods for all the deferred balances, charges or credits. There is no absolutely right or wrong period. The Company proposed a three-year amortization period for deferred costs and credits, consistent with its three-year rate plan proposal. Our testimony addresses rates for a one-year period and recommends that the Commission reject the Company's three-year rate proposal. Accordingly, the Commission should not be bound to a three-year amortization for any deferred cost or credit.

The Commission should exercise its discretion to determining the pass back and recovery periods in this instance and others so as to minimize, to the extent it believes prudent, rate impacts or to achieve other goals. Our proposal to pass back the entire excess deferred SIT balance to customers in the rate year is reasonable in consideration of the magnitude of Con Edison's proposed rate increase. Contrary to Con Edison's suggestion, as we stated in our Initial Brief, there is no material "hockey stick" effect associated with Staff's proposal (Staff Initial Brief, pp. 80-81).

Furthermore, the magnitude of the customer benefit is significantly less than the $21 million previously believed and the immediate rate impact when rates are reset, if any, would be only $12 million. This alone mitigates Con Edison's concerns.

G. Sales Volume and Revenue Forecast

Staff finds Con Edison's initial brief addressing the sales and revenue forecast telling, noting that the Company agreed with a Staff proposal not based on the evidence adduced at the hearing, nor based upon econometric principles, but on the magnitude of the resulting adjustment (Company Initial Brief, p. 307). For example, Con Edison accepted Staff's proposed changes to the price deflators because the changes result in a minimal decrease of one gigawatt hour (GWH) in the forecast of the total sales volume (an adjustment that favors the Company) (Tr. 586).

Of note, Staff believes that the Company's Forecasting Panel did not fully understand its own model. In discussing whether the changes in appliance saturation have been reflected by the Company's SC 1 model, Con Edison indicated that the Panel believed the dependent variable of the SC 1 model to be "the growth rate of sales per customer per billing day" (Company Initial Brief, p. 303). The dependent variable is actually the growth rate of sales per customer adjusted by a billing-day index for the quarter as shown in the Panel's workpapers. That quarterly index is less than or greater than one (1) depending on the total billing days in that quarter.

There are other problems with the Company's methodologies and analysis as well that we will address below by issue.

1. <u>Number of Customers</u>

In its initial brief, Con Edison claims that Dr. Liu "did not provide any evidence" that Staff's customer forecasts for Service Class (SC) 2 and 7 are better than the Company's forecasts (Company Initial Brief, p. 305). The record shows otherwise. Dr. Liu has shown that Con Edison's forecasting errors are substantially greater than Staff's for both SC 2 and SC 7, when compared to the recent actual data for 2007. Indeed, the errors in our forecasts for SC 2 are half that of the Company's (Exh. 264, p.3).[26] For SC 7, Staff's forecasts are nearly identical to the

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[26] Con Edison's forecasts for SC 2 are below the actual by 4,119 to 4,429 customers, while Staff's forecasts are below by only 1,978 to 2,411 customers.

actual, whereas the Company's forecasts are below the actual by a margin of more than 1% (Id.).[27] Therefore, our forecasts are superior to Con Edison's forecasts. Furthermore, as we explained in our initial brief, Staff's forecasts for the number of SC 2 and SC 7 customers reflect both the long and the short term trends, but Con Edison's forecasts only reflect the short-term trends (Staff Initial Brief, p. 103).[28]

2. Personal Income Variable

Regarding the personal income variable, Con Edison concedes that a personal income variable should be included in the SC 1 model, but rejects it, claiming there are data errors in the personal income estimate (Company Initial Brief, pp. 298-299). We have already explained that our data estimate was provided by credible resources and relied on standard methodologies (Staff Initial Brief, pp. 91-92). Moreover, quarterly patterns in personal income should not result in errors in the estimate of the annual total sales

[27] The actual numbers of SC 7 customers were 16,884 and 16,946 for the first and second quarters of 2007, respectively. Staff's forecasts are nearly the actuals for the first two quarters of 2007 (a difference of only one and two customers, respectively). In contrast, Con Edison's forecasts are below the actual by 200 and 297 customers for the first and second quarters of 2007.

[28] Con Edison's objection to our forecast of the number of SC 1 customers should also be dismissed (Staff Initial Brief, pp. 103-105).

volume, so long as the annual personal income data are estimate accurately. The estimate of the annual total revenue is what matters in determining a sales forecast.

3. <u>2005-2006 Dummy Variable and Appliance Saturation Levels</u>

Con Edison claims that Dr. Liu's interpretation of the absence of the dummy variable from the other SC models "fails to consider the fact that the response of sales volume to weather varies across different service classes (Con Edison Initial Brief, p. 300)." The Company's allegation is unfounded and not supported by the record. Dr. Liu was aware of the differences in sales response to weather across Service Classes and fully considered in his analysis the impact of appliance saturation.[29] The difference in the response of sales volume to weather is reflected by the weather coefficients in each of the SC models.

Furthermore, in the context of the daily sendout analysis, the difference in the level of the responsiveness of SC 1 customers to changes in weather further invalidates inclusion of the dummy variable. The total sendout to CDD relationship Con Edison claims is not reflected in the SC 1

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[29] Most of the other SC models are more properly specified by including an economic variable so they better reflect the sales impact of appliance saturations without including the dummy variable used in SC 1.

model. The higher responsiveness in SC 1 sales to weather suggests a steeper slope for SC 1 in 2004. Con Edison's attribution of the change in the total sendout-CDD slopes in 2005 and 2006 to SC 1 demand *could hold only* if the responsiveness of SC 1 customers and the rest of the Con Edison system to CDD changes were assumed to be the same in 2004.

4. <u>Appliance Saturation Levels</u>

As to appliance saturation levels, Con Edison either ignores or refuses to recognize the connection between the level of the responsiveness to weather changes and the changes in appliance additions, calling Dr. Liu's explanation of appliance saturation implication "a leap of faith" (Company Initial Brief, p. 302). The Company's argument should be rejected. As we explained in our Initial Brief, Dr. Liu's conclusion is based on strong evidence: (1) the rates of appliance additions were higher in 2005 and 2006 (Staff Initial Brief, pp. 96-98); (2) the level of the SC 1 responsiveness to weather did not go down in 2006 when the model was estimated using the data through 2005 (Staff Initial Brief, p. 99); (3) the higher level of responsiveness to weather changes remained in the third quarter of 2007 (Staff Initial Brief, pp. 99-100); and (4) on a weather normalized basis, per customer sales grew at a rate of 6% in 2006 and 2007 (substantially higher than the 1.3% captured by the model over the historical period) (Staff Initial Brief, p. 98).

The Company also argues that Dr. Liu has not shown that the increase in the saturation rate in recent years was any higher than the average growth rate that was captured in the model (Company Initial Brief, p. 303). Yet again, the record shows otherwise. As we explained in our Initial Brief, the average growth rate captured in the model is only 1.3%, whereas the actual annual rates of the change in the weather normalized sales for the third quarter of 2006 and 2007 were both around 6% (Staff Initial Brief, p. 98, Tr. 618, Lns. 11-21; Tr. 619 Ln. 4 - Tr. 620, Ln. 3).

The rest of the Company's arguments on appliance saturation levels have been thoroughly addressed in our Initial Brief. Two facts support Staff's recommendation to remove the dummy variable from the 2005 and 2006 SC 1 models. The first is that the appliance saturation data shows a surge in saturation rates in 2005 and 2006 (Staff Initial Brief, pp. 97-98). Second, the actual data for the third quarter of 2007 shows that elevated sales response to weather remained elevated in a normal weather period (Staff Initial Brief, pp. 99-100).

There is no evidence to support Con Edison's dummy variable approach and no data provided in this proceeding indicates that the Company's assumption that the impact captured by its dummy variable is temporary in nature (Staff Initial Brief, pp. 93-101). Therefore, the Company's dummy variable approach should be rejected. The removal of the dummy variable, along with Staff's other adjustments, results in an increase of 220 GWHs to the total sales volume forecasted by the Company.

On the other hand, if the dummy variable approach is accepted, the only way to produce an accurate sales volume forecast is to change the forecast of the dummy variable from 0 to 1 for the third quarters of 2007 and beyond. With such a change, the impact captured by the dummy variable will be assumed to remain permanent throughout the forecast. This alternative would actually result in an increase of 234 GWHs in sales volume for SC 1 alone, resulting in a total adjustment greater than Staff's 220 GWHs adjustment (Staff Initial Brief, p.100, footnote 35)). Such an approach, although less conservative than Staff's, could be adopted by the Commission because it would be consistent with our analysis that shows that the impact captured by the dummy variable was a result of the surge in appliance saturations in 2005 and 2006 and has permanently elevated the level of the responsiveness of sales volume to weather.

5. Increase to Cooling Degree Days in non-Summer Months

Con Edison attempts to justify its calculation of normal CDD levels by arguing for the need to smooth daily observations of CDD to track cooling activities (Company Initial Brief, pp. 305-306). As we explained in our Initial Brief, smoothing daily CDD is irrelevant to forecasting total CDD for the month or quarter (Staff Initial Brief, p. 102). Since Con Edison used CDD for all months of the year to develop its forecasting models, it must include the 30-year average CDD for all months of the year to develop the normal weather in order to produce an unbiased forecast (Id.). Otherwise, the sales volume forecast will be understated.

Con Edison's Forecasting Panel does not seem to fully understand Staff's estimate of the normal CDD. In its initial brief, Con Edison states that Staff included "normal CDDs in the months of April, May, November, and December" (Company Initial Brief, pp. 297, 305-306). The Company is wrong. CDD in May through October were already included by Con Edison in its estimate of normal level of CDD. Staff only included CDDs of all other months to the estimate of annual level of CDD (Tr. 3904, Ln. 17 - Tr. 3905, Ln. 2).

In conclusion, Con Edison's arguments against Staff's sales forecast adjustments are misleading, wrong or not credible. All of Staff's adjustments to Con Edison's sales volume forecast are justified, well supported by the record, and should be adopted.

H. Cost of Capital

Con Edison's initial brief on the cost of capital is flawed on many levels. Statements which were shown to be incorrect during cross examination are repeated as fact, Commission precedent is ignored, misleading statements are used to bolster arguments, and data which has been shown to be flawed continues to be relied on by the Company in misleading ways.

1. Capital Structure

The Company again states that its use of stand-alone capitalization (as opposed to use of a consolidated capital structure) when setting rates "conforms with recent Company rate plans (Company Initial Brief, p. 254)." This assertion is made despite the fact that Mr. Hoglund agreed on redirect that the capital structure ratios used in recent Company rate cases were part of joint proposals approved by the Commission (Tr. 2978, Lns. 5-8).

Furthermore, the fact that an earnings sharing mechanism uses an actual stand-alone capital structure does not mean that rates were set based on such a capital structure (Company Initial Brief, p. 254). Surely, the Company understands these facts, and yet it persists in mischaracterizing the significance of elements that are the practical application of orders adopting multi-year joint proposals.

The same misleading approach is applied when the Company cites the National Grid/KeySpan merger proceeding as showing that Staff and the Commission adopted a position contrary to Staff's testimony in this proceeding. We pointed out, the capital structure approved in the National Grid/KeySpan merger was but one part of a joint proposal approved by the Commission (Staff Initial Brief, p. 108). Staff has also explained that long-standing Commission precedent is to use a consolidated capital structure and adjust it to reflect reasonable levels of debt and equity for non-utility operations (Staff Initial Brief, pp. 108-109).

The Company has also repeated the incorrect assertion that "Staff incorrectly assumes that the equity and debt in the non-regulated portion of CEI's business will not change from the levels at June 30, 2007" (Company Initial Brief,

p. 256). This statement is made despite the fact that Company witness Hoglund acknowledged under cross examination that Staff's non-regulated adjustment would change dramatically should the non-regulated activities be funded differently (Tr. 2951-2952). Should the Con Edison finance its non-utility operations with levels of equity that would support an A-rating, Staff's adjustment would be eliminated.

We are disappointed that the Company ignores the record in this proceeding and continues to repeat erroneous and misleading statements.

2. Return on Equity

Con Edison's use of misleading statements and incorrect data is also present throughout its discussion of return on equity. In our direct testimony, we calculated a Return on Equity (ROE) of 8.85% and rounded the result up to 8.9% (Tr. 3754, ln. 21). The Company's contention that Staff's result was 8.95% and was then rounded down to the 8.9% recommended level (Company Initial Brief, p. 260), seems intended create the erroneous impression that Staff rounds numbers down when they should be rounded up.

The Company states that Staff's ROE recommendation is more than 200 basis points below the authorized returns of the companies in Staff's proxy group (Company Initial

Brief, p. 260). This statement is based on the analysis by Dr. Morin that the average "recently authorized" ROE for that group of companies is 11.1% (Company Initial Brief, pp. 278-279). This analysis uses data from AUS Utility Reports and was first used in Dr. Morin's rebuttal testimony (Tr. 2666A-12). Our cross examination of Dr. Morin, elicited that the underlying data was inaccurate, stale, and not reasonably comparable to the circumstances of this rate proceeding (Tr. 2668-2674). Additionally, indications of what other are allowing in returns are not an indication of the correctness and discipline behind those allowances.

Staff demonstrated that the AUS Utility Reports data for Con Edison was flawed for many reasons: one of the returns was set in 1994 and many of the returns were set in 2004 or earlier; that sharing thresholds were used as "allowed" ROEs; that many of the returns were for multi-year rate plans (and thus would reflect a stay-out premium); that the companies in the proxy group are riskier than Con Edison; and that almost none of the companies in the proxy group employed a RDM for their electric operations (Staff Initial Brief, pp. 154-156). Once again, the Company ignores the actual evidence in the record since it discredits their data.

In discussing the DCF methodology, the Company repeats unsupported claims that "it is widely expected that utilities will continue to lower their dividend payout ratio over the next several years" (Company Initial Brief, p. 264). As we have pointed out, Dr. Morin has been asked to provide proof of such claimed expectations, and he has provided none. In addition, Dr. Morin states that he is even unaware of Con Edison's future dividend policy (Staff Initial Brief, p. 123-124).

The Company has also chosen to ignore clear Commission precedent regarding several ROE methodology topics. The weighting of the various equity costing methodologies has been decided by the Commission as two-thirds DCF, one-third CAPM repeatedly in litigated cases. The Commission has also repeatedly decided in favor of using an annual dividend approach with the DCF methodology as opposed to a quarterly dividend approach (Staff Initial Brief, p. 129), and the Commission has repeatedly decided in favor of a six-month stock price period rather than the spot price (Staff Initial Brief, p. 128).

Another area where misleading statements are made by Con Edison in its initial brief relates to the application of market-derived return estimates to book values. The Company cites Dr. Morin's concerns regarding over-reliance on the DCF methodology when market-to-book ratios exceed 1.0 as proof of his concern with applying market-derived ROE estimates to book values. Under cross examination, Dr. Morin readily admitted that "it is universal practice" to apply market-derived returns to book values (Tr. 2694, Lns. 16-17). He also stated that it was a reasonable way to set fair and reasonable rates (Tr. 2694, Lns. 18-23). The Company also used this methodology, as it has for several decades (Tr. 2693, Lns. 12-21).

There appears to be an attempt to use Dr. Morin's concerns regarding the reliance on the DCF methodology to question the practice of applying market-based returns to book values, a practice he finds to be both reasonable and universal. The Company has actually tried to evolve its case into a plea to abandon historical book value rate base regulation into a plea for having rates set on market value. This was not the basis for the initial filing, and as Staff responded during cross examination, it would result in upward and downward spirals (Tr. 3782, Lns. 10-24).

The Company has also used its initial brief to introduce new testimony on the topic of above-book market values. In footnote 163 on page 268, the Company introduces the views of Dr. Alfred Kahn. While the attempt to add such information to the record at this time is inappropriate, Staff notes that the Company has also chosen to ignore Dr. Kahn's concluding remarks on the subject.

On page 50 of The Economics of Regulation: Principles and Institutions, Volume I (1971), Dr. Kahn states that the fact that market values have remained above book values "indicates that in most jurisdictions r (returns on equity) has been high enough, relative to *k* (cost of capital), so that its application to the lower book value, in determining allowable earnings, has not destroyed the willingness of investors to continue to pay above book value for public utility company shares."

In other words, the allowed ROEs, set using market-based data, have been applied to book values and investors still have felt that the allowed return exceeds to cost of capital, as seen by the market-to-book ratios in excess of 1.0. Staff addressed this fact in responding to a question from the bench during the evidentiary hearing (Tr. 3783).

The Company is also misleading in its statement that Dr. Morin has found "no evidence that the market price of risk or the amount of risk in common stocks has changed over time", using such a statement to bolster the use of the Company's risk premium approach (Company Initial Brief, p. 273). As Staff stated in its direct testimony, Dr.

Morin has offered no studies or analyses to determine the extent to which Con Edison is more or less risky than his utility proxy group, and no studies or analyses have been offered to show that Treasury yields have remained at the same level of risk relative to electric utility stocks (Tr. 3758-3759).

Under cross examination, Dr. Morin was asked specifically what studies he has performed to investigate such risk levels or any changes to them, and he never answered the question despite Staff counsel providing him three opportunities to provide an answer to that question (Tr. 2688, Ln. 22 through 2691, Ln. 2). Of course, Con Edison can state that he has found no evidence that the market price of risk has changed over time because he has not studied it (Company Initial Brief, p. 273).

In its initial brief, Con Edison has made misleading statements and comparisons concerning the adjustments Staff has proposed to make to the proxy group ROE to account for the differences between Con Edison electric and the proxy group. The Company adjusts its debt cost by the equity return credit quality adjustment proposed by Staff (Company Initial Brief, p. 276). This is a very peculiar thing to do, given that Dr. Morin has acknowledged under cross examination that the adjustment is "an adjustment to the equity return and not an adjustment to the bond return" (Tr. 2681, Lns. 8-10).

It is a common understanding that the higher the level of risk an investment carries, the higher the return requirement of investors will be. Dr. Morin acknowledges this in his direct testimony (Tr. 2580, Lns. 17-22). He also states under cross examination, "it's well proven in finance that the relationship between risk and return is a linear one." (Tr. 2681, Lns. 10-12) Bondholders require a higher return for higher risk. This can be seen in Exhibit 358, which shows that debt investors currently require approximately 25 basis points of extra return to invest in bonds that are rated "Baa" (equivalent of "BBB") as compared to bonds that are "A" rated (a three-notch credit rating difference) (Exh. 358).

Staff's proxy group, as well as Dr. Morin's, is obviously riskier than Con Edison's electric operations. Staff's proxy group has a BBB/BBB+ average rating and an average business profile score of "5". Con Edison is A/A+ rated and has a business profile score of "2" (Staff Initial Brief, p. 147). Given that "shareholders are at the bottom of the food chain" when it comes to receiving a return on their investment, according to Dr. Morin, it follows that shareholders would require an even greater premium to invest in a riskier stock (Tr. 2682, Lns. 11-12).

Staff has calculated that investors would require a 29 basis point increase in return to invest in the riskier proxy group as opposed to Con Edison electric (Staff Initial Brief, p. 148). This is similar to the 25 basis point return requirement demanded by debt investors for a three-notch credit rating difference discussed earlier.[30]

Oddly, however, Con Edison takes this adjustment, meant to measure the equity return difference between BBB/BBB+ and A/A+ companies, and deducts it from the Company's debt cost to show that it would lower its debt costs to those of a "AA" company.

Con Edison also makes misleading statements in its initial brief when discussing Staff's proposed adjustment to account for the risk reduction provided by Staff's proposed RDM. The Company states that the proposed RDM "serves to deprive equity investors of the primary source of any upside potential" (Company Initial Brief, p. 277). The Company also states that the RDM proposal introduces risk in that the Commission may deny the Company timely

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[30] We note that Dr. Morin proposed a 20 basis point credit quality adjustment to his proxy group in Orange and Rockland Utilities, Inc.'s current electric rate case, Case 07-E-0949.

recovery of deferred balances (Company Initial Brief, p. 277). The Company is erroneous on both counts.

The Company acknowledged that the risk of weather fluctuations is seen by investors as being symmetrical (Tr. 2953, Lns. 11-15). The possibility that earnings may be constrained due to the RDM proposal is exactly equal to the possibility that earnings shortfalls due to cooler-than-normal weather will be recovered under the RDM. The RDM proposal simply lessens the volatility of earnings. This decrease in volatility is a further decrease in the risk profile of the Company relative to the proxy group, where RDM's for electric utilities are rare (Staff Initial Brief, p. 151).

The allegation that the Commission may deny the Company timely recovery of any deferred balance which may accumulate is a red herring and should be ignored. The Company has provided no evidence that this is a concern of investors. The Commission has a long history of allowing recovery of deferred costs and investors would have no reason to doubt that such recoveries, if any, resulting from the RDM mechanism would also be promptly recovered by the Company.

I. Depreciation

In its brief the Company states that the Commission should reject Staff's proposed average service lives and net salvage changes (Company Initial Brief, p. 287). For various reasons, Staff's proposed depreciation parameters should be accepted by the Commission and those being proposed by the Company should be rejected.

1. Average Service Life Selections

Concerning Account 9514 - Structures and Improvements and Account 9526 - Miscellaneous Power Plant Equipment, the Company states in its brief that Mr. Hutcheson relied primarily on current plant mortality studies in developing his recommended depreciation parameters (Company Initial Brief, p. 286). In fact, Mr. Hutcheson stated the he based his analysis on a single current study only (Tr. 693). Thus, by his own admission, when developing his recommended depreciation parameters, Mr. Hutcheson did not consider other factors such as changes in operating procedures, changes in accounting procedures, labor costs, equipment replacement programs, requirements of governmental authorities, obsolescence and technological changes. Mr. Hutcheson conceded, however, that he considered the foregoing factors to be appropriate to rely on in the Company's previous electric filing, Case 04-E-0572, and that he did, in that case, rely, at least in part, on those other factors (Tr. 725-726). Staff recommends rejecting to Company's proposed depreciation parameters for these two accounts and supports those developed by Staff Witness Rieder (Exh. 270). As noted in his testimony, Mr. Rieder did not exclusively rely on only one study, but rather used that as a single tool, among other factors, to develop his recommended depreciation parameters (Tr. 3928-3929).

Further, Mr. Rieder's analysis fully supports Staff's proposed service lives. Specifically, for Account 9514 - Structures and Improvements, Mr. Rieder agreed that the average service life for this account should be shortened, but not by 25 years as proposed by the Company. When Mr. Rieder compared the current (2005) study results with the 2002 study, as filed in Case 04-E-0572, his interpretation of the 2002 study was that the shrinking band had the 2nd degree as best fit with the widest band at 54 years, well in excess of the Company's proposed 40 year life. Recognizing that lower service lives were largely due to the divestiture of production plants and the transfers from Electric Plant to Steam Plant of the 59th, 74th, and Hudson Ave. stations, Mr. Rieder agreed to the Company's proposal in Case 04-E-0572 to only decrease the life by a minimum amount due to the material impacts of the station transfers and divestiture. Mr. Hutcheson provided no reason in his initial or rebuttal testimony to significantly deviate from the approach taken in Case 04-E-0572, which contributed to Mr. Rieder recommending a decrease to this account's average service life by 10 years, rather than 5 years as done in the last electric rate case, or 25 years as recommended by the Company (Tr. 3930-3932).

Based on the study results and comparing the current study with the 2002 study for Account 9526 - Miscellaneous Power Equipment, Mr. Rieder agreed the average service life should be shortened, but by only 5 years and not by 10 years as proposed by the Company. The 2002 study had the 3rd degree as best fit with the widest band at 81 years. A downward trend was apparent to 48 years but then reversed upward. Mr. Rieder agreed that the then current use of a 50-year average service life was appropriate in light of the plant transfers and divestiture, rather than increasing the average service life as would have been otherwise appropriate based on the study results alone. When considering the 2002 study results in combination with the results of the current study, Mr. Rieder concluded that a decrease of 10 years would be too aggressive. While recognizing the lower lives suggested by the current studies, he recommend a less severe decrease of only 5 years (Tr. 3932-3934).

Regarding the other accounts with which Mr. Rieder's recommended average service lives differ from that of Mr. Hutcheson, the Company's brief does nothing but reiterate the rebuttal testimony provided by Mr. Hutcheson. As provided in his original testimony, Mr. Rieder's analysis fully supports his recommended average service lives. For Account 9534 - Station Equipment, Mr. Hutcheson proposed that the average service life be shortened from 50 years to 45 years. Based on his interpretation of the study results, Mr. Rieder concluded that this move was premature and proposed that the average service life remain at 50 years. The rolling bands show that the 1st degree is best fit with only one of the 10 most recent bands below the current 50-year average service life. For the shrinking bands, the 3rd degree is best fit but is not materially different from the other degrees. The 1st degree has all bands fitting, and the 2nd and 3rd degrees have all but the most recent bands fitting. The widest bands are at 53 years, 52 years, and 46 years, respectively, and show a relatively flat trend. The 2002 study shrinking bands indicate that the 3rd degree is best fit, but, it is not materially different than the 1st or 2nd degree. The widest bands average service lives range from 44 years to 49 years to 53 years for 3rd, 2nd, and 1st degrees, respectively. Based on the 2005 study indications showing an increase in the average service lives when compared to the 2002 study, the relatively flat trends within each study, and the relatively close fit indices for the various degrees, each showing average service lives near the current 50-year level, Mr. Rieder disagreed with the Company proposal to move toward a lower life and recommends the Commission reject the Company's proposal, as well (Tr. 3934-3935)

Mr. Hutcheson also proposed to prematurely lower the average service life from 35 years to 30 years for the sub-account 9565 - Line Transformers - Overhead. For this sub-account the rolling bands indicate the 1st degree as best fit with all bands fitting. The most recent bands range between 27 years and 35 years with a slight downward trend. The shrinking bands show the 1st degree as best fit, by default, with all bands fitting. The widest band is at 34 years with varying trends, and all but the most recent band is between 30 years and 35 years. The 2002 study shrinking band also had the 1st degree as best fit with its widest band at 34 years. Consistent with the 2002 study, the 2005 study continues to indicate that 35 years is an appropriate average service life. Because the lower indicated life from the current study, 34 years, is only slightly lower than the current 35-year average service life employed by the Company and higher than the 30-year life proposed, Mr. Rieder concluded that it would be premature to change the current average service life of 35 years (Tr. 3935-3936).

For Account 9567 - Services - Underground, Mr. Rieder proposed an increase to that average service life from 70 years to 75 years. Rolling bands indicate the 2^{nd} degree as best fit with most recent bands ranging from 82 years to 101 years. The 1^{st} degree is not materially different with the most recent bands ranging from 104 years to 140 years. The shrinking bands indicate a trend toward longer service lives, except for the most recent bands, with the 2^{nd} degree being the best fit and not materially different than the 1^{st} degree. The 2^{nd} degree widest band is at 81 years and all bands are over Mr. Rieder's proposed 75 years. The 1^{st} degree widest band is 86 years, with all bands over 80 years. The 2002 study shrinking bands had the 1^{st} and 2^{nd} degrees with similar fits with widest bands at 83 years and 79 years, respectively. Except for very recent trend toward slightly shorter average service lives, which are still longer than Mr. Rieder's proposed 75 years, all indications, including comparisons with the 2002 study, show that an increase is appropriate (Tr. 3937-3938).

Thus, the Commission should accept Staff's proposed average service life for this account.

Mr. Rieder also proposed that the average service life for Account 9576 - Underground Street Lighting & Signal Systems be increased from 65 years to 70 years. The rolling bands indicate the 1st degree has all most recent bands fitting with live in excess of 135 years. The 2nd degree has all but two most recent bands fitting with lives in excess of 87 years. The shrinking bands indicate the 1st degree is best fit, by default, with all bands fitting and the widest band at 84 years. The trend is toward longer lives until the most recent bands where it begins to reverse. The most recent band is 71 years. The 2002 study had the 1st degree as best fit, by default, the widest band at 81 years, and a trend toward longer lives with the most recent bands ranging between 177 and 282 years. Mr. Rieder recommended a conservative 5-year service life increase for this account instead of the 10 years or 15 years indicated by the study results, primarily because of the amount of anticipated retirement and replacement work that was expected to be done on the underground infrastructure, which would tend to hold down the lives. The current study's most recent trend actually supports that conclusion and, therefore, he recommended only a modest service life increase of 5 years, which should be accepted by the Commission (Tr. 3938-3939).

2. Net Salvage Factors

Similar to its treatment of average salvage lives, the Company's brief does nothing but reiterate the rebuttal testimony of Mr. Hutcheson when addressing the two contested net salvage factors. Again, Mr. Rieder's analysis fully supports this recommended net salvage factors (Tr. 3939-3942), which, as noted by the Company in its brief, were based on sound statistical studies (Company Initial Brief, p. 291). For Account 9534 - Station Equipment, Mr. Rieder recommended that the net salvage factor be increased by 5% rather than 10% as proposed. The most recent one-year bands and shrinking bands suggest a trend toward higher negative salvage percentages. However, the full experience band and 5-year bands support only a slight increase at this time from the current negative 20% net salvage value. The full-experience band is 26.58% negative and the 5-year band has varying trends. For these reasons, Mr. Rieder proposed the net salvage factor be increased from negative 20% to negative 25%, which should be accepted by the Commission (Tr. 3941-3942).

For Account 9554 - Station Equipment, Mr. Rieder proposed that the net salvage factor be increased by 5%

rather than 10% as proposed by the Company. The study indicates a slight trend toward higher negative percentages and the most recent 5-year bands are all above current percentages. However, the Full Experience Percentage is only 28.56% negative and only three most recent shrinking bands are over 25% negative. Thus, only a modest increase from 20% negative to 25% negative is warranted and should be accepted by the Commission (Tr. 3942)

III. INFRASTRUCTURE INVESTMENT

A. Review of the Company's Past T&D Infrastructure Investment

The initial briefs of the Consumer Protection Board (CPB) and the County of Westchester include comments regarding the level of Staff review that was performed on the Company's T&D infrastructure investments made under the current rate plan as well as those proposed by the Company in this case. In its brief on Page 24, CPB states that "neither DPS Staff, nor any other party in this proceeding, conducted an effective evaluation, audit or prudence review of the T&D capital expenditures made during the current rate plan." As described during cross examination of the Staff Infrastructure Investment Panel (Tr. 4101, 4106-4109), and in our initial brief (Pg. 163-169), and again detailed below, Staff has conducted a thorough evaluation of the Company's on-going T&D expenditures and therefore CPB's statement has no basis and should be rejected.

It is clear that the level of investment undertaken by the Company during the last three years has been very high relative to historic levels. However, following an extensive review of the budget presented in Case 04-E-0572 (Case 04-E-0572, Staff's Infrastructure Panel direct testimony), including hundreds of multi-part information requests (Case 04-E-0572, Staff's Infrastructure Panel direct testimony, Exhibit IP-1) as well as face-to-face meetings, Staff found the specific projects and overall direction that the Company's infrastructure investment program was taking to be reasonable and necessary. Under the current rate plan, the Company was allowed to defer the carrying charges on net plant that was added above and beyond the net plant addition targets included in the Joint Proposal. This deferral mechanism was put in place by the Commission to address two primary Staff concerns. First, Staff was concerned that the Company might not be able to complete the amount of T&D investment at the level and on the schedule that was forecasted in Case 04-E-0572, and wanted to protect ratepayers from having to pay Company shareholders for incremental carrying charges collected in rates on projects that were funded but never completed or undertaken. Second, the deferral mechanism was intended to provide the Company with the proper incentive necessary to undertake appropriate T&D projects if it was capable of completing them during the term of the rate plan. As the term of the rate plan progressed, the Company demonstrated that it was able to complete a higher level of T&D investment than Staff's baseline position taken in the rate case and reflected in the Joint Proposal. The fact that the Company was able to perform at a much higher level became evident to Staff early in the first rate year as a result of its ongoing meetings and interactions with the Company on T&D infrastructure investment.

As summarized in Exhibit 338, Staff held formal meetings with the Company on numerous occasions during which the Company's T&D infrastructure projects were discussed. It is important to note that the review and interaction that took place at these meetings was only a portion of Staff's review of the Company's T&D infrastructure programs. Staff had continuous interaction with Company personnel prior to and after the meetings through phone conversations, email, and other written correspondence to obtain a complete understanding of the projects and programs. In addition, Staff made visits to substations under construction, construction sites to monitor specific projects such as the replacement of direct buried cable in Staten Island (an outgrowth of failures in 2005), and shadowed Company personnel performing stray voltage testing and inspections as required by the Commission's Electric Safety Standards. This ongoing interaction was necessary in order to fully understand the factors causing the growing need for infrastructure investments.

As required in Case 04-E-0572, the Company submitted to Staff and all parties detailed annual reports submitted as Exhibits 141, 142, and 143 in this proceeding that updated the Company's T&D budget forecasts for the ensuing year, and provided detailed reconciliations of the Company's actual and forecasted expenditures for the prior year. Although these reports were formal filings, they too were not the sole source of information used by Staff in its ongoing review of the Company's T&D investments. Staff's ongoing review during the three year rate period included a multitude of informal data and information exchanges, site visits as well as an ongoing review of the Company's 10 year project horizon and 10 year growth analyses. This provided, and continues to provide, Staff with a complete picture as to the need for the significant

T&D investment program currently in progress at the Company.

The annual reports (Exhibits 141, 142 and 143) provided the current status, estimated dates of completion, and costs expended to date for ongoing projects. In addition, the Company's reports provided a detailed explanation and justification for those expenditures that varied by more than fifteen percent from the forecasted budget. For those projects not previously identified by the Company in the original rate case filing, the Company provided detailed project descriptions, justification of the need for the projects, cash flow requirements from inception through completion, an explanation of how the cost figures were derived, and supporting work papers and other back-up materials.

Staff's periodic budget reviews with the Company were an iterative process. (Tr. 4107) At each of these reviews, Staff and the Company discussed changes that had taken place in the budget and actual expenditures from its previous meeting. Each of these meetings would address:

- The budget, actual expenditures, and project status of all major transmission, substation, and distribution projects;
- Significant budget changes (both increased and decreased) from the previous meeting;
- Significant deviations in expenditures (both increased and decreased) versus the budget forecast;

- The current ten year load growth projection;
- Schedules and expenditures for all new substations on the ten year horizon;
- Progress on all key projects; and
- Periodically reassess the five year budget plan.

As detailed in the annual reports, (Exhibits 141, 142 and 143) the upward and downward changes to the Company's T&D budgets and actual expenditures were due to several factors such as increasing costs of materials; increasing cost of land; land acquisition delays; increased interference costs; permitting delays; the Company's ability to actually do more than anticipated; and higher than expected load forecasts, pushing up actual need dates of various projects. In addition, there were a number of Commission orders in other proceedings, such as Case 04-M-0159 concerning statewide safety standards and Case 06-E-0894 concerning the Company's Long Island City Outage, which required increased investments in certain areas.

Specific examples of major projects and programs for which Exhibits 141, 142 and 143 provide detail on how the Company's actual expenditures differed from what was forecast during the term of the current rate plan are; the feeder and transformer load relief program, the secondary burnout replacement and secondary reliability programs, technology enhancements, the over-duty circuit breaker replacement program, the paper insulated lead covered

(PILC) cable replacement program, and major transmission projects. The purpose, need, and timing of the Company's expenditures on these projects and programs were fully reviewed and supported by Staff and/or were in compliance with explicit Commission directives issued during the term of the current rate plan. In addition, some of these projects and programs were discussed in Staff's Infrastructure Panel direct testimony in case 04-E-0572. A summary of the purpose, need and timing of the Company's expenditures on these projects and programs is as follows.

1. <u>Feeder and Transformer Load Relief</u>

At the end of each summer load period, the Company performs an analysis to determine those primary distribution feeders and associated equipment that would be overloaded in the following summer based on then-current projected growth forecasts. This analysis is essential to ensuring that the Company's system is upgraded to meet its design criteria. In the spring of each year, Staff receives a periodic progress report of the Company's efforts to meet these load criteria. During the term of the current rate plan, the Company experienced levels of new business due to economic load growth that was above forecasted levels. This required the Company to perform more than expected feeder load relief including load transfers to other substations.

2. Secondary Burnout Replacement and Secondary Reliability Programs

Secondary burnouts are failures in secondary cable caused by a variety of factors, but most notably cable insulation deterioration, which results in a fault condition. Increases in secondary burnouts are often associated with periods of high loads (i.e., extended heat spells in the summer) and high levels of salt usage. During the term of the current rate plan, the Company experienced record level summer peak loads and a severe winter season that resulted in the increased spreading of salt. Both of these circumstances resulted in the Company spending significantly more dollars for the secondary burnout replacement program than originally forecast.

While Staff recognizes that secondary burnouts occur, it has urged the Company to be more proactive in trying to prevent secondary burnouts. The Company has instituted a secondary reliability program during the current rate plan that is aimed at doing just that. This is a preventative program that identifies cable that may be on the verge of failure and maintains service boxes to remove conditions that accelerate cable deterioration.

The secondary reliability program is an outgrowth of the Commission's Electric Safety Standards order which requires the Company to inspect each of its facilities once every five years. Staff has encouraged the Company to increase expenditures on the secondary reliability program over the past three years and to better account for such expenditures. Staff believes that the secondary reliability program will ultimately reduce the number of burnouts and manhole events over time. This is a major effort that covers approximately 170,000 service boxes throughout the Con Edison system.

3. <u>Technology Enhancements</u>

The Company invested in several technology enhancement projects in response to Commission orders. For example, the Company began implementation of the 3rd generation Remote Monitoring System (RMS) transmitters and receivers and expanded the System Trouble Analysis and Response (STAR) program.

4. <u>Over-Duty Circuit Breaker Replacement</u>

This program is essential to facilitating the deployment of more distributed generation in the Company's service territory. Replacement of over-duty circuit breakers has been a Commission priority for a number of years. The Company has been able to replace over-duty circuit breakers at a faster rate than the Company originally forecasted during the term of the rate plan.

5. PILC Cable Replacement

PILC cable has been identified as a Con Edison system weakness in Staff's Washington Heights investigation report. Over the past few years, Staff has worked closely with the company to improve the accounting for PILC cable replacement, including identifying PILC cable replaced as part of the feeder load relief program. As such, the PILC cable replacement program is much more defined and Staff can better monitor expenditures and progress.

6. Transmission

In the transmission area, Staff examined the delays in significant transmission and substation projects and the consequent below-budget expenditures for those projects. Additionally Staff examined the projects that are planned to meet changes in the supply and demand outlook including the projected closing of the old Poletti generating unit.

Staff also had meetings with Con Edison engineers to review measures being taken to reduce the probability of 345 kV transmission cable faults and to update system protection equipment to protect system equipment without false circuit breaker operations that remove transmission lines.

B. Review of the Company's Projected T&D Infrastructure Investment

On Page 14 of its brief the CPB states that "parties and the Commission do not have the benefit of a recent independent assessment of Con Edison's construction program planning in relation to the needs of its customers for reliable service, or any reasonable substitute for such an investigation" and that "given Con Edison's incentives and the general absence of proper oversight of its capital expenditures, it is reasonable to conclude that Con Edison's projected T&D capital spending is overstated." These conclusions are without merit and should be rejected.

On Page 18 of its initial brief, CPB is again critical of Staff's review of the projected T&D expenditures. It states that Staff's analysis "does not assess whether the spending in the historical period was actually necessary and conducted in a highly cost effective manner. Further, even where actual spending was found to be close to budget in historical periods, it cannot be concluded that spending on that project should continue, or increase, as the Company and DPS Staff often propose." These criticisms should be rejected. Staff's review of the projected T&D expenditures in the current rate case was a continuation of what it had already been doing for the prior three years, with a focus on those projects and programs that were expected to be going into rate base during the rate year commencing April 1, 2008. The basis of this review and analysis was founded on the knowledge base developed during the term of the current rate plan combined with additional information obtained through hundreds of multi-part information requests (Exhibit 4058), face-to-face meetings, emails and telephone communications.

As detailed in Staff's testimony (Tr. 3984 - 4040) and initial brief, that review included; verification that the Company was on schedule to complete the projects and programs that had already been under way during the current rate plan; an analysis of the reasonableness of the total dollars being forecasted for existing and new projects and programs; and verifying the need for the proposed projects and programs.

The CPB states at Page 20 of its brief that "the PSC is faced with the consequences of more than a decade of inadequate oversight of Con Edison's capital expenditures, coupled with severe reliability problems in the Company's network in recent years, a request to recover $1.6 billion of overspending on capital projects in the last three years, and requests to spend approximately $2 billion per year on capital projects for the foreseeable future. In this predicament, for purposes of establishing rates for the year beginning April 1, 2008, the Commission should establish rates based on a forecast of T&D infrastructure spending that is lower than Con Edison's, primarily in recognition of the overwhelming record evidence that the Company's capital expenditure projection is exaggerated." This conclusion and recommendation should be rejected. Furthermore, at page 22 of its brief, referring to the Company's T&D expenditures, the CPB claims that "Con Edison does not have an appropriate incentive to conduct such spending in a cost effective manner, and there has not been a satisfactory review of the excess T&D capital expenditures." It then recommends that "the Commission should direct that the Company's T&D capital spending during the term of the current rate plan be carefully scrutinized in an open and transparent process." This recommendation should be rejected as well. As described earlier, Staff's review and oversight of the Company's T&D infrastructure spending over the term of the current rate plan as well as its review of the projected capital budget has been extensive and reasonable. Staff's review and oversight of the Company's T&D infrastructure planning and construction has been ongoing for years and is in no way limited to the review performed during the discovery phase of this proceeding. The Commission should adopt Staff's specific recommended adjustments to the Company's proposed T&D infrastructure budget and reject CPB's recommendations that are based on unsubstantiated assertions.

The CPB states at Page 7 of its brief that it testified that the PSC's oversight and regulation of Con Edison's infrastructure spending in the last decade has not been satisfactory and has not ensured that capital improvements are made in a cost effective manner or meet the needs of Con Edison's customers. Therefore, it concludes, the procedures used by the PSC to review Con Edison's construction program activities should be overhauled. This conclusion should also be rejected. CPB makes claims to the inadequacy of Staff's review in its initial brief when, in fact as stated by its owns Witness Elfner in cross examination, (Trans 4753, lines. 12- 20) the CPB did not submit any information requests to Staff asking for any list or descriptions of meetings or reviews of Con Edison's construction projects and budgets during the entire 3 month discovery phase of this case. This response raises serious questions as to just how CPB could reach the conclusion that Staff's oversight was inadequate. As described above, Staff performed an adequate review.

The CPB on Page 24 and 25 of its brief appears to reach the conclusion that Con Edison's T&D expenditures made during the current rate plan were not properly scrutinized since 1) Staff did not propose adjustments to recover the deferred amounts related to the investments made during the term of the rate plan; 2) Staff filed no formal report to the Commission; and 3) no public document was produced by DPS staff. This conclusion is without merit. Staff did not propose adjustments to the recovery of deferred carrying charge amounts related to investments made during the term of the current rate plan because it had no reason to based on its on-going review and assessment of those expenditures described earlier. The lack of adjustments does not equate to or infer that there was no review, as CPB would like us to believe. In regard to the comments on reporting, Staff is unaware of there being any requirement that it formally report findings of its review to the Commission.

Westchester County states in its brief at page 6 that "there was no indication that the Staff took any action to inform the Commission of the potential rate impact of the Company's actions or to inform the parties that it felt the excess spending was critically needed to provide safe and adequate service" when referring to Staff's review of the

Company's T&D capital spending over the last three years of the current rate plan. Staff and all parties in the proceeding that were served copies of the annual reports were informed of the levels of spending that the Company was incurring and as stated earlier, Staff is unaware of there being any requirement that it formally report findings of its review to the Commission. In addition, the Commission's order in Case 04-E-0572 recognized the potential rate impacts due to the deferral mechanism and adopted the provision in the Joint Proposal allowing the Company to offset such deferrals with available credits at the end of each rate year in order to limit those impacts.

That being noted, Staff did recommend adjustments to the Company's proposed budgets going forward. To the extent the Company has taken issue with Staff's adjustments in its initial brief, Staff's reply is discussed below.

1. <u>Street Light Isolation Transformer</u>

In its Initial Brief, Con Edison again takes issue with Staff's recommendation that the Company remain responsible for maintaining the isolation transformers (IT) that it proposes be placed in the Company's service boxes. Instead, the Company proposes that NYDOT become responsible for the maintenance of those transformers. The Company claims that requiring it to perform maintenance on the transformers would hamper Con Edison's operational activities, reducing the benefits of placing the transformer in the service box (Company Initial Brief, p.54). Because of its concern for public safety, Staff respectfully suggests that the Company's plans and procedures can be altered to accommodate maintaining the street light isolation transformers, and that the Company could also accommodate public activities such as street fairs to decrease the potential for exposure to possible stray voltage on sidewalks and streetlights.

Staff's recommendation regarding the IT remains as stated in the Initial Brief (pp. 191-193). Installing the IT in service boxes provides an increased level of safety and eliminates the need to coordinate work schedules with NYCDOT. Placing the IT in the base of the streetlight will not mitigate many of the serious stray voltage cases that are produced in the duct that runs from Con Edison's service box to the streetlight. By moving the location of the isolation transformer to the service box, it would provide increased protection to the public. Considering the significant amount of money required for this program, the significant amount of money saved from preventing Con Edison from responding to streetlight stray voltage reports, the opportunity to prevent practically all stray voltage cases associated with streetlights, and the long life span of the IT, the only reasonable option is to place the IT in service boxes.

2. Vented Manhole Cover

The Company disputes Staff's assertion that Con Edison is uncertain about the timing of completion of this program in 2008. Furthermore, Con Edison believes that Staff has not provided any analysis for the basis that the Company will not complete this program in 2008, therefore, Staff's adjustment should be denied. Staff's position related to the vented manhole cover program remains the same as expressed in our Initial Brief (pp. 193-194). The recommended funding level does not hinder the replacement of standard covers. The Company needs more time to properly prepare, plan, and replace the non-standard covers.

While the Company has not used the word "uncertainty" in its responses to information requests, the Company has failed to provide a consistent plan of action for these covers in DPS-302 and DPS-458 of Exhibit 273. Without the Company providing a sound plan of action, Staff finds that the Company should not rush to hastily install non-standard covers. The recommended reduction by Staff should be adopted.

3. Auto-loop Reliability

The Auto-loop Reliability program covers the splitting of seven auto-loops into 14 systems based on load growth. The program also consists of the enlargement of two auto-loops based on load (Tr. 1839, Lns. 8-19). Staff recommended reducing the Company's funding request from \$7.9 million to \$6 million, which will extend this program by one year (Tr. 4030, Ln. 13 to Tr. 4031, Ln. 2). Staff's analysis found that the actual historical expense was found to be lower than budgeted for 2004 to 2006 (Ex. 273, DPS-367 and DPS-466).

The Company states that the purpose of this project was to address load growth on the affected auto-loops and to remain in compliance with specifications. By reducing the funding, Auto-loops that have or are developing loads greater than allowed by the current specifications will not be addressed, thereby falling out of compliance with specification and jeopardizing service reliability to the customer (Tr. 1943, Ln. 18 to Tr. 1944, Ln. 11).

Con Edison's position that it has fallen out of compliance and will remain so if Staff's proposed 1 year extension is adopted (see Tr. 1943, Ln. 18 to Tr. 1944, Ln. 11), raises concern about how the Company chooses to spend its funds in general. The Company spent lower than what it had budgeted for this project during the time the Company maintains that the loops were becoming non-compliant, yet allowed them to fall out of compliance despite having more money budgeted to this program. Additionally, the Company had the opportunity under the existing rate plan to spend what was necessary to make the loops compliant, yet it did not do so.

Despite the foregoing, Staff believes that the Company should be able to complete the program in the one year extended time frame and recommends that its adjustment be adopted as appropriate.

4. Overhead Feeder Reliability

The Company's Initial Brief states that the Staff 2009 adjustment should be rejected since no mention was made regarding the reason for Staff's reduction to the overhead feeder reliability program (p. 58) Staff testimony cited by the Company is in reference to the rate year where the funding level of $450,000 was deemed appropriate and warranted. Testimony was not given by Staff in reference to the 2009 rate year. Thus, the Company's position is without merit as there was no 2009 adjustment made.

5. Over-Duty Circuit Breaker

Con Edison criticizes Staff's proposed revenue adjustment of $3 million for not replacing 60 breakers per year stating that it encourages the Company to focus on bulk breaker replacements instead of completing each substation with over-duty breakers (Company Initial Brief, pp. 360-62) Staff finds the Company's position meritless because the goal of the program is to install synchronous generators. Such generators can not be installed until all over-duty breakers in each substation are replaced. Thus, by setting the number of breakers to be replaced, Staff is addressing two concerns. The way in which the Company arrives at the replacement rate per year is in the control of Con Edison, and the Company has exhibited an ability to meet these numbers in the past. Additionally, Staff's mechanism does not hinder the Company from focusing on replacing all breakers that are over-duty in a substation. The Company's contention that the continuation of this penalty mechanism is counterproductive should be dismissed.

6. ATS Installation USS reliability XW

The Company's Initial Brief states that the Staff 2009 adjustment for this program should be rejected since no mention was made regarding the reason for the reduction. (pp. 61) Staff testimony is in reference to the rate year where the funding level of $1.05 million was deemed appropriate and warranted. Testimony was not given by Staff in reference to the 2009 rate year. Thus, the

Company's position is without merit as there was no 2009 adjustment made.

C. Operation and Maintenance

1. Sarnoff - Mobile Vehicle Program

Staff has made no recommendation for a reduction in the funding level for the use of the Sarnoff vehicle, although, in its initial testimony, Staff states that Con Edison should file a report: (Tr. 4045, Lns. 2 - 16)

1. reassessing the expenses of this program to reduce the costs associated with stray voltage cases found, especially as related to the program's standby cost; and

2. reassessing its current operation to optimize utilization of its current fleet of vehicles.

This is based on the standby cost accounting for 60% of the total funding requested and the frequency of vehicle usage (Exh. 273, DPS-327).

In the Company's Initial Brief, it states the report is unnecessary, the need and cost has been provided, additional details in the on-going Electric Safety Standards proceeding has been provided, and this justification in unduly burdensome (Company Initial Brief, p. 130).

Staff believes that if this additional information has been provided, then this report should not be burdensome. Although, if this was completed, the Company has had ample time to provide this information as proof or justify the way they have investigated other means to reduce cost or provide better benefits for the cost. Staff finds that this process is necessary to ensure the Company is utilizing their funds in the most efficient manner.

IV. COST OF SERVICE

A. ECOS

NYC at Page 34 of its brief states that "the testimony of City/MTA witness Dr. Alan Rosenberg, as well as Staff and NYPA witnesses, establishes that the ECOS is materially flawed and should not be relied upon in this proceeding." This statement may mischaracterize Staff's testimony regarding the company's ECOS. Staff provided specific recommendations in its testimony in regard to the ECOS but it did not state that the ECOS should not be relied upon. Rather, Staff proposed that it should be relied upon using a 15% tolerance band instead of the 10% as proposed by the Company (Tr. 4888).

B. TCC Revenues

Both the New York Power Authority (NYPA) and the County of Westchester (the County) comment in their briefs that the amount of Transmission Congestion Contract (TCC) revenue imputed in base rates that the company receives from the auction of its grandfathered TCCs should be increased to reflect more recent levels of actual auction proceeds. The Company's original proposal imputes $60 million in base rates and provides for a reconciliation between the imputed amount and the actual proceeds through the Company's Monthly Adjustment Clause (MAC).

NYPA states at Page 31 of its brief that the amount of TCC revenues embedded in base rates for the rate year should be set at $149 million. Similarly the County at page 29 recommends that the level be set at $150 million.

This issue is not simply about what is the appropriate level to impute in base rates, but as to what ratepayers receive with regard to the benefit of the TCC revenues being imputed in rates different from what the ratepayers would receive were a reconciliation done through the Company's Monthly Adjustment Clause (MAC) to limit that amount of TCC revenue benefit that the NYPA class receives. More specifically, the NYPA class would be a beneficiary of the amount of TCC revenues imputed in base rates but it would not be subject to the reconciliation since it does not pay the MAC.

This difference is by design, as explained by the Company in its brief at page 216 and 217 which is founded on the allocation method of TCC revenues to NYPA customers under the current rate plan. The current method properly recognizes that NYPA customers should not share in the total amount of TCC auction proceeds that the company receives. As explained by the Company in its brief at page 219, "NYPA has not demonstrated that it is entitled to any greater level of TCC credits than it currently receives'" and "there is no record evidence that establishes a basis for either changing the current allocation methodology or even revisiting that methodology."

Staff continues to not oppose the Company's initial proposal to impute $60 million of TCC revenues in base rates and to reconcile any difference as compared to actual though the MAC. Any increase in the imputed amount would unfairly provide an additional benefit to NYPA customers. In addition, increasing the imputed amount could result in even greater inequities if the actual levels are lower than the imputation amount. For these reasons, the Commission should adopt the Company's proposed TCC imputation amount of $60 million and allow the reconciliation amounts to be passed through the MAC.

C. <u>MSC and MAC Modifications</u>

The Company's brief at page 415, addresses Staff's proposed modifications to its Market Supply Charge (MSC) mechanism. Company witnesses state that in rebuttal testimony that the Company generally agreed with Staff's proposal to modify the current Adjustment Factor-MSC to include the non-market supply related costs that the Company's Electric Rate Panel proposed to move from the MAC to the MSC.

Although the Company generally agreed with Staff, it proposed that a second Adjustment Factor-MSC component be established that would reflect the recovery of non-market supply related costs being moved from the MAC to the MSC and that the current Adjustment Factor-MSC continue to reconcile the difference between estimated and actual market costs. Staff agrees with the Company's proposed modification and reasoning supporting it.

D. Billing Charge

Con Edison continues to argue that the billing charge for its customers be accounted for and billed at the commodity level, such that for a dual service customer taking all service from the utility, two billing charges would appear on the customer's bill - one for electric service and one for natural gas service. These charges would be exactly half (47 cents) of the billing charge for a single service customer (94 cents). (CIB page 404ff) They reject the logical view that a billing charge is for issuing a bill and processing the payment that results, regardless of the number of services provided on that bill. In our initial brief we demonstrated that as recently as September 25, 2007, the Commission reaffirmed that the billing charge is a single account level charge. (SIB page 221-222)

We identified the Company's arguments and addressed them fully in our initial brief. While Con Edison tries to identify the issue as one of unbundling the billing charge into two services, it ignores the orders cited in our initial brief that directly countermand their interpretation. For example,

> Since the billing charge is for a competitive service and is not charged to retail access customers receiving consolidated bills, from either the utility or the ESCO, it should not be subsumed within delivery. (Case 00-M-0504 - Unbundling Track, Unbundled Bill Order, issued February 18, 2005, page 23, emphasis added)

Ignoring both the Unbundled Bill Order and the more recent Commission order regarding its own gas service, cited above, Con Edison instead takes the view that somehow this position is "Staff's view" and "Staff's interpretation" of the Commission's orders. (CIB page 407) The Company goes as to state that even before unbundled bill charges were established, it was "Staff's view … that all consolidated billing customers should receive a backout credit, whether consolidated bills are issued by the utility or by the ESCO and whether the customer is purchasing one or both commodities competitively." (CIB page 407) Yet, Con Edison's own witnesses admitted that this was exactly how they applied the billing backout credit prior to converting it to a billing charge. (Tr. 325, Lns. 4-24) (Tr. 326, Lns. 12-16)

The Company doesn't explain why they would change the application of this principle simply because it was converted from a credit to a charge. They can cite no Commission order that changes that application, because none exists. Con Edison does cite a piece of the Commission's Order initiating the Unbundling Track.[31] (CIB page 408) However, the cite it provides, when read in context, describes the method to be used to calculate the charge amount, which the Commission referred to as "bottom up" as opposed to the "top down" method used to calculate the value of the backout credit, <u>not</u> the application of the charge to customers. If Con Edison's cite were correct here, it would have also found that since it has a lot more electric customers than natural gas customers the splitting

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[31] Case 00-M-0504, Unbundling Track, <u>Order Directing Expedited Consideration of Rate Unbundling</u> (March 29, 2001).

of the charge would have been far different than 50-50. However, the Company is not correct and the cite bears no relevance to the discussion here.

Con Edison also continues to rely on the badly formed table from its gas case appendix. (CIB page 409) We addressed this fully in our initial brief and need not burden the record by repeating that argument here. (SIB pages 220-221) Suffice it to say, that the table is internally inconsistent and does not address the charges applied to electric ESCOs at all. If Con Edison has incorrectly applied its gas billing charges in customers' bills as a result of this table, it should correct that application when it implements the rates that are set by the Commission in its order in this proceeding.

The Commission should again reaffirm that the billing charge is a single charge per bill, regardless of the number of commodity services taken by the customer and that the charge only applies to non-retail access customers. ESCOs should be charged the full 94 cent billing charge when a Con Edison consolidated bill is issued, and the customer should never pay even a portion of that charge. Staff's proposal should be adopted.

V. REVENUE DECOUPLING MECHANISM

A. General RDM Observations

As an initial matter, the Company maintains that its RARIM is the only proposed RDM under consideration in this proceeding because, it says, the Company was the only party to put forth a proposal for a RDM. Such a claim is specious. To the extent that the Company claims the only time a proposal may be considered is if the party making it assigns some fanciful, but ultimately hollow name like RARIM to its testimony, then it is correct that Con Edison is the only party to do so. However, Staff clearly and fully analyzed the Company's proposed mechanism and offered specific criticisms and changes to that proposal that it would like to see incorporated therein. When read as a whole, it is obvious that Staff has provided the Commission with sufficient testimony on which to order a Revenue Decoupling Mechanism substantially different than that proposed by the Company, but in all respects fleshed out absent some invented name other than Con Edison's Revenue Decoupling Mechanism.

Additionally, the Company continues to misrepresent Staff's position regarding economic development via its proposed RDM. Staff has never disputed that the Commission's generic Order regarding revenue decoupling mechanisms notes that parties should consider economic development as one of a number of other considerations used when designing an RDM. In fact, Staff did consider economic development, but felt that any such specific provisions for economic development were not appropriate. Rather, after giving due consideration to that matter, Staff proposed a mechanism that focused on removing any disincentive for the Company to embrace energy efficiency despite the potential for such programs to result in revenue loss as less energy is used by the Company's customers, but that would not also result in an unintended consequence of allowing the Company to reassign its customer base to allow it to cash in on an ultimately artificial new revenue stream. Finally, in response to Con Edison's continued posturing on this issue, Staff's policy recommendations in all areas and over many years have aligned with fostering economic development in Con Edison's service territory (with considerable success), and it is Staff's intention to carry that tradition going forward.

The Commission's generic RDM Order highlighted the importance of gaming in stating that "The mechanism should be designed to prevent gaming by the utility (e.g. shifting customers to different classes)" (Tr. 3959). Con Edison's dismissal of staff's concern regarding Con Edison's possible gaming of the customer forecast (Con Edison Initial Brief at pp. 454-55) belies the detailed testimony of Staff on this very issue (Tr. 3972-3975). In its testimony, the Staff RDM Panel identified specific ex-ante and ex-post gaming incentives that exist with the Con Edison RDM proposal which are eliminated under Staff's RDM proposal.

For example, under Con Edison's proposal, if the actual number of customers in a service class deviates from the forecast number, the Company is compensated (or must refund) the average revenue for each customer over (or under) the forecast, regardless of how large or small that customer actually is. This ex-ante incentive to under-forecast the number of customers is eliminated under Staff's RDM proposal (Tr. 3973).

Furthermore, Con Edison's RDM provides an ex-post gaming incentive with respect to the customer count. For example, if Con Edison had a number of facilities under one meter, such as an apartment building, the Company's proposed RARIM provides an inappropriate incentive to the utility to encourage that customer to treat each apartment as a separate customer, increasing the Company's customer count without actually producing any real economic or revenue growth. This concern is exacerbated when applied to customer classes that contain customers with wide variations of demands and usage, such as Con Edison's S.C. 9, which consists of customers with demands ranging from 10 kW to over 1,500kW (Tr. 3974).

Staff's proposed RDM is not saddled with these deficiencies and is the clearly preferred RDM proposal.

B. Weather Adjustment Provisions

In our Initial Brief, Staff thoroughly addressed all issues regarding weather adjustment raised by Con Edison in its Initial Brief by addressing the Company's testimonial positions. However, to clarify the record, Staff addresses the following two areas discussed by the Company in its Initial Brief.

The Company reiterates its appeal for a revenue decoupling mechanism that would allow it to retain revenues related to hotter than anticipated weather. Con Edison claims that it incurred additional expenses during a cooler than normal summer of 2006, as a result of the preparation for potentially hot weather and the new procedure for a very hot day (Con Edison IB 462). Con Edison is wrong. There is a very small probability that the record 2006 hot days will reoccur in the rate year. Even if they do reoccur in the rate year, the preparation expenses have been reflected in the Company's expense forecast that was escalated from the 2006 base year. In addition, as explained in our Initial Brief, hot weather related revenues far exceed the hot weather related costs (Staff IB. 223). Therefore, The Company should not be entitled to the hot weather related revenue. In addition, Con Edison does not provide any reason and Staff does not see why the Con Edison status quo should remain on weather-related revenues.

As to the estimate of weather impact, Con Edison claims that their regression method does not produce a biased estimate of weather impact on sales even if the autoregressive terms are not included to correct serial correlation of the regression errors (Con Edison IB. 453). Con Edison's is wrong. Con Edison fails to recognize the relationship between the standard error of regression and the standard errors of the estimated coefficients of the independent variables. As we explained in our Initial Brief, a biased estimate of the standard error of regression will lead to biased estimates of the t-statistics for the coefficients which, in turn, will lead to model misspecification (Staff IB. 226). This is because Con Edison will use the t-statistics to determine whether a weather variable and other independent variable is to be included in the model (Tr. 2300-01). As such, the decision to include or exclude a weather variable in the model can not be made correctly with biased estimates of the t-statistics. Therefore, without the autoregressive terms, the regression models cannot be specified correctly. Mis-specified models produce biased result, whether the result is an estimate of the weather impact or a forecast of sales volume.

In defending its weather adjustment proposal, Con Edison draws a comparison between the sales forecasting models with the RARIM weather normalization proposal on statistical sophistication (Con Edison IB. 452-453). The Company's comparison is invalid. The sales volume forecast is developed for each individual class on a monthly or quarterly basis. Historical data for monthly sales volumes are readily available. The only allocation factors involved in sales volume forecasting in a model produced forecast, if developed on a quarterly basis, needs to be converted to a monthly forecast. The allocation factors are readily available from the historical data for sales volume. The sales volume forecast does not require factors for sendout-to-sales for various classes, nor for billing days to calendar days, nor for intra-class allocation. The allocation steps involved in the Company's RARIM is no comparison to that in its sales volume forecast.

VI. SERVICE RELIABILITY PERFORMANCE MEASURES

Staff's position regarding the reliability performance mechanism ("RPM") remains as stated in its Initial Brief on pages 228 to 246. Staff continues to maintain that a new RPM including Staff's proposal for rate adjustments should be adopted in this proceeding, that duration and freqency threshold standards should not be altered from those that are currently ascribed in the Company's existing rate plan, that restoration and remote monitoring system mechanism should be adincluded in any new RPM, and that increased financial exposure to the Company under a new RPM for failure to achieve satisfactory service is warranted.

A. Effective Date of RPM

The Company recommends that the current reliability mechanism remain in effect until April 1, 2008, opposing Staff's recommendation to have any new RPM in effect January 1, 2008. Con Edison's opposition is founded on the current rate plan that the current RPM should stay in effect "through the end of the Electric Rate Plan and thereafter until electric base delivery rates are reset by the Commission" (Company Initial Brief, p. 336).

Staff acknowledges that the quoted statement appears in the Joint Proposal underlying the Company's current rate plan, but notes that the RPM, established by the Commission in one Order, may be revisited at any time to the extent that the Commission believes any change thereto is necessary to improve service quality to the Company's customers. Staff's proposal to start the new RPM metrics or to begin measuring for those metrics from the start of the new year on January 1, 2008, makes sense because the majority of the components of the RPM are measured by the Company on a annual basis in accord with the calendar year.

The Company's claim that the performance mechanism targets should be forward-looking and not applied retroactively is simply a red herring. Staff is not proposing anything that would have retroactive application, but instead would apply metrics at the end of the 2008 calendar year to the Company's performance over that entire year. Moreover, Staff reiterates that it has proposed no change to the actual metrics that the Company's performance is to be measured against. Moreover, having the RPM in effect as of the first day of January 2008 is consistent with how the Commission has handled other utilities, as well as how the current RPM for Con Edison is designed, i.e. the Company's performance is measured on a calendar year, not a rate year, basis.

B. Central Hudson Case

On page 341 of Con Edison's Initial Brief, the Company references Case 00-E-1273, the Central Hudson Electric Rate case, where the Company has claimed that the potential impact of implementing an OMS on the Company's SAIFI and CAIDI standards was recognized by the Commission, and that therefore, the same consideration should be accorded Con Edison to result in relaxed metrics on the Company's performance. Staff notes that the Central Hudson standards were set by way of a joint proposal with Staff and the active parties in that case and notes that any consideration that may have been given in arriving at those metrics is the product of confidential settlement discussions and, thus, not appropriate for consideration here.

Moreover, Staff continues to maintain that the record in this proceeding is severely deficient with regard to STAR's possible impact on Con Edison's SAIFI and CAIDI standards (Staff Initial Brief, pp. 235-40). Additionally, Staff raises the same concerns here that it raised in its Initial Brief with regard to Company Witness Lewis' testimony that Con Edison has not provided any basis for how Central Hudson electric system design and OMS is similar to Con Edison's STAR system to warrant the use of

Central Hudson's system as baseline for comparison with Con Edison.

C. Major Outage Metric

The Company makes reference to the major outage section of the RPM as if it is a new section foreign to the Company's currently existing RPM, and that substantial evidence has not been provided to support Staff's proposal (Company Initial Brief, pp. 350-51).

A major outage metric is included in the Company's existing RPM. Indeed, the existing RPM contains a revenue adjustment of $10 million for each network shutdown or a radial system interruption event.[32] The Company is subject to a revenue adjustment for up to three major outages in each year. Thereafter, Con Edison's SAIFI and CAIDI values are affected.

This metric covers only those major outages resulting from the Company's actions. Staff's position going forward is simply that the Company should remain accountable for significant outages of whose avoidance remains in the Company's control.

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[32] Under the major outage metric, a network shutdown event is a loss of all supply feeders to any of the secondary networks in its operating areas for three or more hours. A radial system interruption event is defined as service interruption to 70,000 customers in a load area for three or more hours.

D. RMS Revenue Adjustment

In the Company's Initial Brief, page 356 to 358, Con Edison rebuts Staff's recommendation of a $10 million dollar adjustment without limitation as extraordinarily excessive and counterproductive.

Staff's recommendation regarding the level of adjustment remains as stated in the Initial Brief (p. 246). Staff notes that its $10 million adjustment without a ceiling on the Company's total exposure for each network that is not found to be operating at a 95% reporting rate is appropriate. Staff has specifically addressed its concern with Con Edison's reporting rates during recent events such as the Washington Heights outage event and again in the Long Island City outage event. During the investigation of the Long Island City event, the Company demonstrated that Staff's recommended 95% reporting rate is attainable. The Remote Monitoring System (RMS) is critical to Con Edison providing information as to what is occurring in its network system during an outage event, evidenced by the numerous specifications and procedures that Con Edison has in place that either reference RMS or the data derived from RMS. Despite this information, the Company proceeded to change its RMS reporting rate from what it initially prescribed as a "minimum 95%" to "a goal of achieving 95%".

Staff believes that the Company made this change to avoid having to keep its reporting level at 95%. Because the 95% level of reporting is attainable and in the Company's control, Staff recommends that the 95% reporting level be used as the metric by which to measure Company performance.

VII. ENERGY EFFICIENCY

A. Response to initial briefs

Con Edison proposed, through three separate incentive schemes, that it be eligible to earn payments for achieving the goals associated with its Demand Side Management (DSM) programs and, under certain circumstances, for programs operated by other organizations including NYSERDA and the NYISO. The Company has stressed the importance of incentives to effective utility administration of DSM programs (Tr. 3006, Lns. 3-7). While the exact cost to the ratepayers of the proposed incentive program will depend on factors such as the quantity of achieved energy savings, the value of the avoided use of resources and the emergence of a greenhouse gas reduction market, Staff concluded that the potential incentive payments were overly generous.

One of the three elements of the incentive proposals would allow the Company to receive 20% of net resource benefits associated with the demand reduction achieved through its DSM program, up to its annual energy savings goal. For savings exceeding the annual goal, the Company would receive 30% of net resource benefits (Tr. 3004, Lns. 19-22, Tr. 3005, Lns. 1-6). Net resource benefits reflect the present value of the estimated avoided costs, including energy and capacity, over the service lives of DSM measures installed each year as result of the Company's programs, minus DSM program costs. Based on a sample calculation provided by the Company in response to New York City's IR 244, this one element of the incentive proposal could equal approximately $92 million, or about 90% of the originally proposed three-year program budget. Staff noted that the estimate could prove low due to several factors, including whether Con Edison installs measures with a measure life longer than the 12-year estimate used in its calculation and whether energy prices increase (Tr. 4243, Lns. 3-22; Tr. 4244, Lns. 1-4).

The Company also advocated two additional incentive schemes: (1) a $22,500 per MW incentive (adjusted upward for inflation) for its role in encouraging incremental enrollment in energy programs administered by NYSERDA, Con Edison and the NYISO (Tr. 4244, Lns.18-22, Tr. 4245, Lns.1-22, Tr.4246, Lns.1-7) and (2) a greenhouse gas reduction market credit, assuming a viable market for the credits materializes (Tr. 4247, Lns. 9-22; Tr. 4248, Lns. 1-9). These incentive proposals would provide the Company with additional opportunities to earn even larger incentive payments.

In order to place the magnitude of the Company's incentive proposal in context, Staff referenced in its initial testimony a report issued in October 2006 by the American Council for an Energy-Efficient Economy (ACEEE), titled "Aligning Utility Interests with Energy Efficiency Objectives: A Review of Recent Efforts at Decoupling and Performance Incentives" (Report) that surveyed recent performance incentive programs in several states. The Report found that, while details varied, the performance incentives generally ranged from about 5 to 10% of the program budgets. Moreover, the Report shows that many of the states with incentive programs lack revenue decoupling (RDM) and lost revenue recovery mechanisms (LRRM). Incentives were sometimes used as an alternative to these mechanisms. Con Edison has proposed an RDM in this case (Tr. 4248, Lns. 12-22; Tr. 4249, Lns. 1-16).

The Company argues that the Report is of limited relevance because the California Public Utilities Commission concluded that the Report only covered "a time period after electric restructuring when energy efficiency achievement and corresponding incentives to utilities were de-emphasized." (Company Initial Brief, p.486). The Company further explained that a 1995 Lawrence Berkeley Laboratory incentive study was "more relevant because it correlates with the greater policy emphasis on energy efficiency gain that New York has chosen to pursue." (Id.).

While Staff cannot speak to the relevance of the Report to California's recent rulemakings proceeding on incentive policy, Staff remains convinced the ACEEE study is highly relevant to its analysis of Con Edison's incentives proposal. The Report's focus on recent incentive designs rather than incentive designs from 10-15 years ago reflects current rather than past trends and therefore gives this Report particular relevance. The Report generally reflects the status of incentive design and policy in place at the time of the Report's release in October 2006. This is important when one considers the significant changes that have occurred in the electricity markets since the early nineties including deregulation, increased concerns regarding electric grid reliability, rising energy prices and a focus on global warming. All of these factors are highly visible in Con Edison's service territory. In addition, regulatory commissions have had several more years of experience in refining incentive policies and designs.

Specifically, the Report highlights incentive designs from nine states operating over diverse geographic regions; under a variety of regulatory and state energy policy frameworks; and offering a range of energy efficiency measures and services. Significantly, the Report shows no state that has an incentive policy as potentially lucrative to the Company as the incentive program proposed by Con Edison in this rate case.

In addition to offering a national perspective on incentive design, the Report provides summaries of incentive policy in individual states. This insight also proves useful. For example, the Report indicates that Connecticut utilities are eligible for 5% of program costs for achieving 100% of the goal and 8% for achieving 130% of the goal. (Report, pp. 24-25). This is significant because the Company cites a study suggesting that utility run programs, such as those offered in Connecticut," can be twice as cost effective as the programs currently being run by state agencies and other centralized administrators." (Company Reply Brief, p.475). Based on the results of these studies, it does appear possible that utilities can successfully administer energy programs with incentives far more modest than Con Edison claims are essential to its administration of energy programs.

Con Edison cites the results of the 1995 Lawrence Berkeley Laboratory Survey (LBL Incentive Study) in defending its incentive proposal (Company Initial Brief, p. 486). Including the LBL Incentive Study by the Company in support of its position is puzzling, because it actually does more to reinforce Staff's position that Con Edison incentive package is excessive than to justify the reasonableness of the Company's proposal. While the LBL Incentive Study forecasts 1993 and 1994 incentive payments for seven utilities ranging between approximately 8 and 50% of DSM programs expenditures, simply looking at the range is not especially insightful. The two highest incentive payments, 33.8% and 50.3% of program budget, are associated with two relatively small programs representing about 7% of the combined DSM budgets of the seven programs in the analysis. A calculation of the combined forecasted incentives for the seven utilities as percentage of DSM expenditures yields about 16%. The New York State Electric and Gas incentive was forecasted in the LBL Incentive Study to equal about 8% of its DSM expenditures. The results of the 1993-94 forecasts in the LBL Incentive Study cited by the Company are far closer to the 5-10% range found in the

ACEEE report than the Con Edison incentive plan which could provide to the Company over 90 of its program budget for simply meeting its DSM program goals.

NRDC and the PACE Energy Project state that "The point of incentives is to optimize energy savings and cost-effectiveness, and thus discussing incentives in terms of percentage of DSM program budget is irrelevant and misses the point." Rewards should be based on outcome and results and not input, such as the amount of money spent on a program, since such amount does not necessarily correlate to the results achieved by a program." (NRDC and Pace Energy Project Initial Brief, p.16). Staff did not offer a specific incentive proposal, but did offer guidelines for a properly designed incentive program and suggested that incentive policy be considered as part of the EPS Proceeding. In testimony in this case, Staff placed emphasis on incentives as a percentage of program budget, not necessarily as an approach to designing an incentive framework, but rather to place the potential cost of incentives in perspective. If it were possible that the cost of potential incentives could approach, or exceed, the cost of the DSM programs, this factor needs to be highlighted and carefully scrutinized. A key question that must be answered in reaching a determination on the appropriateness of incentive payments to the Company is whether expenditures on incentives of the magnitude proposed by the Company are an effective use of ratepayer funds.

VIII. CONSUMER SERVICES

Con Edison continues to advocate for substantial increases in spending on outreach and education programs, call center, and field operations (Company Initial Brief, pp. 141-154). As Staff argued, these increases must be considered in the overall context of this proceeding (Staff Initial Brief, p. 263). That is, the Company is proposing one of the largest rate increases in the history of American electric utilities primarily because of its need to make crucial infrastructure repairs and investments. As such, every Company proposal to increase spending in this proceeding must be carefully reviewed to determine whether it is necessary or whether it may more appropriately be considered when increased spending on projects that are essential to the Company's ability to render safe and adequate service does not comprise a significant portion of the proposed increase in the Company's rates.

A. Outreach and Education Spending

The Company proposes to increase its current annual spending of about $3.6 million on its outreach and education (O&E) program by nearly tripling its budget to $10.2 million while Staff proposes a more modest increase of about $300,000 to $3.9 million (Staff Initial Brief p. 269).

The Company suggests that Staff's recommendation to only increase O&E spending to $3.9 million is driven by a naive attempt to create parity between per customer spending on electric and gas O&E programs (Company Initial Brief, p. 142). Con Edison further argues that a tripling of its O&E budget is necessitated by the challenges involved in communicating about a multitude of electric related issues with its diverse customer population (Id.), by the need to respond to the recommendations that arose from Staff's recent investigations of outages that occurred in its service territory (Company Initial Brief, pp. 141-142), and by the need to carry out an O&E program with respect to its Mandatory Hourly Pricing program (Company Initial Brief, p. 143).

Staff's position on the Company's O&E budget rests on the simple fact that as even the Company acknowledges, at current O&E spending levels, the Company has been able to do an effective job of communicating with its diverse customer base about a myriad of electric related issues (Staff Initial Brief, p. 270). Given the enormity of the rate increase that is expected to result from the necessary increases in infrastructure spending in this proceeding, the Company has not shown the same level of need for the proposed massive increase to O&E spending. Staff acknowledges that the recommendations in Staff's outage reports called for the Company to make certain improvements in its customer communications and that the introduction of new initiatives, such as Mandatory Hourly Pricing, may require the Company to communicate with its customers about new matters. However, given that Staff recommends an increase of approximately $300,000 in the Company's O&E budget and that the Company can and does shift the focus of its O&E efforts from year to year, Staff's O&E budget provides the Company with sufficient funds to continue to effectively communicate with its customers.

Con Edison continues to object to Staff's proposal that the Company be required to develop and file an outreach and education program, asserting that this is unnecessary (Company Initial Brief, p. 148). As the Company acknowledges, however, (Company Initial Brief, p. 147), it is already developing the educational program referenced by the proposal and Staff does not find the Company's reluctance to file the program to be justified.

B. Call Center Operations Remote Agent Technology and Customer Field Operations

The Company raises no new issues with respect to the Company's proposals to increase its call center staffing, introduce remote agent technology, enhance its voice recognition software, and increase the number of outbound call lines to 72 which would alter the positions asserted by Staff. With the exception of Staff's proposal to allow the Company to double the number of outbound lines by increasing them to 48 (Staff Initial Brief, pp. 263-265), Con Edison's arguments in support of these proposals simply do not demonstrate a priority need for the technology at a time when it is necessary for the Company to make such significant investments in its infrastructure.

Staff continues to maintain that the Company's proposal to add 15 customer field representatives (CFRs) will be self funding because it will quicken the rate at which the Company investigates, corrects and bills for advances on inactive accounts (Staff Initial Brief, pp. 267-269).

C. Low Income Program

Aside from questioning Staff's basis for contending that the customer charge discount afforded to participating customers should be increased (Company Initial Brief, pp. 161-162), the Company raises no new arguments in support of its contention that the Commission should reject Staff's proposal to freeze the customer charge for participating customers at its current level. This proposal by the Company should be rejected. Given that this proceeding is likely to result in a substantial rate increase, failing to increase the assistance provided under the Company's low income program would be inimical to the very purposes that underlie the program (Staff Initial Brief, pp. 265-267) and would not provide thee necessary assistance to these customers with their energy charges.

IX. MISCELLANEOUS

A. Mandatory Hourly Pricing

1. Implementation Schedule

Con Edison (Company Initial Brief, pp. 157-158) and the Retail Energy Supply Association (RESA) (RESA Initial Brief, pp. 20-21) oppose Staff's proposal to delay the expansion of Mandatory Hourly Pricing (MHP) until customers with demands between 1MW and 1.5MW have 6 months of interval data to review and customers with demand greater than 500kW and below 1MW have one year of interval data to review (Staff Initial Brief, pp. 285-286). Con Edison notes the Commission's "need two years ago to move the state's largest electric customers to hourly pricing rates 'expeditiously' so that they receive accurate price signals (Company Initial Brief, p. 157). While Staff agrees that the Commission desired to move "expeditiously" in the MHP Order,[33] the circumstances are different in this case.

Con Edison's current MHP customers had been on Time-of-Use rates before they were moved to MHP, while the proposed MHP group has had no experience with time sensitive rates. These proposed customers have a much steeper learning curve in order to understand and react to MHP. Delaying the expansion of MHP until customers have sufficient tools to analyze and react to MHP, should reduce adverse reactions to the rate and maximize customer's responsiveness to hourly prices.

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[33] Case 03-E-0641, Proceeding on Motion of the Commission Regarding Expedited Implementation of Mandatory Hourly Pricing for Commodity Service, Order Denying Petition For Rehearing and Clarification in Part and Adopting Mandatory Hourly Pricing Requirements (Issued April 24, 2006) ("MHP Order").

2. <u>Outreach and Education (O&E)</u>

In response to Staff's recommendations regarding Outreach and Education (O&E) for the MHP customers, the Company makes the accusation, "Mr. Graves did not include any additional rate relief for his second suggestion, i.e., outreach and education for the MHP customers, including a newsletter" (Exh. 53). Staff witness Graves did not provide additional rate relief for O&E because that issue was addressed by the Staff Customer Service Panel (Staff Initial Brief, pp. 269-272).

While the Company states, "The Customer Operations Panel testified that Mr. Graves' proposed outreach and education program was 'excessive'." (Tr. 828), (Company Initial Brief, p. 158), Staff's recommendations utilized information resulting from the evaluations of previous implementations of MHP filed by Consolidated Edison and National Grid (Tr. 3867-3873), Con Edison's own consultants said, "Some customers still need additional resources to enable them to assess hourly pricing" (Tr. 3868). The Company projects its expenditure of $6.1 million for meters and meter installation cost to implement MHP for this new group of customers. Staff proposes to spend only a small fraction of that amount to educate customers about the rates being implemented. It is not "excessive" to provide customers as much information as possible to enable them to realize the maximum benefit from this new technology. It makes little sense for the Company to make the proposed expenditure without giving customers the necessary tools and information to enable them to effectively use the technology.

3. Penalty for Denying Access to Replace the Meter

The Company provides three arguments in support of assessing a $1,000 fee on customers that do not allow access to their meters.

First, the Company is apparently suggesting that Staff's recommendation, that customers have the option to take retail access service, was intended to indicate that the utility would be relieved of the requirement to install an interval meter for such customers (Company Initial Brief, p. 158). However, the Company states that the Commission directed utilities to provide interval meters for all customers in the usage range subject to MHP, not only fully-bundled customers (Company Initial Brief, footnote 97). Thus, the Company's suggestion is clearly incorrect.

Staff was not suggesting that if a customer chooses to take service from an ESCO the Company would not be required to install an interval meter for that customer. Staff was arguing that, if a customer was not allowing the Company access to its meter because it feared being billed on an hourly rate, such a customer has the option to switch its service to an ESCO that provides a fixed rate. That option was not available to customers in the 1992 example that the Company chose.

Second, the Customer Operations Panel expressed its belief that the number of cases where the fee would be imposed would be "very small" but that a fee "is necessary to encourage all customers to provide timely access." (Tr. 830) and that absent such a fee, the Company would be "without any leverage to encourage" customers to cooperate because some customers would have a "direct interest in delaying the meter conversion." (Tr. 831). It asserted that "Mr. Graves fails to provide an adequate response to this real world concern." (Company Initial Brief, p. 159).

This asserted need for "leverage" over customers by Con Edison, portrays a poor working relationship with its customers. It seems that Con Edison has opted for the stick as opposed to the carrot approach. Instead of this punitive approach, Con Edison should be explaining to customers the benefits of having an interval meter. As Staff explained, National Grid reported encountering no problems with refusal of access by similar sized customers (Tr. 3875).

The Company cites its experience in the deployment of AMR in Westchester County as its final argument in favor of its no-access charge. The Company describes MHP as a mandatory program (Tr. 3879-3880) for which customers must have the proper meter. It asserts that Mr. Graves agreed that "a large number" of meters in the Con Edison service territory "are inside," and therefore that the Company must be allowed access to change the meter and if customers fail to let the Company in, the meter cannot be changed (Tr. 3881). It states that Mr. Graves did not know whether the Company had any issues with customers providing access for changing meters as part of its deployment of AMR in Westchester (Tr. 3882) and that the Company has encountered customers who have continuously refused the Company access (Id.). The Company asserts that the Commission has at least two pending customer complaints with the Commission relating to this program (Tr. 3883-3884).

The Company finds equally important, the fact that Mr. Graves questioned the relevance to the issue of access denial of meter installation in the AMR pilot in Westchester, because he assumed that the pilot involved replacing the meters of only residential customers (Id.).

It asserts that he subsequently acknowledged that the Company is installing or has installed AMR for all customers in the Rye and Peekskill areas (Tr. 3884-3885). The Company concludes that this renders its Westchester experience very relevant to its assumption that more than one customer required to be transferred to the MHP expansion program will refuse the Company access to change the meter and that it is therefore, it is entirely proper to have a special charge in the event that customers failed to permit access. It argues that a customer cannot receive MHP - a program desired by the Commission to send pricing signals and affect customer energy usage - absent a meter. (Company Initial Brief, pp. 159-160)

The limited experience in Westchester described by Con Edison does not provide an adequate basis to support its proposal for a special charge to be assessed upon customers who deny the Company access. Staff continues to believe that the necessity of such a charge has not been justified by the Company.

X. CONCLUSION

For the reasons stated herein and in Staff's initial post-hearing brief, Staff's proposals and adjustments should be adopted.

Respectfully submitted,

Dakin D. Lecakes
Steven J. Kramer
Guy R. Mazza

Dated: December 14, 2007